Leaders of the BRICS–Brazil, Russia, India, China, and South Africa–meet in Rio today to swap World Cup stories and launch a long-discussed “BRICS Bank.” The bank creates two funds—a development lending facility (New Development Bank or NDB) backed by $50 billion in capital ($10 billion from each of the BRICs), and a $100 billion rescue fund (Contingent Reserve Arrangement, CRA) for countries suffering from exogenous shocks.

There is a great deal of optimism surrounding the launch of the institution, with some seeing it as a serious political and economic counterweight over time to the World Bank and IMF. While the political motivations for the initiative are easy to identify, the economic benefits are much harder to pin down. I am skeptical that the BRICS Bank will be an effective development institution or rescue facility, and see serious risks that its good ambitions could be undermined by poor investments, bad policies, and even corruption. Here are five reasons why.

1. No obvious pot of high-quality investments. Part of the motivation for a new development bank is to meet an unfilled need for development projects the World Bank and regional development banks cannot or will not fund. The early focus of the NDB is on infrastructure, and I would fully agree that there is a critical need for more infrastructure in industrial as well as emerging economies. But there are good reasons why private investment is wary to make strategic investments in this area, and many reasons (including environmental, social, and governance related) why the official community is careful to act. Unless we are going to abandon these
concerns, which I’d oppose, there will not be easy investments to fund, which could lead to excessive risk taking.

2. **Limited institutional capacity.** Instituting a global development agenda—identifying and implementing projects, monitoring against corruption, measuring the impact—takes extraordinary institutional capacity, something that will take decades for the new bank to develop. (Even at the World Bank, we have seen a recent shift to putting more people in country in part to support project implementation.) In the meantime, the pressure to lend will force tough choices. The NDB could piggyback on the investment expertise of others, including the World Bank and IMF, but the political imperative to differentiate will make that difficult. The NDB could of course link in with high quality private investors, but that has its own problems in a world of weak governance and may tend to lead to a narrow range of low-risk, low developmental impact projects (e.g., 5-star hotels) with an even narrower range of trusted co-financing partners. My greater concern in this case would be that the new Bank becomes captured by the finance ministries of the borrowing countries and backdoor fiscal financing for politically popular projects. Conversely, for creditor countries of the new bank, importantly China, the incentives to encourage lending that supports their overseas investment strategy could be profound.

3. **Exogenous is in the eye of the beholder.** Limiting emergency financing to exogenous, short-term shocks aims to protect the resources of the institution and avoid the charge that it is simply delaying needed adjustment. But of course distinguishing exogenous shocks from those requiring policy adjustment is hard, and the use of its financing to delay adjustment (and avoid the politically contentious approach to the IMF) will be hard to resist. I wouldn’t be surprised to see the CRA have some sort of rule or informal understanding linking drawings above a certain level to an IMF program, but again that limits the uniqueness and potential additionality of the arrangement.

4. **Conditionality is hard.** Ultimately, if lending by the bank doesn’t stem a crisis, adjustment will be needed, and it’s hard to believe that the institution will be effective at developing and enforcing conditionality. All one needs to do is recall the image of German leaders in 2010-11 telling Greece what reforms were needed, or the U.S. experience with conditionality on AID lending, to be reminded that the record of bilateral conditionality is poor. As painful as the medicine the IMF dispenses is, when adjustment is needed there is an advantage to
multilateralizing policy conditionality through the IMF. While notionally this bank is multilateral, for the foreseeable future its view will be dominated by a small number of creditor countries.

5. **It is still debt.** My presumption is that, in the early days, the political support for the institution will ensure that it is promptly repaid, and if a borrowing country runs into trouble that it will treat its obligations to the NDB/CRA as senior. But that seniority is a de facto political outcome, not enforced by law, and if someday the borrowing countries perceive that there is limited sanction to running arrears the facilities could be quickly exhausted.

Discussion of the political motivations for this effort often touch on the taper tantrum, the sharp reversal of capital flows that many emerging markets saw last year after the Federal Reserve began to discuss its exit from non-conventional monetary policies. But the BRICS Bank has been under discussion for at least five years, and the driver for its creation reflects a longer term frustration of the rising powers that its voice is not well heard in the major international financial institutions and decision making groups. In some respects, the criticism isn’t fair, as serious (if imperfect) efforts have been made to give these countries a greater voice through the G20 and other fora. Also, in important respects the World Bank and IMF’s views on policies affecting these countries have changed. For example, on capital controls, the IMF has a much more nuanced view and is willing to support controls in a wide variety of cases, even outside of crisis. The Washington consensus is far from the rigid doctrine its critics contend.

Not that the major powers don’t need to do more, a message my colleague Julia Sweig hopes Washington hears. From this perspective, the failure of the U.S. Government to pass IMF reform is all the more tragic, as it fuels initiatives like the BRICS Bank. In addition, I also don’t see much harm in emerging markets in effect buying insurance against adverse shocks, or the development of new institutions as long as they coordinate effectively within the global architecture. But I am less convinced that the BRICS Bank, even if effective, is a game changer for global finance. The U.S. dollar will still be the primary reserve currency in 10 or even 20 years, and U.S. financial institutions and financial centers will continue to anchor global financial markets—as in the past, there will be tremendous inertia, or hysteresis, to the shift to a new reserve currency or financial system. The BRICS Bank may be celebrated today for accelerating that trend away from the dollar, and its intentions are good, but if it doesn’t manage the risk well it could in the end be a setback to those who would like to see a more multipolar world.
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