

## WHAT NEXT FOR THE BRICS BANK?

A new development bank to be created by the 'Rising Powers' of Brazil, Russia, India, China and South Africa (BRICS) is intended to promote greater cooperation between developing countries, and address what is seen by many as a history of misguidance and underinvestment by the World Bank and the International Monetary Fund (IMF). However, several questions remain about the establishment of the BRICS bank and its potential impact on future development cooperation. The timeframe for its creation is still uncertain and economic and political links between the BRICS countries need to be strengthened in order for them to agree a clear development agenda to underpin the new institution.

### Challenges ahead

The commitment to launch a BRICS Development Bank (BRICS Bank) has been greeted as a potential game-changer for global development practice. However, the BRICS Bank was not launched as expected at the 2013 BRICS Summit in Durban, South Africa. The assembled heads of state did agree to establish the BRICS Contingent Reserve Arrangement (CRA) - a stabilisation fund of \$100 billion in reserves, and a BRICS Business Council to stimulate trade and investment. However, the launch of the BRICS Bank itself was postponed until the next summit in Brazil during 2014.

Numerous areas of uncertainty remain regarding the creation of the BRICS Bank. These include location, capital structure, governance structure, leadership and the criteria that will determine what projects it funds. Other expected difficulties are obtaining a top credit rating for the BRICS Bank and reconciling the BRICS countries' diverse economic and political interests. The motivation for establishing a BRICS bank is to be a counterpart to the World Bank and IMF, and promote a vision of development driven by developing countries. The BRICS have combined foreign currency reserves of \$4.4 trillion and account for 43 per cent of the world's population.

One prominent proposal has suggested that the bank be capitalised with \$41 billion from China, \$18 billion from Brazil, Russia and India and \$5 billion from South Africa. If voting rights within the bank are linked to capital contribution, India, Brazil and South Africa are unlikely to match China's contribution or have equal voting rights.

Despite articulating common development goals, the economic and political relations between the BRICS are still uneven. For example, whilst China is the largest trading partner of most of the BRICS, the others trade relatively little with each other. Political conflict exists between India and China with regard to their respective roles in Asia, and Brazil, Russia and South Africa focus largely on their regional political standing over and above their relations with other BRICS.

The limited scope of business and diplomatic relations between the BRICS beyond China hinders their ability to create a common development agenda to underpin a new BRICS Bank.



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## Historical perspective

The provision of financing for development, as we think of it today, is a recent phenomenon. It was born in the International Bank for Reconstruction and Development (which became the World Bank), set up in the aftermath of World War II to help rebuild Europe within a new, US-based international economic system. With an overwhelming focus on Europe it did not provide a loan to an African government until 1950. By 1957 there were still only two African World Bank members. This changed during the 1960s with decolonisation and especially after 1968 when Robert McNamara became president of the World Bank. The later focus of development finance on low-income countries (LICs) was mainly a product of the 1970s oil shocks and concurrent collapse in commodity prices.

As the World Bank's lending to Africa expanded over the 1980s, conditionalities grew to the extent that by 1990 over a third of the Bank's lending to sub-Saharan Africa was structural adjustment lending of one form or another. Such conditionality provision proved unpopular and the focus of much heated debate. The IMF, which started specifically as an institution to provide short-term loans to member states suffering balance-of-payments crises, saw its remit expanded in a similar way. Its role in developing countries was not especially prominent until after 1977, in line with the general crisis period which brought the World Bank into closer involvement with African, Asian and Latin American states.

Having criticised the approach of the World Bank and IMF, East Asian countries (after suffering a financial crisis in 1997-8) began accumulating very large foreign exchange reserves as a defence mechanism against balance-of-payments crises which could bring conditionality provisions into effect.

## Changing the future of development cooperation

While the scope of the BRICS coalition has widened quickly, its focus was initially on the reform of multilateral institutions, particularly the IMF and World Bank. A BRICS Bank has been seen as a direct challenge to developed nations' dominance of traditional fora. These institutions have been criticised by the BRICS countries, and other developing countries, in three general areas: governance, approach and outcome. The governance structures of the IMF and World Bank are said to be dominated by industrialised countries, particularly the G7

## The Chiang Mai Initiative

While the remit of the BRICS Bank overlaps with that of the World Bank, the BRICS Contingent Reserve Arrangement (CRA) could present a direct challenge to the IMF. One close precursor to the CRA is the Chiang Mai Initiative signed in May 2000 between the Association of Southeastern Asian Nations (ASEAN) countries plus China, Japan and Korea. The initiative was multilateralised in 2010 and renamed the Chiang Mai Initiative Multilateralization (CMIM). The aim of CMIM is to strengthen the capacity of the region to safeguard against increased risks and challenges in the global economy. The core objectives are to address balance-of-payments and short-term liquidity difficulties in the region, as well as to supplement existing international financial arrangements. What can CMIM tell us about the potential role of the new stabilisation fund, the CRA?

- CMIM is limited to a regional grouping. The CRA would be the first attempt to broaden such agreements to a global level. Of course, CMIM is limited to a currency swap and has no link to any development bank function.
- CMIM remains IMF linked. Only 30 per cent of a member's quota is accessible without an IMF programme (the goal is 40 per cent by 2014.) For the remaining 70 per cent the member state must agree to an IMF programme, including policy prescriptions.
- Serious doubts have been raised about the ability of CMIM to provide a financial safety net. Researchers have pointed out that it does not amount to an actual fund, but rather to a broad agreement to provide funds in case they are needed. Institutional surveillance mechanisms have not yet been established, and neither have rapid response procedures.
- The CMIM was tested in late 2008, before it was multilateralised, as a result of the financial crisis. Analysts argue that its small size and lack of rapid response procedures rendered it unusable. Instead, countries resorted to bilateral currency swaps with Northern countries,
- One likely key difference from the CMIM is that the CRA will not include a link to the IMF which brings about policy conditionalities in the event of crisis. Nevertheless, questions remain as to whether a set of institutional mechanisms can be developed to provide disbursements according to agreed criteria in a way that does not replicate the much-criticised IMF procedures.
- It is clear that the world is changing, and that a key concern of the rising powers is stabilisation in the event of crisis, a role they feel the IMF is not adequately performing. Neither CMIM nor the CRA is likely to represent the last attempt to create such an agreement. The role of the IMF remains open to debate and contestation.

Quota restrictions and presidential selection ensures the continuance of this authority. Africa holds only three seats on the World Bank's 25-seat board. Several approaches employed by these institutions have been attacked, from IMF loan conditionalities to the choice of projects financed by the World Bank. There are also continued critiques of IMF and World Bank dominance of the development discourse, a lack of participation by LICs, and negative social outcomes.

Ideally, the BRICS Bank would reduce the up-front risk of investment and attract further early-stage finance, transfer project knowledge and reduce project risk by holding recipient governments to account. At this stage, it is impossible to say whether the BRICS Bank does indeed represent a challenge to established institutions such as the World Bank and the IMF. Yet as an alternative mechanism for providing development financing it does represent a necessary (though not sufficient) condition for such a challenge. The remits of a BRICS Bank and the CRA would clearly overlap with those of the World Bank and IMF. Countries have adopted similar schemes in the recent past to allow for mutual assistance in balance-of-payments stabilisation. Initiatives such as the CMIM have previously worked either bilaterally or on fairly narrow regional bases.

If the BRICS Bank, as has been suggested, takes the CMIM as the basis for a wider agreement, it will be the first time such a regional agreement has been posited as the foundation for an institution with global reach. The 'Rising Powers' countries have often stated that they are not expecting the BRICS Bank to bring about a revolution in the international economic system. Brazil's Finance Minister Guido Mantega has pointed to the need for Brazil to maintain trade flows during possible global financial market turbulence as a key reason for the BRICS Bank. Private sector observers have made similar statements, suggesting the BRICS Bank should be an auxiliary source of funding that is more aligned to the BRICS development agenda, rather than a counterweight to the World Bank.

The BRICS leaders' statement from the 2013 Summit cites 'insufficient long term financing and foreign direct investment' as the reasons behind the creation of the BRICS Bank, thereby avoiding direct criticism of the IMF or World Bank. The institutional structure of the BRICS Bank, and especially its disbursement mechanisms, will indicate whether there has been a clear break from previous models, and a new emphasis placed on South-South Cooperation (cooperation between developing countries). These are due to be agreed by the 2014 BRICS Summit in Brazil.

### **Impact on developmental outcomes**

Press reports have suggested that the focus of the BRICS Bank's investments will be in infrastructure, energy and telecommunications. This would be a return to the infrastructure-focused aid that traditional donors left behind when they shifted towards social sector spending. There has also been a shift in Chinese and Indian funding to agricultural development, debt relief, and preferential market access. BRICS countries' development support has also emphasised technical assistance particularly in agriculture and health.

### **Lessons from Regional Development Banks**

The proposed BRICS bank will have direct and indirect development impacts, which will need to be assessed. Indirectly, its activities will create demonstration effects that other institutions may seek to replicate. This is likely to depend on (a) how successful the bank is seen to be, and (b) how different it is from other institutions in its activities. These factors will also affect its direct impacts.

Perhaps the most important determinant of these factors will be the bank's mandate regarding the sectors and locations where it will focus, and the forms of financing it will employ. The creation of the mandate and how it is interpreted in practice will be influenced by the sources of funds that capitalise the new bank, and how it is governed in terms of the allocation of voting rights.

The experience of other relevant institutions may be instructive. The Brazilian Development Bank (BNDES) is capitalised by the Workers Support Fund, which it manages. This is aligned with its mandate to invest in machinery, industrial equipment and economic infrastructure.

The Regional Development Banks (RDBs) have broader mandates, as well as different governance structures. Perhaps the key difference between them is the relative importance of lenders and borrowers. While the African Development Bank (AfDB) governance structure locks-in a majority for African countries (i.e. borrowers), the other RDBs allow a much larger role for non-borrowing members. For the Inter-American Development Bank (IADB) this is the US; for the Asian Development Bank (ADB) it is Japan. These differences have a significant impact on each of the RDB's activities.

Other common patterns in the BRICS' approach to development include:

- Basing aid on principles of South-South Cooperation that emphasise development 'partnership' and mutual learning rather than 'donorship'.
- Focusing on mutual benefits without the attachments of policy conditionality in governance, economic policy or institutional reform. China, in particular, emphasises 'national sovereignty' and development partners' responsibility for their own long-term development.
- Focusing on trade and commercial exchange as a basis for development, and designing assistance to complement foreign direct investment. This focus still permits tied aid, although aid is not tied to policy conditionality. Examples of tying aid in this way include linking it to purchases from the source/donor country or channelling credit lines directly to companies rather than partner/recipient country governments.
- Focusing on individual project viability versus long-run debt sustainability. China finances some projects with loans and others with grants. It is believed that strictly adhering to a recipient's ability to repay leads to the infrastructure underinvestment seen in LICs.
- Applying the recent lessons of BRICS countries – especially Brazil, India and China – to LICs in areas from health to agriculture.

## Recommendations

If the BRICS countries are to make progress achieving the goals they have set themselves with the BRICS Bank, a number of enabling conditions need to be in place, including:

- A continued focus on domestic growth and stability in the BRICS. Creating skilled jobs, promoting infrastructure investment, rationalising regulation and attracting foreign direct investment remain essential to the continued improvement of the wellbeing of citizens still emerging from poverty and to the political legitimacy of international development engagements by these countries.
- Deeper engagement of the BRICS in multilateral forums and regional trade forums such as the World Trade Organization (WTO), and advocacy for qualified leadership candidates from the BRICS.
- Pressure to align the policies of the new bank with sustainable development and other global public goods debates. The BRICS Business Council has the potential to be a useful ally in some of these debates, particularly in the areas of energy security and water conservation.
- Promotion of transparent and democratic bank governance. This includes providing better quality trade and investment data with respect to the size and terms of financing flows, as well as the structure and conditions of deals, and concessions for natural resources. Demands for human rights, social impact and environmental sustainability criteria to be considered in investment decisions, and for engagement with the new bank by local populations and civil society, also need to be addressed.

## Further reading

**Griffith-Jones, S. (2012)** 'South-South Financial Cooperation', Initiative for Policy Dialogue, Columbia University, Background Paper No. 7

**Mwase, N. and Yang, Y. (2012)** 'BRICs' Philosophies for Development Financing and Their Implications for LICs', IMF Working Paper, Strategy, Policy and Review Department

*Rising Powers in International Development: An Annotated Bibliography:* <http://www.ids.ac.uk/files/dmfile/RPIDLiteratureReview.pdf>

**Stern, N. and Romani, M. (2012)** 'Investment, Recovery and Growth', in **Brookings Institute, Think Tank 20: New Challenges for the Global Economy, New Uncertainties for the G-20**, Washington DC: Brookings Institute

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