Waking up to the BRICS

Author : Samir Saran

Originally Published 2014-08-06 00:00:00 Published on Aug 06, 2014

In spite of its modest economic weight in the initial years, the New Development Bank (NDB) can change the ethos of development finance irreversibly. Rather than replacing or supplanting existing development finance institutions, the NDB will seek to supplement existing resources.

In his 2001 paper titled "Building Better Global Economic BRICs", economist Jim O'Neill of Goldman Sachs calculated that "if the 2001/2002 outlook were to be extrapolated, over the next decade, China would be "as big as Germany" and Brazil and India "not far behind Italy" on a current GDP basis. Cut to 2013; Jim O' Neill's expectations seem modest. Last year, China was the world's second largest economy, Brazil ahead of Italy and India just one rank behind in terms of current GDP. In purchasing power parity (PPP) terms, all the BRIC countries were within the top 10, with China and India at second and third position respectively. BRIC, in Wall Street lingo, is an "outperformer."

Despite the crippling financial crisis, BRIC has done better on pure economic terms than most expectations. But the acronym is today representative of much more than an investment narrative alone. With the inclusion of South Africa, BRIC became BRICS, giving a pluralist and inclusive veneer to an economic idea. This group now has a significant political dimension, as is evidenced by the increasing number of converging positions on political issues.

In a follow-up paper in 2003, titled, "Dreaming with BRICs: The Path to 2050," Goldman Sachs claimed that by 2050, the list of the world's largest 10 economies would look very different. It is remarkable then, that in 2014 the list already looks radically different, and it is clear that it is time to "wake up" to the BRICS.

NDB versus existing banks

In this context there were at least two concrete arrangements inked at the sixth BRICS Summit in July, which will have a large economic and political impact. These were the Contingent Reserve Arrangement and the New Development Bank (NDB). Conversations and reportage on these two were shrill, coloured and obtuse in the run-up to the Summit. It continues to follow in the same vein. Indeed the NDB is at once the most celebrated and critiqued outcome of the Fortaleza Summit. Now that we are a few weeks away from its public conception, it is time for a reality check on this widely discussed BRICS achievement.

The first reality is the NDB can neither replace nor supplant the role of the existing development banks. The NDB will not be able to compete with the reach and expanse of existing institutions such as the World Bank, which has a subscribed capital of over $223 billion. The bank borrows $30 billion annually by issuing Triple-A rated debt in international bond markets. Such easy access to capital markets on the back of high promoter creditworthiness allows the bank to have a lower cost of funds. Other development finance institutions enjoy similar financial backing. The Asian Development Bank (ADB) too has a large balance sheet, backed by 67 member nations and a subscribed capital of $162 billion.

In contrast, the NDB will require over half a decade before it can accumulate the stated capital base of $50 billion from within BRICS and another $50 billion (approximately) from other countries and institutions. Indeed, in the immediate term, only a modest $150 million has been promised by each of the BRICS countries. A contribution of $1,850 million thereafter, staggered over five to six years, will require some doing as the BRICS countries are grappling with weak balance sheets, fragile current accounts and other domestic imperatives.

Then, there are other questions that will need to be answered in the days ahead. If China is unable to dominate this institution, will it prefer to prioritise investments through its (proposed) Asian Infrastructure Investment Bank? How soon can the central banks of the member countries devise arrangements to act as depository institutions for the NDB? And, how will the NDB raise funds in different countries? What will be the currency or currencies of choice? All important posers which can be addressed if the resolve is unerring.

Development finance

The second reality is, in spite of its modest economic weight in the initial years, the NDB can change the ethos of development finance irreversibly. Rather than replacing or supplanting existing development finance institutions, the NDB will seek to supplement existing resources. In fact, the World Bank President, Jim Yong Kim, has welcomed the idea of the NDB and acknowledged its potential in infrastructure development and the global fight against poverty.

An important difference could be in the way conditions and restrictions are imposed on loan recipients. Bretton Woods Institutions such as the World Bank have been known to impose conditions for lending that create structural mismatches between project funding, demand and supply. As recently as last year, the World Bank Group decided to restrict funding for new coal plants in developing countries, deciding instead to invest greater resources in "cleaner" fuels. Of course, the World Bank would be well advised to reconsider this decision given lifeline energy needs and the energy access realities in developing countries such as India.

The NDB's mission must be to create a business structure where borrowing countries are given greater agency in prioritising the kinds of projects they would want funded. Over a decade, this could become the demonstrator project through which the relationship between donors and recipients, lenders and borrowers, will be rewritten. Hopefully this will be in favour of developing economies and will enable the reimagining of economic pathways.

Location and ownership

The third reality - perhaps, the most debated - is that the location of the NDB is immaterial when governance and ownership is equally shared. Location has frequently been confused with ownership, skewed by our imagination of existing institutions such as the World Bank. According to its Articles of Agreement, major policy decisions at the World Bank are made through a Super Majority - 85 per cent of votes. Vote shares in turn are determined by the level of a nation's financial contribution. With around 16 per cent voting share at the World Bank, the U.S. has a de facto veto. Conversely, BRICS, with 40 per cent of the global population and a combined GDP of $24 trillion (PPP), collectively accounts for a mere 13 per cent of the votes at the World Bank.

As such, the concentration of voting power and headquarter location in Washington DC in the case of the World Bank is merely a coincidence. Japan dominates the functioning of the ADB with a 15.7 per cent shareholding, despite the headquarters being located in the Philippines.

It is also useful to note that previous World Bank presidents have been U.S. citizens and the International Monetary Fund's (IMF) list of managing directors is composed entirely of Europeans. Even the ADB's presidents have been Japanese citizens, with almost all of them having served in the Finance Ministry in Tokyo. In this regard, the NDB, with its intention of rotating leadership, seeks to overhaul the existing governance framework prevalent in the international development finance institutions. Through equal shares of paid-in capital in the NDB, there is a clear intention of creating an alternative model that focusses on voting-power parity. The smallest country can negotiate at par with the biggest country.

Will BRICS create a framework that is as democratic in sharing governance space with other investors and stakeholders? This will be something to watch for as the systems and structures evolve. The notion that the NDB has been "Shanghai-ed" is perhaps a shallow understanding of this exciting new initiative.

With an equal voting share, all five countries have to be on board to move in a particular direction. Admittedly, this can be hugely inefficient and troublesome. Therefore, it is incumbent upon BRICS members to ensure that this initial at-par equity in governance does not unexpectedly allow for a super majority like gridlock, restricting decision making because of a lack of consensus. The NDB must be dynamic and lithe, much like the BRICS grouping itself. It would be useful for BRICS members to institute a professional management body for steering everyday operations of the NDB as well as all non-policy related decisions, including those dealing with project funding.

And most importantly, as discussed earlier, BRICS members should democratise the bank's functioning if new stakeholders are included in the future. They must find ways to engage the recipients and beneficiaries in its decision-making apparatus. If anything, the NDB must be a template for change, not a mirror to the existing hegemony of money.

(Samir Saran is Vice-President at Observer Research Foundation, Delhi)

Courtesy: The Hindu, August 6, 2014

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