Will the new BRICS institutions make a difference?

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THE SIXTH SUMMIT of the BRICS, held on July 15, 2014 in Fortaleza, Ceará state, announced establishment of the BRICS Development Bank and an agreement to pool BRICS currency reserves. The initiative coincides with the 70th anniversary of the Bretton Woods conference that created the International Bank for Reconstruction and Development (World Bank) and the International Monetary Fund (IMF).

The new BRICS institutions do not compete with the Bretton Woods institutions but may—or may not—contribute to the architecture of a new international financial system. Though not new, this topic has gained prominence in the 2008 global crisis and the rise of emerging countries, especially China, on the list of the world's leading economies.

BRICS Bank

Bhattacharya and Romani (2013) estimate that each year from US$800 billion to US$990 billion is spent on infrastructure projects in developing countries (including "emerging" countries). Projects are financed by national governments (57%), the private sector (25%), national development banks (10%), multilateral development banks and official aid programs (6%), and other resources (2%). The authors estimate, however, that between US$1.8 trillion and US$2.3 trillion will be needed annually over the next 10 years to ensure construction of the necessary infrastructure in these countries. Is this a reason to create a new development bank?

The authors believe it is. Current financing is limited by operational and political restrictions. National governments restricted public spending as their deficits rose in response to the 2008 crisis. Infrastructure projects involve long-term investments that crowd out private investment, especially in less-developed countries. Multilateral banks provide only a small share of resources, they require guarantees that limit the investment portfolios of countries, and their instruments are not adequate to encourage private sector participation. In the investment portfolios of the multilateral banks, political considerations often override technical considerations.

The limitations highlighted by the authors cover not only the World Bank but the main regional banks: the Inter-American Development Bank (IDB), established in 1959), African Development Bank (AfDB, 1964), Asian Development Bank (ADB, 1966), and the European Bank for Reconstruction and Development (ERDB, 1991). All multilateral banks accept shareholders outside the region, and in all of them the United States is one of the top five shareholders (Ottenhoff, 2011). The BRICS Bank would be the first nonregional multilateral institution that does not have a U.S. presence. This is the political significance of the bank. But if the political meaning is clear, what is unclear is whether the bank will create a new efficient governance structure to assist in construction of infrastructure projects in developing countries.

The initial capital of the BRICS Bank is US$50 billion, and it may reach US$100 billion. The funds will be directed to sustainable infrastructure projects. The bank will deal with undeveloped countries generally, but the initial emphasis seems to be on the African continent. The headquarters will be in Shanghai, China, with a regional office opening simultaneously in Johannesburg, South Africa. The choice is not fortuitous: The Chinese have a special interest in improving infrastructure in African countries to meet their demand for agricultural commodities, minerals, and fuels.

The premise is that the BRICS Bank would have more flexible criteria for granting loans. However, two points need to be reconciled. First, it should accept a higher risk than the World Bank, for example by giving greater weight to the benefits infrastructure projects bring to developing countries. In that case, the bank should work with the local government on construction of the project and provide technical assistance so that project benefits are guaranteed. The bank would be less risk-averse and give priority to improving the infrastructure of undeveloped countries.

Second, to be financially sustainable over time the bank needs to capitalize. This requires that it obtain a positive investment grade credit rating, as regional multilateral banks have. With this the bank can be less risk-averse, but loans must be guided by technical proposals that justify a project with a cost-benefit analysis that recognizes externalities. Moreover, the bank should accept new shareholders. There is no reason to exclude developed countries as long as the BRICS are majority shareholders.

Reconciliation of these two points will mean new governance for the new multilateral bank. At the moment, it is still unclear how the bank will operate. One advantage for the bank is that China has proven to be good at executing infrastructure projects. This is an issue on the minds of policymakers. Brazil is an example of a country that is struggling to execute its infrastructure projects. Thus, if the BRICS Bank succeeds, it can provide good lessons for Brazil. The bank's presidency will rotate every five years and China only takes over this position after 20 years. This demonstrates the traditional cautious posture of the Chinese.

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Currency Reserve Pool

After the Asian crisis of the 1990s, the Chang Mai Initiative was created to address problems of foreign exchange liquidity in the region. Currently, Association of Southeast Asian Nations members plus China, Japan, and South Korea participate in the initiative, which has a reserve pool of US$240 billion. A country can withdraw up to 30% of its quota from the pool. To withdraw more, countries must have an IMF-supported program to guarantee the additional Initiative lending. The Initiative has been criticized for tying loans to IMF programs and for its likely ineffectiveness, because its resources are not sufficient to overcome regional currency crises and so are only useful to relieve short-term liquidity difficulties.

The BRICS Currency Reserve Pool Agreement starts with US$100 billion, with China contributing US$40 billion, Brazil, India, and Russia US$18 billion each, and South Africa US$6 billion. This is not an agreement to replace the IMF. Here the proposal has a clear political meaning: Although IMF country members have approved new quotas, these have not yet been put into practice. The new quotas are considered a step toward the BRICS goal of IMF sharing voting power equally between developed and developing countries.

In short, the two initiatives—the BRICS Development Bank and the Currency Reserve Pool—are associated with the debate on world financial governance as demand heightens for greater voting power in the Bretton Woods institutions for emerging countries.

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World Trade Organization

The World Bank and the IMF are institutions governed by power—a country member's vote is weighted by its quota, which is set according to economic and political criteria.

At the World Trade Organization (WTO), decisions are consensual. Until the late 1990s, the consensus was built by the Quad (Canada, the EU, Japan, and the US). Since 2003, when Brazil, India, and China led the veto of the EU and US proposal for agriculture negotiations in the Doha Round, the consensus has no longer been confined to the Quad. However, a BRICS consensus has not yet emerged. Unlike its consensus on IMF and World Bank reforms, BRICS member interests in WTO reforms have not converged.

The latest BRICS impasse occurred in late July. The Bali Agreement on Trade Facilitation of December 2013 was celebrated as a sign that the WTO had not become irrelevant. For it to enter into force in July 2015, all WTO members were to sign the agreement by July 2014. India, however, has conditioned its signature on a change in the rules that limit the value of the agricultural subsidy, currently 10% of production, because it makes the 2013 food security program unviable. A "peace clause" was voted that would extend the deadline for signing the Bali agreement to December 2017, but the Indian government argument that the rules were not clear was supported by Cuba, Venezuela, and Bolivia.

In this case, the BRICS interest in strengthening the WTO, as voiced in all declarations of its Summits, suffered a serious setback. Differences between the BRICS countries when negotiating trade agreements reflect the interests of their diverse productive sectors that shape political actions. This type of thing also occurs between the US and EU countries. However, in the postwar period both had an interest in maintaining the multilateral system because of the Cold War.

In addition of sharing more power in international financial institutions and advocacy for more flexible rules to accommodate greater autonomy in a country's domestic policies, consolidation of the BRICS will require proposals that arise from common interests. This consolidation will be tested by the BRICS Bank as political and economic asymmetries between its members create difficulties for conduct of a joint project to build a post-Bretton Woods world order.

References

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