BRICS and the pursuit of growth

An FGV seminar assesses cooperation between BRICS countries as they all pursue sustainable growth.



Solange Monteiro

SINCE ITS FORMAL ESTABLISHMENT IN 2009, the BRICS group has provoked controversy about how valid it is as a bloc. Size—28% of world GDP and 42% of world population—does not seem sufficient to unite countries with such different realities and challenges, especially economic. In early June, the FGV Growth and Development Center convened a group of international experts to discuss the growth issues of the BRICS and the possibilities for their cooperation.

"The BRICS are identified more as a political bloc than an economic one, but what interests us are the factors that generate wealth in some countries to the detriment of others," said Pedro Cavalcanti, of FGV Growth and Development. One study by the center's Roberto Castello Branco, João Victor Issler, and Bruno Delalibera found a connection that integrates the BRICS economies despite their apparent differences. The study found that to a greater or lesser extent, BRICS countries have common growth cycles, which suggest that the dynamics of each member can affect other members of the bloc more than growth in developed economies. Since the members consist of three major suppliers of commodities (Brazil, Russia, and South Africa) and two major consumers of commodities (India and China), that result seems logical. Quarterly GDP (excluding India) shows that the strongest interactions are between Brazil and China, China and South Africa, and Brazil and Russia.

"Besides trade, the BRICS do share factors and challenges common to emerging economies, but they also have very big differences," Castello Branco noted. Among the differences is degree of urbanization: in Brazil 85% of the population lives in cities, in China 54%, and in India 32%. Raising productivity is a challenge for economies that have a large service sector, such as Brazil and South Africa, while adding value to its manufactures is a particular challenge for China. Demographic differences are also great. The large share of the young in the populations of India and South Africa (the demographic bonus) will generate growth by 2040, while China and Brazil are already worried at seeing their own demographic bonuses tapering off. Castello Branco points out that a number of policies would serve more than one country in the bloc, such as improving worker skills, investing in infrastructure, reforming the financial system, and fighting corruption. In his opinion, "The performance of the BRICS will depend largely on how they face these challenges."

Differences and affinities

In the short term, the BRICS countries that have the best growth prospects are those that are further ahead in reforming their economies: even slowing down, China is expected to grow 7% in 2015, and India should lead the global expansion with 7.5% in 2015, according to the International Monetary Fund. In contrast, Brazil and Russia are expected to contract

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by 1.8% (IBRE staff estimation) and 3.5%. In the case of India, Eswar Prasad, professor at Cornell University and a research associate at FGV Growth and Development Center, pointed out that controlling inflation was the mantra for the economic reforms that began in 2008, well before Prime Minister Narendra Modi was elected, and consolidated the way for new reforms. "This resulted in building trust, which helped the policy agenda of the new government," he said. The fall in oil prices, which India must import, helped to push inflation down and reduce the pressure on the budget, which has brightened the fiscal outlook.

Although the reforms so far have put India in the spotlight, they are not sufficient to ensure optimism about the long run, Prasad said. For India, he believes that the dynamics of the service sector that has boosted exports has inhibited development of the domestic market, a weak aspect of India's economy.

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"You cannot create job opportunities with good salaries to support the increase of domestic demand without developing the manufacturing sector," Prasad said. To promote industry, he believes conditions in India are still unattractive. "Infrastructure is a problem: transport infrastructure is not in good shape, and the financial system does not work well. India still has a long list of reforms that will take time," he says. Like Brazil, India needs to improve its business environment, fight costly bureaucracy and inflexible labor laws, and broaden financial system reform. "We have a high level of savings, 35% of GDP. But it is concentrated in families, and today the financial system does not have the capacity to intermediate household savings and foreign capital to fund long-term fixed investment," he said, pointing out that this blocks investment in infrastructure. "We need to take advantage of the favorable domestic and external situation to further reform. We have the cards to have growth. What's on the table now is whether we will be able to play well or create more problems for ourselves," he says.

Infrastructure is also a constraint to attracting productive investments in South Africa, says Jean-François Brun, lecturer at the Université d'Auvergne and also a research associate at FGV Growth and Development Center. "South Africa has low-quality infrastructure in telecoms and transportation, and a major energy deficit," Brun said—a situation that is common in Sub-Saharan Africa as a whole and may jeopardize sustainable growth. "The continent is rapidly changing thanks to the exploitation of natural resources," he said. "As a result, Kenya, Ghana, and Senegal can turn very quickly into emerging economies, growing 6%, 7%, and more. This has helped South Africa," he said. "On the other hand, the high share of natural resources, which accounts for 30% to 50% of the expansion of African countries, is also a vulnerability factor for the region." The growth of South Africa's GDP predicted for 2015 is a moderate 2%. South Africa does have a more diversified economy, a consolidated banking system, and a sound fiscal policy. Although a value-added tax (VAT) was introduced in the late 1980s, Brun pointed out that the country's low institutional capacity prevents the improvement in fiscal stance that VAT would allow. "The bureaucracy does not perform well. The VAT has become inefficient because numerous exemptions have generated distortions and prevent public spending from growing."

With regard to China, seminar participants highlighted the potential of the reforms President Xi Jiping is carrying out. Domestically, Castello Branco emphasized tax reform in China's provinces, the reduction of shadow banking, and the opening of services to the private sector as important measures to boost and diversify the economy and stimulate domestic consumption. Jonathan Fenby, a partner at Trusted Sources consultancy, pointed out the importance of the anticorruption campaign to improve the efficiency of the Communist Party itself.

With an excess of productive capacity, savings amounting to 48% of GDP, and US$4 trillion in international reserves, China has opened important fronts abroad. It is participating in the construction of routes for importing supplies and exporting its production through railways, pipelines, and the new Silk Road, which will cross Central Asia. With the gradual opening of the capital account, China aims to internationalize its currency, the renminbi. And with the creation of the Bank of the Brics and the Asian Development Bank, it is creating alternatives for international financing of projects of strategic interest in its own vicinity and in Latin America. "Tokyo, Washington, and Manila are concerned about a possible regional risk," Fenby said, warning that "it will be necessary to observe developments in East Asia and consider possible tensions with Taiwan in 2016."

Yao Yang of the Peking University Center for Economic Research and associate professor of FGV Growth and Development Center was straightforward about China's ambitions. He said that the measures China has adopted to maintain 7% growth over the next 10 years will demonstrate the same resilience that Japan and South Korea had in the oil crisis of the 1970s and the Asian crisis in the 1990s. "China will be the largest economy in the world in 2020–25, and China, Japan, and Korea will account for 50% of world demand in 2040–50, creating a big market for the world," he predicted.

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Brazil and the new China

For now, China's gradual slowing down and rebalancing of its economy toward more domestic consumption highlights the need for Brazil to become more competitive to match China's trade dynamism. Generally speaking, China's changes should encourage Brazil to rely less on exporting commodities. While in 2002 soybeans, iron ore, and oil accounted

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for 57% of Brazil's exports to China, by 2014 the three products accounted for 80%. "The increase in the share of personal consumption in China's GDP poses a challenge for Brazil to diversify its exports and seek to participate in supply chains and the export of services," said IBRE's Lia Valls Pereira.

Murilo Ferreira, CEO of steel company Vale, noted that part of the Chinese government's efforts to prevent further slowdown of the economy is to continue to stimulate infrastructure and real estate investment by encouraging formation of public-private partnerships (PPPs) and reducing the cost of mortgages. Even with these initiatives, however, decline in demand for mineral commodities is inevitable. Vale projected annual growth of iron ore exports to China of just 1.2% in 2015–20, compared with 20.4% in the last 15 years. This fall in Chinese demand for commodities is a concern for the rest of the world as well as Brazil. "In 2014, China accounted for 58% of world demand for iron ore," Ferreira said. Last year, China accounted for 18% of Brazil's total exports, of which iron ore accounted for 5.5%.

Mauricio Mesquita Moreira, chief economist at the Inter-American Development Bank, also advocated that Brazil diversify exports and add value to its exports to China. "The worst of all worlds is one in which the government does not eliminate trade barriers for fear of deindustrialization and the private sector does not fight for access to markets, remaining focused on the domestic sector," he said. Moreira noted that the speed at which Chinese exports have diversified has affected Latin America as a whole: "From 2002 to 2014, Venezuela, Chile, Brazil, and Peru recorded a trade surplus with China thanks to high commodity prices, but on average Latin America had a negative trade balance." He also pointed out the need to attract Chinese direct investment, which is expected to increase in some South American countries. In May, during the visit of Chinese Prime Minister Li Keqiang to Brazil, the two countries signed 35 agreements involving US$53 billion as part of the US$250 billion that China plans to invest in Latin America in the next 10 years. "So far, Chinese investment often has reinforced the pattern of bilateral trade we already have, without stimulating product diversification in

Brazil," Moreira said, noting that from 2000 to 2014, Chinese direct investment in the region focused on energy (57%) and metals (34%), and the main recipients of Chinese investment were Brazil (38.4%) and Peru (31.9%). Chinese lending followed the same pattern. According to the Inter-American Dialogue, of the US$199 billion China has announced to finance Latin American governments and companies from 2005 to 2014, US$50 billion went to infrastructure projects and US$33 billion to energy. "We have to improve our macro and fiscal position and be pragmatic in our trade policy. We need to foster South-South cooperation, avoiding the creation of financial dependency on China. The focus should be trade, not aid, in the pursuit of sustainable growth," Moreira emphasized.

The challenges of China's transition were also the subject of discussions at an IBRE workshop last June for a Chinese delegation led by Yang Zhenwu, president of the *People's Daily* newspaper. At the time, Zhenwu underlined the opportunities of the new Chinese growth path: "Accelerating urbanization will mean a demand for commodities with higher added value, which Brazil can exploit. … We also see the change in China's policy to attract foreign capital to be beneficial as it would give Brazil the opportunity to make new investments in China." At the time, IBRE's Pereira stressed

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that there is always a dichotomy between opportunities and challenges in the relationship between the two countries. "On the one hand," she said, "Chinese demand contributed to the growth of the Brazilian economy and mitigated the effects of the international financial crisis; on the other hand, competition from Chinese products has caused Brazilian products to lose market share in the U.S. and South America as well as in Brazil's domestic market." Pereira pointed out, however, that Brazil's lack of competitiveness cannot be attributed to China: "We have structural issues, such as low investment and a poor business environment, as well as a fiscal deficit and inflation that we have to resolve." To make Brazil grow, there is no alternative to putting its house in order and focusing on opportunities.