



Stanford

Center for International
Development

Working Paper No. 450

**The Importance of Multilateralism in the Twenty-First
Century**

by

Anne O. Krueger

August 2011



Stanford University
John A. and Cynthia Fry Gunn Building, 366 Galvez Street
Stanford, CA 94305-6015

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Abstract

The globalization of the past half century (and even earlier) has enabled the ascent from poverty of billions, and improved the quality of life of many more. The gains in terms of health, life expectancy, literacy are taken for granted. Further gains from globalization are within grasp for many more.

But successful globalization has depended in part on the ability of the multilateral institutions, especially the International Monetary Fund and the World Trade Organization, to underpin the smooth functioning of the international trading system and the international monetary system. Indeed, strengthening these institutions is even more desirable than in the past because of increased interdependence. The recent financial crisis has shown many ways in which the system needs strengthening and support. Yet, to date, the commitment of countries' governments to the multilateral system seems to have been weakening. It is crucial for future growth that that trend be reversed and that the open multilateral trading system and the international financial arrangements be strengthened.

Keywords: Multilateralism, economic success, transition of financial system.

JEL Classification No.: F01, F20, F30, F40.

♦ This is a slightly edited version of a talk given at the Annual Meetings of the IMF and the World Bank in Singapore in September 2006, as I was leaving the International Monetary Fund. This paper is also included in my book *The World Economy; Challenges for the Twenty First Century*.

*Anne Krueger is Professor of International Economics at the School for Advanced International Studies, Johns Hopkins University. She is also a Senior Fellow of the Stanford Center for International Development (of which she was the founding Director) and the Herald L. and Caroline Ritch Emeritus Professor of Sciences and Humanities in the Economics Department at Stanford University. Email : annekrueger@jhu.edu

Chapter 14. The Importance of Multilateralism
in the Twenty-First Century¹

Multilateralism has been the key to the huge economic successes of the past half century. The achievements of the multilateral economic system are increasingly underappreciated as it is ever more taken for granted, while the need for well-functioning multilateral international economic system is greater than ever as globalization proceeds. I shall argue that the multilateral financial institutions have performed remarkably well in underpinning economic success of unimagined proportions over the past sixty years. However, just as we take the air we breathe for granted, so, too, do many now take those successes and the multilateral system underpinning them for granted. They ignore the “public good” benefits that the multilateral system provides and focus instead on a narrow view of the short-term costs, often taking the benefits for granted.

On the face of it, there is wide support for the multilateral institutions and for the principle of multilateralism. But too often these days, that support is little more than lip service. On almost all issues, the cumulative impact of decisions that affect the strength and health of the institutions is usually underestimated, if it is recognized at all, and the “common good” is generally under-represented in global fora.

¹ This is a slightly edited version of a talk given at the Annual Meetings of the IMF and the World Bank in Singapore in September 2006, as I was leaving the International Monetary Fund.

I start by considering some of the many reasons why multilateralism is so important. Then I want to remind us of some of the successes of the system over the past sixty years. Then I turn to some of the reasons why support for the system is not as strong as one would expect in light of its great accomplishments. Finally, I will examine some of the practical issues on which the common good seems to be underestimated relative to the particular concerns of individual countries or groups of countries.

The Role of Multilateralism

To their enormous credit, the founders of the post-war international economic system knew, and understood, the importance of multilateralism. They knew it in theory, but they also knew it because they had all experienced the enormous cost of individual actions taken outside a multilateral framework in the 1930s. Then, governments, struggling to offset the impact of the Great Depression, undertook measures that, in effect, were designed to export their problems and that could only succeed if other countries did not take similar measures.

Competitive devaluations were designed to boost exports, but could have succeeded only if other countries did not respond in kind. But, of course, there were irresistible pressures on countries against which devaluation had been undertaken to follow suit and retaliate, and competitive devaluations worsened the situation.

Countries also raised their own tariff barriers, hoping to stimulate their own economic activity by reducing imports (again exporting both unemployment and reduced output to other countries). But, again, the fact that other countries were undertaking similar measures negated any beneficial effect. The volume of world trade shrank and high tariff barriers increased distortions and inefficiencies in the global economy. The American Smoot-Hawley tariff of 1930.

was followed by such calamitous events that after the Second World War protectionism in much of the world was held at bay, if not defeated, for years by the mere mention of the name.

Interestingly, most European countries had learned the difficulties of negotiating tariff levels bilaterally (and therefore discriminating among countries) back in the 19th century. They had therefore adopted most favored nation (MFN) clauses in their trade treaties, insuring that imports of each commodity would be treated similarly regardless of country of origin. It was not, however, until the 1920s that the United States government recognized the drawbacks of bilateral trade treaties (at least as seen from an American perspective): the trading partner with which the United States was negotiating would have to lower its tariff for all its MFN partners, while the American tariffs were not extended to others. Most countries chose to offer more favorable tariffs to countries where they would receive larger reciprocal reductions (across other partners) in exchange. Thus, MFN countries could reduce tariffs with each other, leaving the US (and other countries that did not have MFN clauses) confronting the higher tariff rates. The United States was therefore in a position of bargaining with all MFN countries while being excluded from tariff reductions already undertaken among MFN members. It was largely because of this manifestly unfavorable experience that, in the 1930s, Cordell Hull, the American Secretary of State, so enthusiastically supported "reciprocal tariff agreements" in an MFN context.

But the experience of competitive devaluations was equally compelling: an action taken by one country could be in its self-interest unless others followed, in which case all would be worse off. A multilateral framework to avoid this possible outcome seemed clearly warranted.

Correctly, the founders of the postwar international economic system recognized that multilateralism was desirable, not only to reduce and, they hoped, to eliminate the possibility of any recurrence of the 1930s, but also to promote nondiscrimination in international transactions. For my purposes today, I shall focus on the three key organizations: the International Monetary Fund, charged with maintaining international financial stability; the World Bank, responsible for the provision of development capital; and the World Trade Organization (earlier the General Agreement on Tariffs and Trade) supervising the world's multilateral trading system.

The founders of the postwar system recognized the benefits to be had from a resumption of international capital flows, but believed that the experience of the 1930s had destroyed prospects for a resumption of most private capital flows. They therefore were concerned with enabling official capital flows through the International Bank for Reconstruction and Development—now the World Bank—and did not focus on difficulties that might arise **either** from discriminatory treatment by source of private capital flows **or** from the lack of an agreed international framework governing treatment of foreign capital. Hence, the postwar international economic system and organization was assumed to be complete when, in addition to the GATT for multilateral trade relations and the World Bank for official capital flows, the IMF was charged with international financial and macroeconomic stability and rules governing current account transactions. The absence of a regime for private capital flows resulted from the assumption that these flows would be relatively unimportant.

What **was** enshrined in the Fund's Articles of Agreement was provision for convertibility of domestic currencies for current account transactions. By definition, if a currency is convertible without restrictions, it is multilateral and there can be no discrimination for current account transactions. Issues relating to discrimination on the capital account were not addressed,

on the assumption that there were relatively few such transactions. Obviously, trade credits and perhaps some other short-term credits might enter international trade, but it was not thought that issues of discrimination would arise. Interestingly, this oversight led to problems even when private capital flows had resumed at very low levels: difficulties arose because of governments' terms for granting official export credit, aid tying, and related issues.

One of the most striking ways in which the world has changed has been the emergence of private capital flows as a major force in the world economy. I shall return to this issue later and argue that the absence of a multilateral, nondiscriminatory framework governing international capital flows (and exchange control mechanisms) is an important and potentially costly gap in the multilateral economic system.

The arguments for a level playing field in which all transactions with foreigners are subject to the same regime are straightforward, glaringly obvious, and hence very dull. Each country's citizens will be better off sourcing imports **and** finance from the cheapest available source; and selling goods and services and undertaking capital transactions where they can obtain the best terms. And, as I shall note later, efforts to discriminate by country of origin or destination also confront enormous practical problems that normally can be addressed, if at all, only with a highly complex, distortionary, and costly set of regulations.

While the arguments for multilateral regimes for trade, current account transactions, exchange regimes, and capital flows are profoundly correct, they do not provide a dramatic demonstration of the virtues of multilateralism. Experience with efforts to depart from multilateralism has provided more dramatic illustrations of the need for multilateral solutions to international economic policy issues.

Let me mention just three: efforts to impose trade sanctions bilaterally; American experience with so-called voluntary export restraints; and anti-dumping and countervailing duty administration.

Efforts to impose trade sanctions against a country or group of countries are of course an extreme form of trade discrimination. Yet experience shows that they are seldom very effective unless **all** countries participate or those imposing sanctions can prevent trade through a blockade or other means. Even in cases where "most countries" are supportive, even one open border (whether the authorities are openly permissive, simply turn a blind eye, or cannot enforce) has generally been sufficient to mitigate most of the potential impact of trade sanctions.

American experience with country-specific so-called "voluntary export restraints" (wherein country-specific levels of the good in question were to be permitted) illustrates the same point: VERs have been greatly reduced in their impact by third-country effects. Perhaps the most famous case concerned semi-conductors: the imposition by the US of a VER led to a major expansion of capacity in third countries and led many American companies to shift production activities using semi-conductors offshore. American semi-conductor producers gained little, if anything, while American consumers of semi-conductors (PC assemblers, etc.) suffered.

But the experience has been more general: when a particular country or group of countries is targeted, the existence of other suppliers (or consumers) of the product significantly reduces, if it does not totally prevent, the intended effect. European car producers were the big beneficiaries of the ill-fated effort by the U.S. to impose VERs on imports of Japanese cars, and Korea became a major auto producer more quickly than it otherwise would have.

Anti-dumping and countervailing duty measures are, by design, discriminatory against countries (and firms) that are found to be using "unfair" means to lower their selling price in the market to which they export. In many instances, firms have been able to shift production from a plant in the country against which the AD or CVD measures is applied to one elsewhere. But when that has not been the case, third country producers are often the big beneficiaries. A famous case was Polish golf carts; the full story is too long to recount, but the main effect of the American effort to impose a CVD on Polish imports was to induce entry of Spanish carts into the American market.

I hope I have said enough to indicate the crucial importance of multilateralism in a well-functioning international economic system. And, since there are occasions when individual countries can perceive it to be in their self interest to pursue discriminatory policies if it is believed that others will not do the same, an international economic regime underpinning and enforcing multilateralism in international transactions is vital. Third country effects; the temptation to retaliate; the fact that an open international economic system has many aspects of a "public good": all of these are arguments that underpinned the postwar international economic system.

But the experience of the postwar years, and the unquestionable success of the system, speak even more strongly as to its importance. In most discussions of globalization today, it seems to be forgotten exactly how far the world has come in the sixty years of the postwar international economic system.

Recall that the war-torn European and Asian economies were devastated and, in the aftermath of the war, had output levels significantly below those of the prewar years. Most had severe exchange controls, often with bilateral clearing arrangements, high tariffs and often

quantitative restrictions on imports. The average European tariff on manufactured goods imports stood at over 40 percent, but that number understates the extent of trade restrictiveness as quantitative restrictions often kept imports below even the quantities demanded at those high tariff levels. Only 4 countries in the world had full currency convertibility. And, of course, many countries were still very poor, or underdeveloped, as they were then called, with very low per capita incomes and correspondingly poor indicators of health, nutrition, literacy, and other measures of well being.

But starting in the late 1940s, the global economy embarked upon a quarter-century-long period of rapid economic growth, greatly outperforming any prior period of comparable length in world economic history. European recovery accelerated rapidly, and most countries had re-attained their prewar output levels by the early 1950s. But they sustained their growth rates well into the 1960s and early 1970s. At the same time, Japan's economy began growing and by the 1960s was achieving rates of economic growth of 7-9 percent—well above anything that had earlier been thought possible.

Expanding world trade was the "engine of growth" in the postwar years. While real GDP was growing at rates far in excess of those realized in earlier eras, world trade was growing at almost twice the rate of real GDP growth. In part, the recovery from wartime conditions and growth of GDP spurred trade growth. But in addition, successive rounds of tariff reductions under GATT and other trade liberalizing measures spurred growth in trade and GDP. At the same time, bilateral trading agreements were gradually abandoned and then multilateral clearing of balances, and, finally, full current-account convertibility followed. It was a virtuous circle: reduction of trade barriers spurred economic growth; and economic growth enabled the further reduction of trade barriers. To leap ahead of my story, by the end of the 20th century, tariffs on

manufactured goods among developed countries had fallen from over 40 percent in the late 1940s to an average of less than 5 percent, and quantitative restrictions on trade in manufactures were largely a thing of the past.

Several points about this phenomenal success deserve noting in connection with the role of multilateralism. Perhaps most important, the developing countries, with a few exceptions, failed to participate in trade liberalization in the quarter century after 1950. They mostly erected high trade barriers against imports of manufactures as it was believed that protectionism for "infant industries" was the appropriate policy to achieve more rapid economic growth.

Despite their failure to participate, however, developing countries grew at rates well above those that had been achieved in earlier eras. The fact that the world economy was growing rapidly enabled relatively favorable terms of trade and growth of export earnings (although their share of world trade declined as the industrial countries' trade liberalization led to even more rapid growth there). While the East Asian "tigers", whose policies included increasing integration with the international economy, were growing at spectacular rates, other developing countries benefited substantially from the rapid growth of the world economy, despite their failure to liberalize. In an important sense, those "inner-oriented" developing countries were "free riders" of the multilateral system: the rapid growth of trade benefited them even though they had not themselves liberalized their trade at that time. It enabled them to enter markets more readily than they otherwise would have done, and to increase their exports when domestic incentives were appropriate. That same growth enabled even greater benefits to accrue to them when they liberalized their own trade regimes in the 1980s and 1990s, encouraged by the examples of East Asian success. Trade barriers, both tariffs and quantitative restrictions,

have been lowered dramatically in most of the economies now referred to as "emerging markets", thereby contributing to their further growth.

A second, and related, point, is that "globalization" was certainly occurring during the golden quarter century. Trade as a share of global GDP was rising, not only because of falling trade barriers but also because transport and communications costs were dropping sharply. It bears repeating that in 1931 a 3 minute phone call between London and New York had cost \$293 in constant 1998 prices. By 2001, that same call cost \$1; and today it costs at most just a few cents. Ocean shipping added about 30 percent to the f.o.b. value of exports in the late 1940s; that figure had fallen to 3 percent by the late 1990s. Air freight, a rarity in the immediate postwar years, now accounts for 40 percent of world trade in value terms. Those cost reductions meant that more and more goods were tradable; that many services were increasingly tradable; and hence that globalization was proceeding during the period.

In that connection, the tremendous advances in living standards around the world that accompanied rapid global growth should also be recognized. For example, life expectancy in India has risen from about 39 years in the early 1950s to over 60 years today. Similar dramatic increases have taken place in most developing countries. Since 1960, life expectancy in the developing countries has risen at roughly double the rate in the richest, with the result that the gap in life expectancy between rich and poor countries has shrunk from 30 years in the 1950s to around ten years today. Literacy rates have risen sharply, and other indicators of well being have improved dramatically in most countries.

But the main point is that the trade liberalization and globalization that took place during the first quarter century after 1945 was undertaken in a multilateral context. Bilateral trading

agreements fell dramatically in importance; more and more countries adopted Article VIII convertibility; tariff and non-tariff barriers fell sharply.

Almost all of this took place in a multilateral system underpinned by the IMF, the World Bank and the then—GATT. But there was one exception to this generalization, and that exception may have contributed significantly to the current under-appreciation of multilateralism's importance. That was the establishment of the European Common Market, which has evolved into the European Union.

As is well known, intra-European trade barriers were reduced even more sharply than were Europe's external trade barriers. As the common market evolved, the European economies were increasingly integrated until now there is a common currency and Central Bank, a common agricultural policy, an internal customs union, and much more.

And the European economies were dramatically successful not only in recovering to their prewar level of economic performance, but in sustaining that growth over the next several decades. In truth, the European economies were benefiting from their global (multilateral) trade liberalization, increased integration which enhanced competition in each of them (in addition to other benefits) as well as from the worldwide expansion that was occurring. But, to many observers, Europe's stellar performance appeared (misleadingly) to be attributable to European integration. In fact, something like 90 percent of Europe's trade liberalization had been multilateral, and probably around an extra 10 percent had been extended preferentially within the continent.

The misperception that Europe's success has been largely attributable to its internal preferential arrangements has probably contributed to the failure to appreciate the importance of multilateralism, to the thrust toward preferential trading arrangements and to other bilateral and

regional arrangements. As I shall argue later, this is highly dangerous for all members of the international economy, as preferential arrangements will achieve their intended purpose only in the context of a strengthening of the multilateral system.

To appreciate more fully why this is so, let us turn to the next thirty years after the Golden quarter century. The 1970s represented a major turning point. Perhaps most importantly, the "Bretton Woods system" of fixed exchange rates had to be abandoned, as major countries were unwilling or unable to follow the domestic economic policies that would have been necessary had it been decided to maintain fixed exchange rate regimes. It was probably fortunate for the international economy that that abandonment took place before the quadrupling of the oil price in 1973, as flexible exchange rates between the major currencies enabled the absorption of a significant portion of the shock with less economic dislocation than might have occurred had countries been trying to sustain their earlier, fixed exchange rates.

But several other, related, phenomena occurred. Worldwide inflation accelerated. Many oil-importing countries accessed private capital markets to borrow to finance their oil imports in the years immediately after the oil price increase, with the private capital markets in effect "recycling" the windfall gains from oil producers to the oil-importing developing countries. When, in the 1980s, industrial countries adopted anti-inflationary policies, the higher debt-servicing costs faced by developing countries, and other factors, led to the "debt crisis" of the 1980s.

The official international community—both the IMF and the World Bank—reacted, supporting adjustment efforts in many of the afflicted countries. By the late 1980s, growth in emerging markets was accelerating, and debt "overhangs" were addressed through the Brady plan and other measures. The Paris Club—another multilateral effort—found its role in the

restructuring of official debt to official creditors greatly enhanced. I should note in passing that these efforts were necessarily in a multilateral context, as the debt which had to be restructured under the Brady Plan was held by a large number of industrial countries, and any country that had alone tried to enable a restructuring of developing country debt held by its nationals would have confronted the awkward fact that nationals from other creditor countries would benefit by its actions. Multilateralism was essential for the resolution of these difficulties.

Over this period, the International Monetary Fund had adapted significantly to its new role. The Fund shifted toward greater emphasis on support and surveillance of economic policies in developing countries, and greater focus on the consistency of exchange rates with monetary and fiscal policies, largely in the context of current account issues.

But in the 1990s there was another sea change in the international economic system. The world economy was growing rapidly, fuelled by growth in world trade, in turn the result at least in part of further trade liberalization under the Uruguay Round. At the same time, the collapse of the Soviet Union led to major challenges in transforming those economies into functioning market economies. Again, bilateral efforts to support the transition would, by themselves, have been far clumsier. The existence of the GATT, subsequently the WTO, as a means of bringing trade regimes into the multilateral system, was essential. So, too, was the admission of economies in transition to the Fund and the Bank, enabling them to adopt the rules of the game for their exchange rate regimes and current account transactions.

Simultaneously, many of the developing countries whose economic performance in the 1980s had contrasted poorly with that of the successful East Asian economies began undertaking policy reforms, including shifting to a more open economy, in the hope and expectation that

their economic performance could be improved. By the mid-1990s, China's rapid economic growth was recognized by all, and India's economic reforms were beginning to bring results.

Earlier, some of the East Asian economies had profitably utilized large private capital inflows—in the case of Korea averaging almost 10 percent of GDP during the high growth years—and had shown their creditworthiness. This, combined with the improved prospects of many emerging markets, had led private creditors to pay much more attention to emerging markets. As a consequence, private capital flows to emerging markets mushroomed: whereas in the early 1980s, less than half of capital flows to developing countries had originated from private sources, by the mid 1990s, private capital flows predominated. And whereas a small number of developing countries had been significant borrowers from private markets even in the 1980s, a much larger number of countries, including economies in transition, were able to access them by the mid 1990s.

At the same time, preferential trading arrangements, or PTAs, were proliferating. Until the late 1980s, the European Union and the European Free Trade Association (which consisted of some of the European countries that had not joined the EU) had been the major PTAs in the world economy, and the thrust of most changes in trade policies had been for intensification of multilateral relations. There had been some efforts at PTAs among other groups of countries, but most of them had been largely ineffective and, in some cases, abandoned. But after the U.S.-Canada Free Trade Agreement, which eventually became NAFTA, other PTAs abounded. To be sure, many of them were between transition economies of Eastern Europe and the European Union, but there were also many others. Today, there are very few countries that are not members of one or more PTAs and many are members of many!

From the beginning of the stampede toward PTAs, economists noted that these could be either a "stepping block" toward multilateral trading liberalization or a "stumbling block". If a PTA opens the way toward greater multilateral trade liberalization and is consistent with a multilateral system, it can improve the welfare of the countries involved in the arrangement, and will not involve significant "trade diversion" from the rest of the world. If, however, the main effect of a PTA is to divert trade from previous trading partners towards members of the PTA, it will reduce the welfare of members and also lead to increased resistance against, (or less support for) further multilateral opening. In addition, there is also the consideration that, when countries' trade officials are focusing their attention on negotiating PTAs, there are fewer resources—and perhaps less motivation—to support the multilateral system.

While private capital flows were increasing in absolute and relative importance, and countries continued to liberalize, a series of events diverted attention from these trends. These were the crises in Mexico in 1994, Thailand, Indonesia, Korea and Malaysia in 1997-98, Russia in 1998, and Brazil in 1999. These crises, especially in the Asian countries, came as a major shock, in part because the rapid and sustained growth of those countries over such a long period had led most observers to believe they were invulnerable, and in part because of the rapidity and severity with which the crises erupted. These were different from earlier current account crises, in part because the capital account was more open and thus permitted more sizeable outflows relative to trade flows. It is not my intention here to analyze these episodes: for present purposes, the only point is to note that there was a great deal of learning to be done by all about the factors contributing to the crises and about the appropriate policy responses when crises did occur. Focus on those issues significantly distracted the international community from attention

to the larger questions that arose in response to the emergence of such very large private capital flows and the drift away from multilateral international economic relations.

Lessons have been learned, and many countries' economic policies have changed in ways that make them less vulnerable to financial crises: there have been shifts to more flexible exchange rate regimes, attention has been paid to issues of debt sustainability, reserve levels are higher, and there is greater focus on the consistency of monetary and fiscal policy with exchange rate regimes. And, of course, the IFIs played an important role both in facilitating economic reform and disseminating the lessons learned: yet again something multilateralism was best equipped to do.

Where We are Today

The international economy has prospered over the past few years. World real GDP has grown well in excess of 4 per cent annually for four years running and is projected to sustain this pace into 2007. And all regions of the world are sharing in this growth. The world is a far more affluent place than it was a half century ago. Living standards, measured by indicators such as life expectancy, infant mortality, nutritional status, and literacy, have all improved. To be sure, some parts of the world have been more successful than others, and some have failed to share in the gains, and these problems need to be addressed.

Nonetheless, the broad brush picture is one of phenomenal economic success encompassing virtually the entire world, unparalleled by any period in economic history. And the multilateral system has underpinned much of that success. Countries undertaking reforms have realized gains far greater than they would have had the world economy been significantly less vibrant. And experience with reforms has been applied elsewhere, in part because the IFIs have enabled rapid transmission of lessons learned. The fact that trade and capital flows take

place on a level multilateral playing field enhances efficiency, and increases competition in ways that are further growth-enhancing. On the surface, therefore, the outlook appears extremely promising.

But, beneath the surface, there are causes for concern. These arise in significant part because the multilateral system is so deeply embedded in today's international economy, and has been for such a long time, that it is largely and dangerously taken for granted. There are three major, related but not identical, factors that give rise to worry. One is the increased reliance on preferential arrangements, with their implied discrimination. The second is that private capital flows, despite their increased importance, do not yet fall into any coherent multilateral regime. The third is the tendency, probably increasing, for individual countries to place emphasis on their own position vis-à-vis the system, without regard to the extent to which their desired outcome may weaken the institutional underpinning of the very institutions they are trying to influence.

I shall close by considering each of these in turn.

I have already discussed the tendency for increasing proliferation of PTAs. By their very nature they are discriminatory, and each arrangement builds in some vested interests against multilateral liberalization. The best recent demonstration of this is the assertion that the reduction of barriers against imports of agricultural commodities by industrial countries would reduce the preferences that some developing countries receive. Yet the idea of preferences was to give developing countries a chance to develop their agricultural sectors over the medium term. So such an assertion for the longer term promises **either** a permanently inefficient pattern of production; **or** current investment in activities that will later have to be dismantled when preferences are removed.

It is not often asserted that the existence of preferential arrangements is a reason for failure to support, or opposition to, further multilateral liberalization. But the fact is that producers already exporting to PTA markets are either efficient and have already achieved the benefits (to them) of trade liberalization or they are inefficient and do not want multilateral competition. Either way, support for further multilateral liberalization has eroded. Many in the policy community have noted the absence of strong support from the US business community for the Doha Round, as compared to support for the earlier rounds of trade negotiations. It is not possible to prove that the absence of support for Doha is the result of PTAs (or the prospect of further PTAs) but it is certainly possible and even, I would argue, likely.

And, regardless of the causes, the multilateral trading system will inevitably be weakened should the Doha Round end without agreement. The failure to recognize the importance of open, non-discriminatory global trade is clearly a major factor in the current impasse. While the unraveling of the system would be a gradual prospect, it is nonetheless one that should be greeted with alarm by all who have shared in the rising living standards and global prosperity of the past six decades.

The second issue, the failure of the international economic system to have a coherent regime governing capital flows, is obviously more serious as private capital flows increase in size and importance in the global economy. Internationally-recognized rules for treatment of foreign assets and capital flows that provide for uniform treatment regardless of country or origin, and otherwise ensure a level playing field and efficient allocation of the world's capital resources, are clearly needed. The fact that most countries have to date extended uniform treatment to inflows and assets regardless of origin or ownership is heartening. But that may

owe much to the traditions of the open multilateral trading system. Preferential trading arrangements permit the possibility of negotiations for favorable treatment for PTA partners and, hence, for discrimination among non-members. This should be cause for alarm and we should seek to head off such pressures before they gain currency. There would be less resistance now to developing protection for multilateral regimes for capital flows than could happen at a later date should preferential treatment become more prevalent.

Some may argue that a uniform regime is desirable for the treatment of foreign direct investment but unnecessary for other forms of capital flows. A major problem with this argument is that money is fungible: transforming one capital flow into another is relatively straightforward. Should investors in one particular country be able to transfer assets to another on preferential terms, it would not take them long to develop ways of using that favoritism to advance the cause of foreign investors from that second country. And, of course, such favoritism would have its flip side in discrimination against foreign investors from countries excluded from preferential treatment.

The third issue—the tendency of countries to place their own short-term interests ahead of their systemic interests in the multilateral system—is also cause for concern. More than one person has told me that his country has nothing to gain from the realignment of voice and representation in the Fund, indicating indifference, at best, to recent efforts. Yet that argument says that the country in question has no interest in the long-term health of the institution. The Fund will be strengthened by changes that better reflect the current relative positions in the international economy: and countries that do not gain shares will nonetheless gain from the healthier international economy that will result from stronger, better-functioning multilateral institutions.

Similarly, more than one major country has taken a position in the Fund supporting a program that violates Fund policies simply because the larger country politically favors the potential recipient of the program. Over the longer term, a weak program is likely to result in a less favorable outcome for the "protected" country. Quite aside from that, however, such behavior weakens the Fund itself, making it less valuable both to the members wanting favorable treatment for their favored clients and to the borrowing countries. There are similar problems with some diversity issues, where there are pressures for one country's national to be appointed or promoted on the grounds of diversity rather than merit. Cumulatively, the damage can be substantial, especially as other countries then argue that they should also be treated favorably, or advocate favorable treatment for their own nationals or a favored client country. Each successful intervention elicits still further interventions. It is a very slippery slope.

The proliferation of PTAs and the continuing absence of a multilateral regime governing capital flows are both glaring and dangerous departures from multilateral principles. The tendency to push narrow national interests is less obvious, and its impact if incremental: but it is no less dangerous a threat to multilateralism and one which we multilateralists ignore at our peril.

The very success of the multilateral system over the past six decades is both a cause for celebration and a strong argument for doing all we can to preserve both the system and the benefits it has brought. The international economy has been hugely successful over the past sixty years. Real rates of economic growth and, with them, poverty reduction, have surpassed what anyone thought possible at the end of the Second World War. There is still a great deal to be learned and done—not least to extend the benefits of economic growth to all citizens—but progress has already exceeded expectations by a wide margin.

The dramatic progress we have seen was made possible by the multilateral economic system and the liberalization that has come about through unilateral actions, through compliance with the conditions of membership of the multilateral institutions, and through multilateral negotiations. The fact that globalization has greatly intensified economic linkages and interdependence among countries increases the importance of open multilateralism. In addressing the challenges we face, therefore, we must be careful to appreciate the continuing—even growing—importance of the multilateral system, and to strengthen it.

Of course, international institutions need to adapt to changes in the international economy. They have and they are. But as calls are made for them to achieve those objectives, the message should be clear that changing roles are in the context of a multilateral system: and that multilateralism has been a success that must be fought for and preserved.

