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BRICS: A NEW PARADIGM?

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The BRICS governments finalized the establishment of the New Development Bank, a new multilateral financial institution popularly dubbed the 'BRICS bank', and agreed on the Contingency Reserve Arrangement, a collection of commitments to bail each other out during a financial emergency, at the Fortaleza summit in Brazil this year. These were broadly seen as the institutional reflection of an economic shift taking place in the world economy between the West and the emerging economies.

Opinion in India was divided. Some commentators saw it as the beginning of a post-Bretton Woods financial system that would rival the World Bank and International Monetary Fund. Others saw it as one more piece in a new China-dominated global financial structure. A few saw it as simply irrelevant in a world where private capital flows dwarf those of multilateral financial institutions.

This is an assessment of the arguments made in favour of the BRICS institutions:

1. A BRICS financial system will pressure the West to give the emerging economies more say in existing multilateral bodies

This is probably the strongest glue binding the BRICS countries together. The BRICS, to quote investment banker Mohamed El-Erian, *"are founded on shared frustration with the outmoded entitlements to which the US and Europe are clinging."* Though the United States and the main European states agreed to surrender a portion of their voting rights in the World Bank and the IMF, four years later they have yet to come good on this promise. The shifting of six per cent of the IMF's vote has fallen victim to the partisan gridlock that has paralyzed the US Congress.

But if this is taken as the primary reason for creating BRICS institutions, the bank as well as the fund are reduced to diplomatic negotiating tools rather than part of a strategy to change the global financial architecture.

If so, they are too small and incoherent to influence Western attitudes if the latter are genuinely opposed to letting the emerging economies have a greater say. To become larger, however, BRICS institutions will need massive infusions of capital that will majorly come from China.

2. The world needs a non-Western global financial architecture

The world would probably benefit if it had many multilateral financial institutions, each competing and being run by different but not necessarily exclusive sets of nations. In practice, such institutions normally require one or two large economies to underpin them. The US, aided by the European Union and Japan, provides the capital and political leadership for the existing Bretton Woods system.

The question is who would provide such guidance to the BRICS institutions. The answer is clear: China, with an economy the same size as all the other BRICS countries together, would end up behind the steering wheel.

Unlike the bank, the CRA's voting share is pegged to the amount of financial contribution. Beijing will control 41% of the CRA's vote share at its inception. With foreign exchange reserves twice that of the other BRICS countries combined, China's share will only rise.

It is the CRA, designed to bail out bankrupt governments, which could develop genuine strategic clout. Loaning to countries in dire financial need is the way to make friends and influence governments. Beijing has already made it clear the BRICS bank and the fund will function independently of each other.

The BRICS bank has received the most attention, but the bank's influence will always be limited. It is dwarfed by the plethora of development banks that dot the planet. Even the national ones of the BRICS members are much larger – last year Brazil's BNES was worth $ 88 billion and China's main development bank $ 240 billion. The bank is even more reduced by the demand for infrastructure financing: South Asia's infrastructure needs alone are $ 2.5 trillion over the next decade.

A parallel financial architecture centred on Beijing is emerging. Beijing plans to set up an Asian Infrastructure Investment Bank with a capital base of $ 100 billion. It has already set up the $ 240 billion 'Chiang Mai Initiative Multilateralisation', which is similar to the CRA though with clearer rules and structures.

For a Beijing wishing to avoid claims of hegemonic aspiration, the BRICS provides legitimacy without undermining its nascent financial architecture. As the G-20 summit in Los Cabos, Mexico, Beijing found offering money to the IMF's firewall against a Eurozone crisis received none of the criticism it had faced when trying to do the same unilaterally – criticism that was both international and domestic.

3. BRICS loans will have less conditionalities than those of the IMF and World Bank.

This is a common refrain derived from much developing country resentment at the conditionalities imposed by the IMF for its loans. The World Bank is more likely to demand environmental impact studies and NGO involvement in the projects it finances.

The argument is that a BRICS bank or the CRA would provide either less intrusive or complicated conditions or offer an alternative, less market-based set of requirements for their funds.

While this sounds good on paper, the fact remains IMF conditionalities have a logic to them. The country that is asking for an emergency loan has probably poorly managed its finances. Often, recipient governments know what is required and use the IMF as political cover for tough decisions they wanted to carry out themselves. India, for example, carried out economic reforms far beyond what was required by the IMF during its 1991 economic crisis for its own reasons – but used the IMF as a cover.

It is questionable if the BRICS conditionalities will differ too greatly from the IMF's. The CRA accepts this reality by saying any loan that exceeds 30% of a member's capital contribution will be contingent on the recipient country having an IMF agreement as well.

India has no complaint about World Bank/IMF conditionalities. It is the single largest recipient of loans from the World Bank and has never made a murmur against their conditions. It has a more chequered relationship with the IMF, but India has not gone back to the fund since 1991 – most of whose clients today are Europeans.

4. Today's multilateral financial bodies do not provide the kind of funding emerging economies need

The World Bank has walked away from financing many types of infrastructure projects, largely because of lobbying by environmental lobbies. Thus, in the power generation sector where the World Bank has ceased to fund coal-fired power projects in India, even though coal remains India's primary fuel source. It is largely absent in the area of nuclear power.

Other lending criteria may trip up India's ability to access World Bank funding. It was able to avoid being declared ineligible for such loans based on per capita GDP last year, though this was partly done by India buying World Bank bonds.

A BRICS bank is unlikely to be hindered by such issues – and it will help that infrastructure is a concern for at least three of the member countries and BRICS leaders have declared infrastructure to be the priority of the bank.

However, the paid-up capital of the bank is simply too small to make a major impact on the sort of infrastructure demands that India needs. In theory it can be scaled up, but the need to maintain equality among all the members means South Africa, the smallest of the five, will severely limit the bank's growth.

INDIA'S POLICY OPTIONS

A multipolar financial architecture is broadly in India's interest. And given its infrastructure needs are so great, the more lending for infrastructure that is available the merrier. Similarly, India could do with more bailout sources in case it experiences another 1991 or worse.

New Delhi must be clear-eyed that much of what is being built around the BRICS is driven by China and that Beijing's interest is to create a global architecture, financial and otherwise, that excludes the US. The US has begun moving more tentatively to a similar policy regards China, at least in trade.

It would be preferable for India to be at the high table of both these structures. New Delhi's capacities to influence either system will be limited for some time because of its own financial constraints and it will be a vestigial presence in both structures. India should compensate for its lack of money with the provision of ideas for such institutions. It should work to help set the rules on accepting new members, determining the nature of the funding and minimizing the use of such institutions for the strategic calculus of others. And it should seek to build alliances within both structures with other mid-level nations.

India should pursue its present policy of seeking modifications to the existing Bretton Woods architecture. It should also not be taken in by post-colonial rhetoric: the truth is that it has done well from the World Bank-IMF system and has achieved a comfort zone with the former in particular.

India should nevertheless keep a foothold in the Sino-centric architecture that is being put together. Even if it may reluctant to borrow directly from Beijing, it should seek to have a say in the purpose and direction of Chinese lending capital to third countries, notably in Africa.

What India should remember, however, is that the real financing source for its infrastructure should be private capital. These are the only flows that are large enough to make a difference. They also provide sustenance to the private sector, though development aid is increasingly entering equity markets as well. At present, just about 20 developing nations have access to these flows, the rest lacking the credit rating or financial capacity to absorb large amounts of private capital. India is thus in an advantageous position and should, more than anything else, work on getting the right business environment to expand these flows to a magnitude greater.