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Can Multilateralism Survive the Rise of the BRICs?
Introductory note for roundtable 7

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The world economy is undergoing a transformation of unprecedented magnitude. According to Richard Freeman (2005), the participation in the global economy of India, China and the former Soviet Union is adding 1.5 billion new workers to the global workforce, leading to an almost exactly doubling in size[1]. According to Goldman Sachs (2003), in 2025 the combined GDP of the BRICs (Brazil, Russia, India, and China) should account for half of the GDP of the G7, and by 2040 it should exceed it. In 2050, the first three economies ranked by GDP should be China, the US and India.

Two features of this phenomenon stand out. Never in economic history has such a large workforce been absorbed in such a short period of time. Only once – with the US and Germany in the late XIXth century - have two new players simultaneously risen to the top of the economic power league[2]. It is thus hard to overestimate the magnitude of the shock.

This accelerated rise represents a major challenge to the multilateral trade, monetary and financial system of the post-WWII era. This system was created at the initiative of the US to organise economic relationship among a limited number of similar and mostly like-minded countries. It recent decades, it has successfully expanded to absorb an increasing number of new and more diverse participants. However, the acceleration of changes has two implications. First, the strains it is creating *within* Western societies will in all likelihood test the resilience of the system to an unprecedented degree. Second, it is bound to shift the balance of *global* power and to call for changes in global governance because unlike their predecessors, the newcomers are big enough to challenge the *de jure* or *de facto* leadership that the US and to a lesser extent Europe have so far exerted over the system.

This transformation is more threatening to Europe than to the US, because it has demonstrated a lesser internal ability to adjust to a changing world economic landscape because it is more likely to be relegated to second-class status, and because it has more to lose in a reform of the global governance institutions. Furthermore, in recent times the EU has concentrated on domestic issues like enlargement and discussion over the project for a constitution and has as a consequence overlooked changes in the rest of the world. Only recently have Europeans heard the China and India wake-up call.

For the US and the EU, the adjustment to those challenges probably dominates most other medium-term policy issues, and certainly dwarfs all bilateral policy disputes. A major

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[1] Freeman considers that prior to the participation of those countries, the global workforce comprised the labour force from industrialised countries, most of Latin America and part of Africa.
[2] For example, in the early XIXth century the cumulated population of the US and Germany accounted for about a fourth of the population of Western Europe. Furthermore, their GDP per capita was only about a third lower than that of the UK. In 1950, the cumulated population of Japan, South Korea, Taiwan, Hong Kong and Singapore accounted for one-fourth of that of the US, Western Europe, Canada and Australia. Source: Angus Maddison, Historical Statistics, http://www.eco.rug.nl/~Maddison/.

question is thus whether the two dominant players of today can, in spite of their differences, converge on how to handle the shock, and are able to define joint responses.

This note briefly addresses the issues raised by the rise of the BRICs and their implications for US-EU discussions. Section 1 deals with the economic shock. Section 2 addresses the challenges to multilateralism. Section 3 concludes by raising issues for discussion.

1. Globalisation fatigue

The almost sudden increase in the world labour supply implied by the inclusion of the BRICs in the global economy is bound to have profound consequences on wages, employment and the distribution of income. Freeman reckons that because the entrants lack the capital stock of the incumbents, the global capital-labour ratio has been cut by close to 60% and will only attain its previous level again in 30 years, in spite of the very high saving and investment rates in China and the other entrants. This a major reason for the downward pressure on wages and the increase in the global return on capital that are being felt in the countries that previously constituted the world economy.

The magnitude of the shock is compounded by the increasing ability of global companies to decompose the value chain and to outsource whatever segment of it to where it can be produced in a more cost-effective way.

Furthermore, the entrants are relatively well-endowed in human capital. This certainly is true for Russia and India, as well as for China which is investing massively in higher education (by 2010, its annual output of science and technology PhDs should match that of the US). The initial pattern of comparative advantage and trade is thus shifting rapidly. As Paul Samuelson (2004) emphasised in a recent (and controversial) paper, this erosion of the rich countries' traditional comparative advantage in skill-intensive goods is not only likely to alter the distribution of income. It could also lead to a decrease in the gains from trade and therefore to a net loss for the incumbents.

This transformation is taking place against the background of mounting signs of *globalisation fatigue*. A decade or so after the process started to accelerate, it affects both Europe and the US.

In Europe (at least in part of it), persistently high unemployment and dysfunctional labour markets make the adjustment to shocks especially painful as laid-off workers from major companies face the perspective of protracted unemployment and significant income losses. The angst over globalisation and relocations recently found a political expression in the French rejection of the constitutional referendum.

What is more surprising is that in spite of a lower unemployment rate, a better functioning labour market and an established comparative advantage in innovation, a somewhat similar climate exists also in the US, as indicated by current congressional nervousness vis-à-vis China over trade, offshoring, currency controversies and the take-over of US companies. For the EU, the uncomfortable message is that even a Europe that had gone through its painful reform agenda and succeeded in becoming an innovation-based economy would not escape the strains of adjustment.

To avoid the transformation of globalisation fatigue into a real backlash, the US and the EU need to go beyond mere sermons on the benefits of open trade and the imperative of structural reforms. Required adjustments need to be buttressed by labour market institutions that effectively equip employees for change and by public policies that channel part of the gains from trade to those institutions.

An example of such institutions, albeit of limited effectiveness, is the US Trade Adjustment Assistance (TAA) programme that was established in 1974 and reformed in 2002 to provide assistance to displaced workers. No such programme exists in Europe. The EU assists regions, not workers, and it finds itself in the uncomfortable situation of advocating market opening without having an effective instrument for compensating those who lose out in the process. This is why it has been proposed to establish a kind of TAA that would supplement national efforts to retrain displaced workers and accompany their search for a new job (Sapir, 2004).

What is clear in any case is that political support for open trade and multilateralism can no longer be taken for granted.

2. Challenges to multilateralism

Support for the multilateral order is not only being weakened by the magnitude of the challenges that developed and developing societies face. This support is also being undermined by a rise of regionalism that affects trade and finance.

In the trade field, the rise of regionalism is impressive. Since the World Trade Organisation was created 10 years ago to strengthen multilateralism, the number of regional trade agreements has doubled. With 40 new such agreements notified to the WTO in 2004 alone, the trend is accelerating. Today, an average WTO member belongs to 5 regional arrangements and the EU alone has such agreements with more than 100 countries in the world[3].

The BRICs cannot be held responsible for this transformation, but they are actively taking part in it. Brazil has promoted the Mercosur, explicitly taking example on the EU. Russia has been busy recreating links with countries of the former Soviet Union. Together with Japan, Korea and the ASEAN countries, China has created the ASEAN+3 grouping. Even India, one of the staunchest supporters of the multilateral system, is now part of the regional game – at least because remaining outside of it would have involved excessive risks.

As regards natural resources, the BRICs are already exerting a significant pressure on global markets, which is only expected to increase. They already account for about 18% of world oil demand and this proportion is expected to rise to 30% in twenty years (Goldman Sachs, 2004). China is increasingly keen on securing access to natural resources through (mostly bilateral) special arrangements and the take-over of energy companies.

In the financial and monetary fields, the BRICs and especially China have taken the lead. One of the major lessons that the Asian countries have drawn from the 1997-98 crisis is that they should avoid going to the International Monetary Fund again. Beyond accumulating reserves to build-up their own, national insurance against shocks, the Asian countries have started developing regional cooperation and mutual assistance schemes. After the 1997 project for an Asian Monetary Fund had been abandoned at the insistence of the US and the EU who regarded it as an intolerable threat to the IMF, less formal but nevertheless effective forms of cooperation have been put in place such as the ASEAN+3 surveillance process and the Chiang Mai monetary and exchange rate cooperation initiative. While less formal, these agreements come increasingly close to what an Asian Monetary Fund could have achieved.

Regionalism is thus today a *fait accompli* that is here to stay. The question is whether it can peacefully and constructively cohabit with multilateralism or is rather bound to undermine it and ultimately conflict with it. The key issue in this respect is what countries consider guarantees their security best. The very concept of a multilateral system rests on the

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[3] Evidence on and discussion of the rise of trade regionalism can be found in the proceedings of a recent conference co-organised by Bruegel on 27-28 June 2005. See www.bruegel.org.

assumption that security is collective. According to this concept access to raw materials, products, services and capital is guaranteed by the depth and resilience of the corresponding markets and by the rules governing the multilateral institutions. For example, energy security rests on the depth and liquidity of a global market and on a global governance that prevents manipulation, rather than on costly self-insurance or on bilateral deals which are subject to renegotiation. In the same vein, financial security rests on the depth and liquidity of global financial markets and on the potential for accessing on reasonable conditions to IMF loans, rather than on special arrangements with a subset of countries. A multilateral system is thus strong as long as the participating countries have sufficient trust in it to consider that it represents a form of insurance they would be able to rely on if needed.

The evidence is that at least China does not trust the concept of collective security very much. This is certainly in part due to its size: a country big enough to create major imbalances on global markets can hardly rely on the assumption that those markets will always have sufficient depth to provide the liquidity it may lack. But lack of trust is also attributable to the governance of the multilateral system, which is still formally (for the G7 and the IFIs) or informally (for the WTO) dominated by the US and to a lesser extent the EU[4]. While a noticeable progress was made a few years ago with the creation of the G20, the lack of reform of the global institutions (or the slow pace of it) acts for it, and possibly for the other BRICs, as an incentive to explore alternative, bilateral or regional routes.

The reform of the global economic and financial institutions and the rebalancing of power it implies are not simply required for the sake of fairness. More importantly, they are necessary to ensure a sufficient degree of ownership in the multilateral system. Rather than to postpone them, the US and the EU should thus accelerate reform to create conditions for a strong commitment to multilateralism.

Such a rebalancing necessarily implies that Europe abandons its current overrepresentation in the G7 and the Bretton Woods institutions to make room for a governance structure that better represents the world economy of today and tomorrow. In turn, this implies some form of pooling of representation in global institutions, especially those where membership is limited. This perspective has been discussed for some time among Europeans, but without much follow-up. External pressures might lead to consider it more seriously.

3. Conclusions

This paper has argued that one of the biggest difficulties ahead for the US and Europe is to handle the integration into the world economy and the global multilateral system of the new entrants – i.e., mainly the BRICs. This is a major challenge that deserves to be addressed jointly by the US and the EU.

The challenge has internal as well as global dimensions. On the internal front, Europe and the US are already suffering from globalisation fatigue, but they are bound to be confronted with increasing stress as a consequence of the doubling of the world economy's global labour supply. The questions to discuss in this regard are (i) how support for open markets can be maintained against the background of deeper and more widespread economic strains, and (ii) whether this can be addressed without scaling up very significantly efforts to assist displaced workers and make them able to cope with change. Little has been done so far to address those issues.

On the global front, the issues are (i) whether sufficient backing for an already weakened multilateral system can be maintained if economies increasingly tend to rely on unilateral,

[4] This is very clear in the case of monetary and financial cooperation. IMF conditionality at the time of the Asian crisis is commonly regarded as having been distorted by US views and interests.

bilateral or regional schemes to insure against potential real and financial shocks, and (ii) what changes in the governance of the international institutions are required to make additional room for the newcomers, ensure that they feel adequately represented, and give them incentives to develop a sense of ownership in this system.

Until recently, the common perception was that those issues would need to be addressed in the medium run. It is increasingly apparent that they need to be taken up without delay.

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