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An enduring need: multilateralism in the twenty-first century

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Abstract That the global economy has been hugely successful over the past 50 years is unquestionable. A major underpinning of that success has been the open multilateral system, which has enabled the emergence of a truly international financial system, reciprocal reduction of trade barriers, and the emergence of many previously poor countries into the status of 'emerging markets' or even 'developed'. The open multilateral system, however, is increasingly under-appreciated and taken for granted. Preferential trading arrangements have proliferated, and with them the possibility of discriminatory arrangements for capital flows. The absence of an international regime for capital flows permits this development and poses a threat to the system, as do all of the issues on which countries' governments assert 'their' interests, and ignore their interests in the overall health of the system. It is to be hoped that the benefits of multilateralism are more greatly appreciated, and that the current trend toward increasing regionalism and departures from the post-war system is reversed.

Key words: multilateralism, global economy, trade liberalization, global financial stability

JEL classification: F02, F33

I. Introduction

Multilateralism has been the key to the huge economic successes of the past half-century. My theme in this paper is that the achievements of the multilateral economic system are increasingly underappreciated as it is ever more taken for granted, while the need for a well-functioning multilateral international economic system is greater than ever as globalization proceeds. I argue that the multilateral institutions have performed remarkably well in underpinning economic success of unimagined proportions over the past 60 years. However, just as we take the air we breathe for granted, so, too, do many now take those successes and the multilateral economic system underpinning them for granted. They ignore

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the ‘public good’ benefits that the multilateral system provides and focus instead on a narrow view of the short-term costs and benefits to them.

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. 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 60 years. After that 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 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.

II. 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 l930s. 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 l930 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 nineteenth century. They had therefore adopted most-favoured-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 l920s that the United States government recognized the drawbacks of bilateral trade treaties (at least as seen from an American perspective) with countries which had used MFN: the trading partner with which the United States was negotiating would have to lower its tariff for all its MFN partners, while the American tariff reductions were not extended to others. Most countries chose to offer more favourable 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 USA (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 unfavourable experience that, in the l930s, Cordell Hull, the American Secretary of State, so enthusiastically supported ‘reciprocal tariff agreements’.

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 post-war international economic system recognized that multilateralism was desirable, not only to reduce and, they hoped, to eliminate the possibility of any recurrence of the l930s, but also to promote non-discrimination in international transactions.

The founders of the post-war system recognized the benefits to be had from a resumption of international capital flows, but believed that the experience of the l930s had destroyed prospects for a revival of most private capital flows.[1] They were therefore 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 post-war international economic system and organization was assumed to be complete when, in addition to the General Agreement on Tariffs and Trade (GATT) for multilateral trade relations and the World Bank for official capital flows, the International Monetary Fund (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 IMF’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 capital flows might finance 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 return to this issue later and argue that the absence of a multilateral, non-discriminatory framework governing international capital flows (and exchange-control mechanisms) is an important and potentially costly gap in the multilateral economic system. This gap is often thought to be confined to that which it creates for the preservation of international financial stability and to do with issues which are primarily the concern of the IMF. But it is, of course, also a gap in the framework of the international *trading* 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

[1] Many participants in the Bretton Woods conference were also concerned about the potential they perceived for destabilizing capital flows, but the issue was not strenuously fought by others because of the belief that they would not, in any event, be forthcoming.

obtain the best terms. And, as I note later, efforts to discriminate by country of origin or destination also confront enormous practical problems that can normally only be addressed, if at all, 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 vivid 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' (VERs; 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 semiconductors: the imposition by the USA of a VER led to a major expansion of capacity in third countries and led many American companies to shift production activities using semiconductors offshore. American semiconductor producers gained little, if anything, while American consumers of semiconductors (PC assemblers, etc.) suffered as the prices they initially paid in third-country markets rose until initial capacity was in place.

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 USA 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 anti-dumping or countervailing-duty measures are 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 countervailing duty 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 post-war international economic system.

But the experience of the post-war 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 60 years of the post-war 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 pre-war 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 per cent, 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 four 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 l940s, 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 pre-war output levels by the early l950s. But they sustained their growth rates well into the l960s and early l970s. At the same time, Japan's economy began growing and by the l960s was achieving sustained rates of economic growth of 7–9 per cent—well above anything that had earlier been thought possible.

Expanding world trade was the 'engine of growth' in the post-war 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. The recovery from wartime conditions and the growth of GDP spurred trade growth. So, too, did falling costs of transport and communications. 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 per cent in the late l940s to an average of less than 5 per cent, 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 favourable 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 per cent to the f.o.b. (free on board) value of exports in the late l940s; that figure had fallen to 3 per cent by the late l990s. Airfreight, a rarity in the immediate post-war years, now accounts for 40 per cent 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 10 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 l945 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 pre-war levels 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 per cent of Europe's trade liberalization had been multilateral, and probably around an extra l0 per cent had been extended preferentially within the continent. While tariffs were reduced from over 40 per cent to zero for countries in the now-EU, they were reduced from the same level to less than 5 per cent for other countries.

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 towards preferential trading arrangements and to other bilateral and regional arrangements. As I 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 30 years after the golden quarter-century. The l970s 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 l973, 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 l980s, 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 l980s.

The official international community—both the IMF and the World Bank—reacted, supporting adjustment efforts in many of the afflicted countries. By the late l980s, 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 IMF had adapted significantly to its new role. It shifted towards 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 l990s 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 World Trade Organization (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 l980s had contrasted poorly with those 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-l990s, 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 used large private capital inflows—in the case of Korea averaging almost 10 per cent 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 l980s, less than half of capital flows to developing countries had originated from private sources, by the mid-l990s, private capital flows predominated.

And whereas a small number of developing countries had been significant borrowers from private markets even in the l980s, a much larger number of countries, including economies in transition, were able to access them by the mid-l990s.

At the same time, preferential trading arrangements, or PTAs, were proliferating. Until the late l980s, 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 US–Canada Free Trade Agreement, which eventually became the North American Free Trade Agreement (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 towards PTAs, economists noted that these could be *either* a 'stepping stone' towards multilateral trading liberalization, or a 'stumbling block'. If a PTA opens the way towards 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 l997–8, Russia in l998, 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 analyse 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. Of course, the international financial institutions (IFIs) played an important role both in facilitating economic reform and in disseminating the lessons learned: yet again, something multilateralism was best equipped to do. These reforms, promoted by the IFIs, have made it less likely that these countries will suffer the disruption caused by financial crises. But these reforms have also improved the international trading system: they have made it easier for capital to flow to these countries. The very rapid growth in major emerging-market economies is raising new issues as their increasing weight in the international economy requires attention to the systemic effects of their economic policies.

III. 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 4 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.

None the less, 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, and that progress on reaching a multilateral regime covering services is proceeding more slowly than is desirable. 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 for 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 themselves) 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 unravelling of the system would be a gradual prospect, it is none the less 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 and services, is obviously more serious, as private capital flows and services 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 of 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 favourable treatment for PTA partners and, hence, for discrimination among non-members. Likewise, as services, and especially business services, increase in importance, the absence of a multilateral framework will become increasingly costly: one can even imagine discriminatory services treatment resulting in discrimination in trade. Both of these failures should be cause for alarm. PTAs have already resulted in the potential for discriminatory treatment of capital flows and services, and the issue requires addressing urgently.

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 favouritism to advance the cause of foreign investors from that second country. And, of course, such favouritism 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 none the less 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 programme that violates Fund policies simply because the larger country politically favours the potential recipient of the programme. Over the longer term, a weak programme is likely to result in a less favourable outcome for the ‘protected’ country. Quite aside from that, however, such behaviour weakens the Fund itself, making it less valuable both to the members wanting favourable treatment for their favoured 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 favourably, or advocate favourable treatment for their own nationals or a favoured client country. Each successful intervention elicits still further interventions. It is a very slippery slope.

As to trade issues, the move towards PTAs itself is a move away from multilateralism. And the unwillingness of some developing countries to recognize their interest in the overall growth of the world economy (through the success of the Doha Round) clearly demonstrates their lack of appreciation of the importance of the multilateral system to them. The same argument holds with equal force for agricultural protection in industrial countries.

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 is 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 60 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 the international economic system. In addressing the challenges we face, therefore, we must be careful to appreciate the continuing—even growing—importance of the multilateral system, and the need 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.