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BRICS Development Bank: the way forward

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The BRICS[1] Summit meeting in Durban, South Africa in late March 2013 announced the desire to establish a 'New Development Bank' that could 'mobilize resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries'[2]. This was the Fifth Summit-level meeting for the grouping and the theme for this year was "BRICS and Africa: Partnership for Development, Integration and Industrialisation"[3]. In addition to the bank, the BRICS grouping also announced the construction of a financial safety net (with an initial size of US$ 100 billion) through a Contingent Reserve Arrangement (CRA) amongst BRICS countries aimed at forestalling short-term liquidity pressures, and strengthening existing international arrangements as an additional line of defence[4]. The CRA is mooted to pool reserves based on individual contributions from China ($41bn), Brazil, India and Russia (US$ 18bn each) and South Africa ($5bn)[5]. China's top banker, Chen Yuan, governor of the China Development Bank, is expected to be the top boss in transforming the BRICS Bank from plan to reality[6]. Interestingly the plan to create the new bank was introduced formally at the March 2012 Delhi BRICS Summit[7], even as the idea itself was mooted by India at the BRICS finance ministers' meeting in Mexico earlier that year[8].

Some of the reactions to this initiative have been sceptical – ranging from the mild ('BRICS trying to reduce their reliance on Western financial institutions'[9]) to the critical ('BRICS offering a co-ordinated challenge to western supremacy in the world economy'[10]), to the outright acerbic ('BRICS being a direct challenge to the dominance of the World Bank and the International Monetary Fund'[11]). That the countries comprising this initiative reflect the classic mismatch between strong democratic traditions (as in India, Brazil and South Africa) and autocratic political systems (as in Russia and China), is one of the key arguments levelled against an optimistic outlook on the BRICS bank[12].

Using Helleiner's schema[13] on Global Economic Architecture (GEA) as reference, it is fairly evident that the BRICS development bank is not being pushed as a revolutionary alternative to the existing financial system (Bretton Wood's institutions – the International Monetary Fund and the World Bank). Instead, what we have at present is an agreement on establishing a BRICS Development Bank, which would serve as the first formal institution for this informal grouping called BRICS[14]. Both at the stage of conceiving this idea in New Delhi in 2012, and at the Durban Summit where the idea was formally adopted, the proposed bank has not been projected as a challenge to the existing GEA. The Delhi Summit declared that this bank will "supplement the existing efforts of multilateral and regional financial institutions for global growth and development"[15]. The keyword is reform. The BRICS countries have declared (Articles 13 and 15 from the Durban Summit declaration) that,

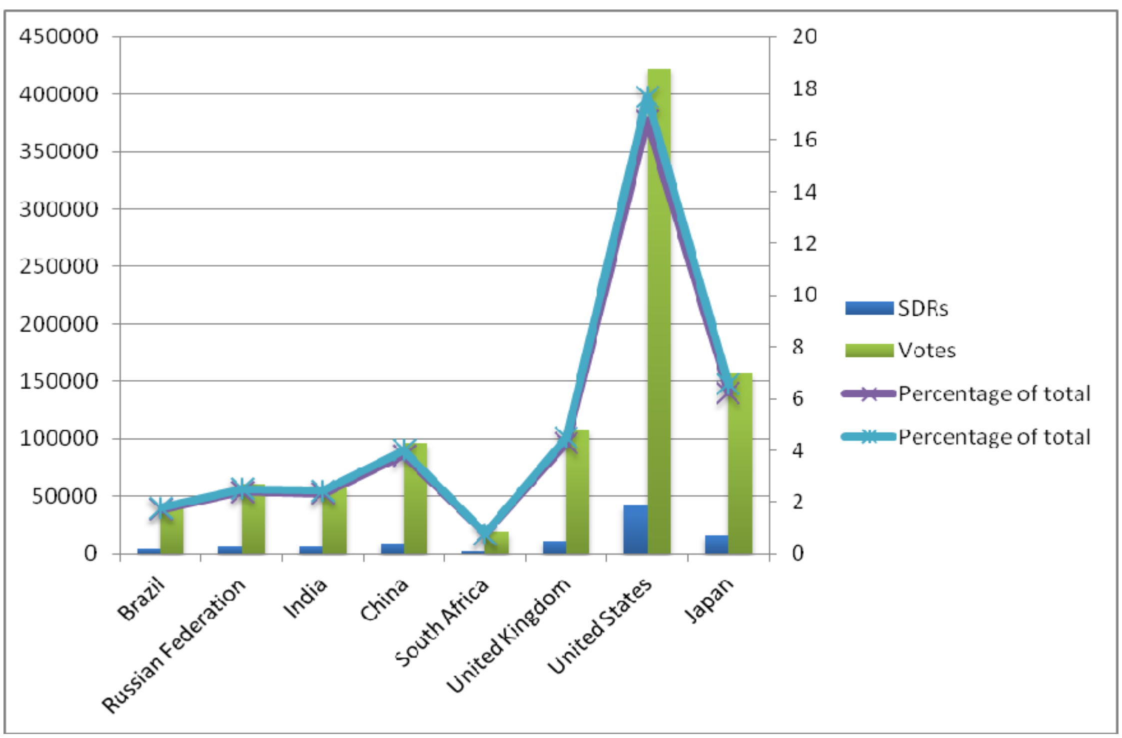
"*We call for the reform of International Financial Institutions to make them more representative and to reflect the growing weight of BRICS and other developing countries... We support the IMF to make its surveillance framework more integrated and even-handed... We reaffirm our support for an open, transparent and rules-based multilateral trading system*"[16].

A necessary reform

This call for reform, as opposed to an outright challenge to the existing institutional mechanisms is desirable and reasonable. All of the BRICS members have benefitted from the rule-based governance of the existing international financial and trade mechanisms, whatever the drawbacks. China's rise as the world's largest manufacturer today is directly related to its commitment to undergo drastic reforms both internally and in acceding to the World Trade Organization (WTO). Russia, most recently, joined the WTO implying that it is further committed to bring its trade laws and practices into compliance with established multilateral trade rules. Others too have benefitted immensely from the existing institutional structure. However, the major problem is that these turnaround economies (from being among the largest and poorest in the world at the turn of the century) remain underrepresented in institutions which were conceived originally for a different set of actors and in a different setting (post-WW II). But that was then. BRICS today account for 27 percent of global purchasing power, 45 per cent of the world's work force, 11 percent of global crude oil reserves, 29 per cent of natural gas, and 43 per cent of coal deposits[17]. BRICS have also become important sources of outward investment with outward FDI rising from US$ 7 billion in 2000 to US$ 126 billion in 2012 i.e. 9 per cent of world flows from just 1 per cent a decade earlier[18]. In terms of overall FDI outflows, BRICS account for one-third of those from developing and transition economies, while as recipients of FDI stock BRICS countries account for 11 per cent of global FDI stock[19]. Most recently, BRICS nations pledged US$ 75 billion to boost the IMF's crisis reserves to support the Eurozone[20].

Yet, within international financial institutions, this transformation of the global economic, landscape vis-à-vis BRICS is not fully reflected. If we examine the quotas for BRICS in terms of Special Drawing Rights (SDRs)[21] and their vote-share in rule-setting at the highest level, and compare it to the US, Japan or even Britain, the allocation in the IMF is unfair (Figure 1). Brazil, China, and India had 19 per cent fewer votes than Belgium, Italy, and the Netherlands collectively, despite their 21 per cent more nominal GDP, 400 per cent more
purchasing power GDP, and 2800 per cent more population[22].

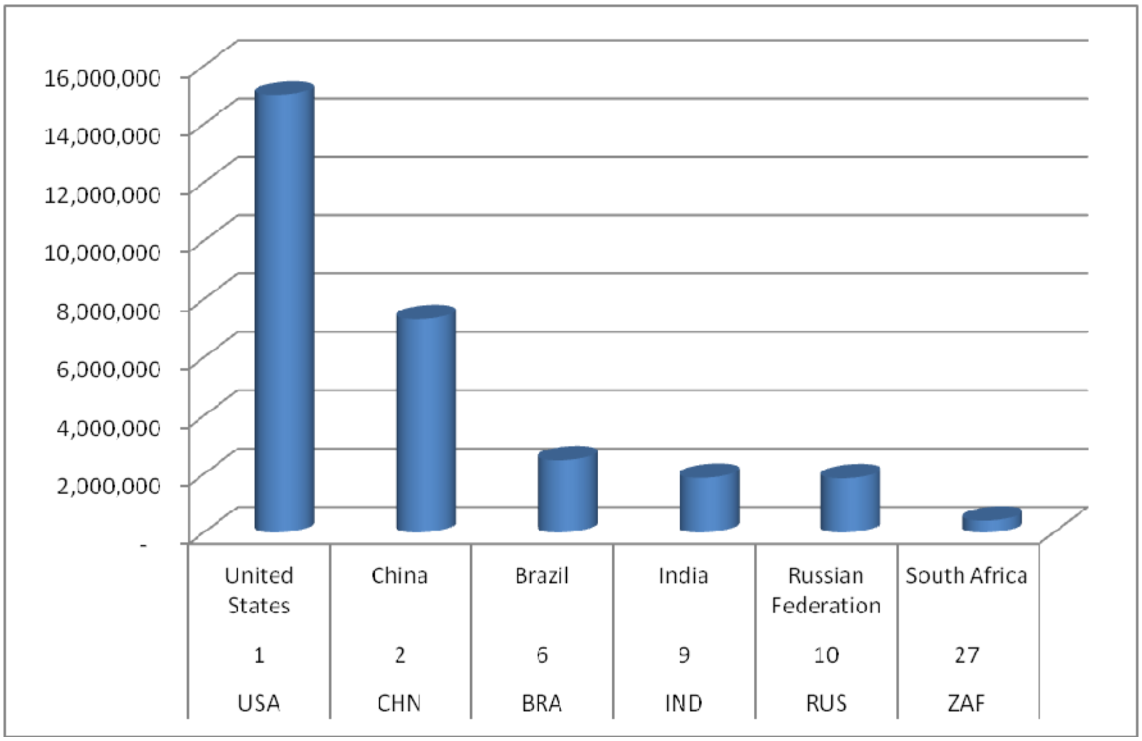
Figure 1: BRICS: SDRs and vote-share at the IMF



Source: Author; Dataset: IMF

While there have been efforts to reform this anomaly in quota and votes by the IMF (in April 2008 and November 2010), this is only at a proposal stage (pending ratification) and that too aiming at a nominal shift of 6 per cent of the quota to emerging markets and developing countries[23]. Beyond this evident need for democratization of international financial institutions, there is also a development imperative that this bank would be able to fulfil. If we examine the economic performance of the BRICS economies in comparison with the developed world, the shortfall of overall growth is evident despite the impressive growth rates (Figure 2).

Figure 2: Gross domestic product [2011; US$ millions; Rank; country code]



Source: Author; Dataset: World Bank

On basic needs indicators, the gap is wider still. Emerging-market economies and low- income countries face a situation where 1.4 billion people still have no reliable electricity, 900 million lack access to clean water, and 2.6 billion do not have adequate sanitation – added to the onerous task that much of this infrastructure investment has to be environmentally sustainable[24]. By the IMF’s own account the target of reducing the extreme poverty rate i.e. percentage of people living on less than US $1.25 a day to 3 per cent by 2030, is ambitious depending both on strong growth rates across the developing world, as well as translation of such growth into poverty reduction[25]. If the infrastructure spending does not rise from the current levels of US $800 billion to at least US $2 trillion annually in the coming decades, it will be impossible to achieve long-term poverty reduction and inclusive growth[26].

Currently, 42 per cent of BRICS outward FDI stock goes to developed countries (34 per cent in the EU itself)[27], while 43 per cent is directed to their neighbouring countries in Latin America and the Caribbean, East Asia, South Asia and transition economies[28]. The actual FDI linkages between BRICS countries are not impressive (Figure 3) although the trend shows an encouraging rise. BRICS partners' share of the outward FDI stock that went to BRICS rose from 0.1 per cent to 2.5 per cent [from US$ 260 million in 2003 to US$ 29 billion in 2011; Table 1][29]. Clearly, therefore, an additional institutional mechanism that supplements the existing GEA, with an added source of financing on terms favourable to the participating member-grouping is a necessary reform.

Figure 3: BRICS and FDI stock patterns (2011; per cent)

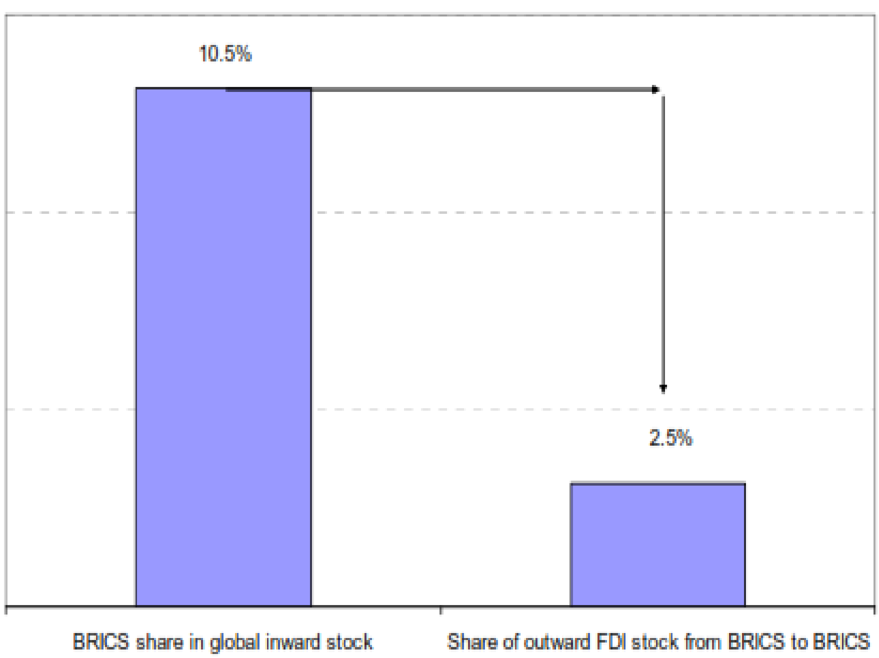


Table 1: Features of Intra-BRICS FDI

Country	Trait of intra-BRICS FDI	Value at end-2011	FDI into BRICS (as percentage of outward FDI)
1. *Brazil*	Direct investment in other BRICS countries is modest	US$0.5 billion	0.3%
2. *China*	Although it is the largest overall investor among the BRICS countries at USD 425 Billion, yet intra-BRICS investment amounts to only 2.2 % of this total.	South Africa and the Russian Federation received stocks of US$4.1 and US$3.8 billion, respectively, by the end of 2011; the two countries were the eighth and ninth largest recipients of Chinese FDI.	2.2%
3. *India*	Within BRICS, Russian Federation accounted for three-fourths of Indian FDI stock, while Brazil, China and South Africa absorbed US$74 million, US$229 million and US$194 million, respectively.	US$2 billion	3.2%
4. *South Africa*	Accounts for largest share of intra-BRICS investment	One-fifth of the outward FDI stock was located in the "BRIC", chiefly in China, followed by Russia, India and Brazil.	20%
5. *Russia*	Remains relatively low in terms of outward FDI to BRICS	FDI stock at US$1.1 billion.	0.3%

Source: Compiled by author from UNCTAD[30]

From paper to reality

Later in September 2013, a review of the progress made on both the Bank and the CRA would be made by BRICS members on the sidelines of the G-20 Summit[31]. At present the Finance Ministers and Central Bank Governors from BRICS have been tasked with negotiating and concluding the agreements which will establish the Bank and the CRA. While the need for such reform has been outlined earlier, in order to arrive at a functional financial arrangement for BRICS (and other developing countries), it is important to underscore two cardinal principles, namely, institutional efficacy and institutional purity. Three issue-areas which have been flagged as problematic on course to realizing this financial arrangement relate to the specifics of fund contribution towards bank seeding, fears on China's domination of the bank, and the actual location of this bank[32].

It maybe pointed out that on the matter of seed capital, there is yet no agreement between members on either the size of the seed capital (though an amount of USD 50 Billion as seed capital has been discussed in media reports on the issue) or on the physical location to host this proposed bank . The authorized capital of any bank comprises an element of "paid-in capital" (seed money; individual member contributions acting as the bank's cash reserves) and "callable capital" (funds that are pledged as guarantee for any bonds issued by the bank to raise funds in the capital markets for its lending program). In the case of the BRICS development bank, ideally, the burden of the seed capital should be distributed equally and not based on the country's wealth and projected growth. The element of "callable capital" can be the main vehicle for raising funds subsequently. Equal distribution of the seed capital would ensure equal voting rights. The latter would ensure that countries are not faced with an IMF-like situation where contributions determine quota and voting rights.

The seed capital plan could therefore be modest at the outset, allowing most members to contribute equal shares, and without diverting much needed capital from economic growth requirements domestically. The callable capital could be raised by borrowing from capital markets elsewhere. This is one of the aims of the Bank i.e. to borrow from global capital markets by issuing bonds as a non-resident borrower in the United States, Europe, Hong Kong and elsewhere[33]. However, this may not be as efficacious as World Bank bonds (which are AAA-rated; guaranteed by 180 member states) at the outset. BRICS being a smaller set of developing economies and, clearly, with a modest profile of guarantors, could begin with pooling funds which could then be used to underwrite the sovereign ratings of the BRICS over time[34].

While the Finance Ministers and Central Bank Governors from the member-countries would deliberate on the matter of both fund contribution and actual physical location of the bank, before arriving at any operational consensus the operative factor which requires greater discussion is whether China is favourably placed in deriving greater benefits including, among others, from internationalizing the *renminbi* (RMB) through this platform. Certainly, given the rise of China as the world's largest exporter and manufacturer, one would have to get used to the RMB being increasingly used as a settlement currency and/or in swap arrangements[35]. However, to presume that the RMB would acquire a status as an alternate reserve currency i.e. a store of value such as the US Dollar (or hitherto the British Pound), through the BRICS bank requires a great leap of faith owing to China's weak financial system and lack of international policy credibility in this matter. Internationalizing the *renminbi* in any real sense is not possible unless China becomes a net importer of goods and net exporter of capital[36]. This would imply reversing the current export-driven model of growth, and on the part of recipients it would mean accumulating RMB assets in significant amounts – none of which is happening anytime soon. Nonetheless, the BRICS bank will remain an important institutional arena for China, in whatever small manner, to gradually allow the Yuan to become a *more* international currency (emphasis added) to be accessible to foreign banks, who could then invest in China's interbank bond market. Quid-pro-quo clearly requires China to address the concerns of other economies in this member-grouping, and somewhere its financial heft has to be balanced with the requirements of the other members for some level of institutional purity to be established. Ultimately, the success of the Bank depends on a big 'if' relating to China being able to address its own financial reforms, and demonstrating respect for mutuality of interests for the members in the institutional set-up.

While institutional purity is, therefore, a necessary condition for cohesion in this grouping, it is not sufficient. The BRICS has to be watchful of the institutional efficacy of this arrangement. For instance, China is often blamed for offering no-strings-attached development aid, particularly in Africa, as opposed to the conditional aid from development banks or multilateral lending[37]. While development aid from the North too has its share of critics, and which is one of the reasons for the call for reform, the onus is on the proposed BRICS bank to establish safeguards and covenants (ex-ante and ex-post) that apply throughout the borrowing period and towards repayment, in addition to policy adjustments that are rule-based and equitable[38]. Clearly, the most immediate precedent for BRICS to structure these institutional arrangements is the Chiang Mai Initiative Multilateralism (CMIM)[39], with China as a common factor in both. That arrangement is also based on a reserve fund, where foreign exchange is earmarked for crisis prevention but held in separate national accounts[40]. The operational principal for withdrawal of funds is that only 30 % of the amounts can be withdrawn without an IMF program in place, as per the latest revisions introduced in 2012[41]. Clearly, linking any drawing beyond the eligible funds to IMF guidelines serves as a “de facto” conditionality against lax economic policies[42]. Keeping the reform agenda intact, the BRICS bank too should not lose sight of IMF linked and de-linked portions, while at the same time ensuring autonomy in financial management.

The other aspect of institutional efficacy is inclusiveness. There are several other countries which have immense promise in terms of future economic prospects from the ‘developing’ camp itself (Indonesia, Mexico, Malaysia, Turkey, the Philippines, Thailand, Vietnam, Colombia, and even Nigeria to name a few). Institutional efficacy also implies that the structure of the BRICS development bank should, ultimately, allow the bank to be the vehicle of development finance for this new tier of emerging markets, even though some of these economies represent lower levels of opportunity at present. Only such an approach would ensure that the BRICS development bank, as an institutional arrangement, reflects pareto-improving reforms[43].

These guidelines (as well as other institutional components such as the AMRO surveillance for the CMIM) should inform the BRICS bank initiative, in order that national and regional decisions are more coherent globally, and initiatives such as the BRICS development bank do not end up as a race to the bottom in the name of more role-play for the developing world.

This would also ensure that the BRICS bank is proactive (bottom-up) in setting the agenda for improved global economic governance[44]. The idea is not to relieve developed countries of their responsibilities, instead the BRICS development bank alternative should be promoted as an agency that provides a fillip to the shortfall (and delay) of assistance from developed countries[45]. The Bank, in fact, could emerge as the prime vehicle to deliver the ideational role for BRICS, securing greater leverage in the UN, WTO, G20, and the various multilateral finance initiatives. In the short term, then, member countries would do well to agree on key issues regarding the operating activities of the bank (practical setting up of the bank). The medium term goal, clearly, is financing of economic development, job creation and urbanization inside the BRICS, widening its geographical reach eventually[46].

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End notes:

1 BRICS is the acronym for the group of countries comprising Brazil, Russia, India, China and South Africa. Originally, the acronym was coined by Jim O'Neill at Goldman Sachs at the turn of the century, excluding South Africa which is the latest entrant to this informal club of large and fast growing emerging economies.

2 See Nicholas Stern, Amar Bhattacharya, Mattia Romani, Joseph E. Stiglitz (2013), "A New World's New Development Bank", 1 May 2013, at http://www.project-syndicate.org/commentary/the-benefits-of-the-brics- development-bank#E22l18ZmdjiMVYev.99 (Accessed May 12, 2013) for a detailed discussion.

3 Fifth BRICS Summit declaration titled, "BRICS and Africa: Partnership for Development, Integration and Industrialisation",at http://www.brics5.co.za/fifth-brics-summit- declaration-and-action-plan/ (Accessed April 27, 2013).

4 Ibid

5 Radhika Desai, "The Brics are building a challenge to western economic supremacy", April 2, 2013, at http://www.guardian.co.uk/commentisfree/2013/apr/02/brics-challenge-western-supremacy (Accessed May 2, 2013).

6 Chen Yuan has been secretary of CPC China Development Bank Committee and governor of CDB from March 1998 to the present; See Jens F. Laurson and George Pieler, "A 'BRICs' Bank? No Thanks, The IMF And World Bank Are Bad Enough", April 22, 2013 at http://www.forbes.com/sites/ laursonpieler/2013/04/22/a-brics- bank-no-thanks-the-imf-and-world-bank-are-bad-enough/ (Accessed April 26, 2013).

[7] John Kirton, “Burgeoning BRICS Consequences for Canada”, February 5, 2013, at http://www.brics.utoronto.ca/biblio/kirton-brics-canada-2013.pdf (Accessed May 10, 2013).

[8] “BRICS Finance Ministers Fail to Agree on Development Bank”, Updated March 27, 2013, at http://en.rian.ru/business/20130327/180270985.html (Accessed July 12, 2013). Prior to this, albeit in a different institutional setting of the G20, Indian Prime Minister Manmohan Singh had discussed the principle of development banks recycling global savings to emerging markets which could absorb capital flows for expansion of investment that could then further propel demand. See “Text of PM's speech at G20 summit”, November 12, 2010; URL: http://www.business-standard.com/article/economy-policy/text-of-pm-s-speech-at-g20-summit-110111200175_1.html (Accessed July 22, 2013).

[9] “India sees BRICS development bank agreed by 2014 summit”, Updated April 20, 2013 at http://in.reuters.com/article/2013/04/19/g20-brics-india-idINDEE93I0DK20130419 (Accessed May 26, 2013).

[10] Radhika Desai, op cit

[11] Lydia Polgreen, “Group of Emerging Nations Plans to Form Development Bank”, March 26, 2013, at http://www.nytimes.com/2013/03/27/world/africa/brics-to-form-development-bank.html?_r=0 (Accessed May 11, 2013).

[12] Ibid

[13] According to Helleiner a new global economic architecture would have to be the outcome of a legitimacy phase i.e. detailed deliberation that the old regime needs replacement, following which comes the interregnum phase (actual experiment and discussion), and finally is the constitutive phase or formal negotiation phase of the architecture. See Helleiner, E (2010), “A Bretton Woods moment? The 2007–2008 crisis and the future of global finance”, *International Affairs*, Vol 86 (3): 619–636.

[14] Francisco Little, “BRICS Means Business: New development bank on the horizon”, No. 14, APRIL 4, 2013, at http://www.bjreview.com.cn/Cover_Story_Series/2013-04/01/content _532403 .htm (Accessed April 21, 2013).

[15] See also Theresa Robles, “A BRICS Development Bank: An Idea Whose Time Has Come?”, No. 210/2012 dated November 14, 2012, at http://www.rsis.edu.sg/publications/ Perspective/RSIS2102012.pdf (Accessed April 19, 2013).

[16] See note 3; op cit

[17] Deepak Bhojwani, “BRICS: Changing the paradigm of international relations”, May 4, 2013, at http://newindianexpress.com/world/BRICS-Changing-the-paradigm-of-international-relations/2013/05/04/ article1574695.ece (Accessed May 30, 2013).

[18] “The Rise of BRICS and Africa”, Global Investment Trends Monitor, UNCTAD, March 25, 2013 at http://unctad.org/en/PublicationsLibrary/webdiaeia2013d6_en.pdf (Accessed April 29, 2013).

[19] Ibid

[20] Deepak Bhojwani, op cit

[21] SDRs are the IMF’s unit of account to lend funds to countries out of a total cumulative SDR allocation amounting to SDR 204 billion (equivalent to about US$310 billion). Members could access foreign currencies

based on their quota, which is arrived at using the weighted average of GDP (weight of 50 percent), openness (30 percent), economic variability (15 percent), and international reserves (5 percent). The valuation of SDRs is based on a basket of currencies comprising the Euro, Japanese yen, Pound Sterling, and the U.S. dollar. For a detailed account of role, allocations, and buying and selling of SDRs see http://www.imf.org/external/np/exr/facts/sdr.htm. For a discussion on SDRs and the reform debate, see Joe Thomas Karackattu (2011), "BRICS: opportunities and challenges", IDSA Issue Brief May 2011; http://www.idsa.in/system/files/IB_BRICS.pdf

22 Kelkar, Choudhry, Vanduzer-Snow, and Bhaskar (2005) in Pradumna B. Rana, "From a Centralized to a Decentralized Global Economic Architecture: An Overview", ADBI Working Paper Series, No. 401, Asian Development Bank Institute, Tokyo, January 2013, pp 5

23 Pradumna B Rana (2013), pp 8

24 Nicholas Stern, Amar Bhattacharya, Mattia Romani, Joseph E. Stiglitz, "A New World's New Development Bank", May 1, 2013 at http://www.project-syndicate.org/commentary/the-benefits-of-the-brics-development- bank (Accessed May 22, 2013).

25 "Development Committee Communiqué", Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries, Washington, DC April 20, 2013 at http://www.imf.org/external/np/cm/2013/042013b.htm (Accessed June 2, 2013).

26 Nicholas Stern, Amar Bhattacharya, Mattia Romani, Joseph E. Stiglitz, op cit

27 The aim of such outward investments has been market access and cross-border acquisitions.

28 "The Rise of BRICS and Africa", op cit

29 Ibid

30 Ibid

31 Francisco Little, op cit

32 Ibid

33 "BRICS development bank expected to contribute "constructively" to BRICS development", updated March 8, 2013 at http://news.xinhuanet.com/english/africa/2013-03/08/c_132219532.htm (Accessed July 23, 2013).

34 "The BRICS development bank: cautious optimism", February 26, 2013 at http://english.caijing.com.cn/2013-02-26/112532145.html (Accessed July 28, 2013).

35 A currency swap basically implies that in the event of credit shortage, during a crisis for instance, the trading partners would not disrupt trade to the tune of the bilateral arrangement arrived at. China has such swap arrangements with Australia, Argentina, South Korea, Brazil and South Africa, among others.

36 For an excellent discussion on the internationalization of the RMB see Chi Lo (2012), *Thinking the Inevitable: China's Economic Superpower Inspiration in the New Paradigm*, Enrich Professional Publishing, Singapore, February 2012, 256 pages.

37 Jens F. Laurson and George Pieler, op cit

38 See also Reza Siregar and Akkharaphol Chabchitrchaidol, "Enhancing the Effectiveness of CMIM and AMRO: Selected Immediate Challenges and Tasks", ADBI Working Paper Series, No. 403, January 2013, pp 5

[39] CMIM is a financial reserve pool arrangement comprising ASEAN, China, Japan, Hongkong and Korea. The arrangement was operationalized in 2010 and serves the twin purpose of addressing a balance of payments crisis or a short-term liquidity crisis, as a supplement to the existing international financial arrangements. The arrangement also has an ASEAN+3 Macroeconomic Research Office (AMRO), which acts as an independent surveillance unit in Singapore. In May 2012, the size of the reserve was doubled to $240 billion. See Biswajit Dhar, "BRICS bank, a misplaced idea?", Mar 25 2013, at http://www.livemint.com/ Opinion/RrGWP2IeD0AraB0oCTx8GM/BRICS-bank-a-misplaced-idea.html?facet=print (Accessed May 7, 2013).

[40] Pradumna B Rana, op cit, pp 11

[41] Ibid

[42] Reza Siregar and Akkharaphol Chabchitrchaidol, op cit, pp 11

[43] As a concept, a pareto-improving situation implies an allocation of resources such that no one is made worse off and at least one person is made better off.

[44] Lydia Polgreen, op cit

[45] Nicholas Stern, Amar Bhattacharya, Mattia Romani, Joseph E. Stiglitz, op cit

[46] See also, "The BRICS development bank: cautious optimism", op cit