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The Brics bank is a glimpse of the future

By David Pilling   Author alerts

If the postwar order is being upended, the right response is 'hear, hear'

Thirteen years ago, Brics was a marketing ploy dreamt up by Jim O'Neill, then chief economist at Goldman Sachs. Now it is a bank. Next thing you know, it will have its own line of designer handbags.

This month in Fortaleza, the five Brics nations – Brazil, Russia, India, China and South Africa – agreed to establish a development bank. They also set up a $100bn swap line, known formally as a contingent reserve arrangement, a deal that gives each country's central bank access to emergency supplies of foreign currency. To borrow a phrase from Anton Siluanov, Russia's finance minister, the five countries are attempting to conjure a mini-World Bank and a mini-International Monetary Fund.

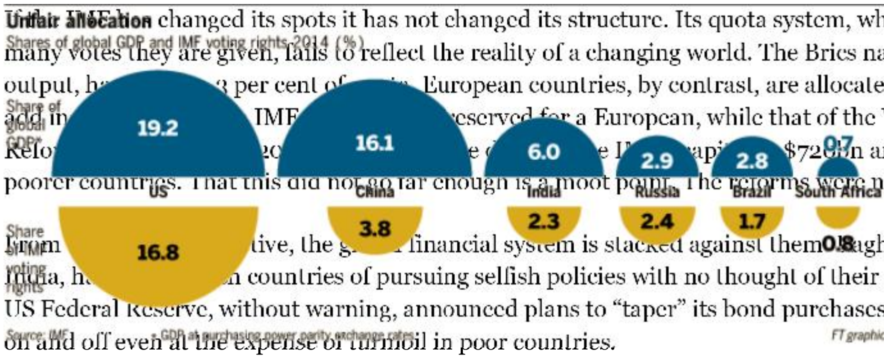
The Brics' plan is good for the world, although you would not know it from the sniffy reaction in the west. There have been two default positions. One is to scoff at the very idea of five such disparate nations organising anything coherent or staying the course. The other is to worry that the world order reflected in the two US-led institutions set up at the Bretton Woods conference of 1944 is about to crumble.

It is indeed a minor miracle that five countries whose initials happen to form a catchy acronym have so quickly gone from Brics to a bricks-and-mortar bank. This is a reprimand to western-led institutions that have failed to adapt. If the postwar order really is being upended, the right response is "hear, hear."

The new Brics bank, which will fund infrastructure projects, will have initial capital of $50bn and maximum allowable capital of $100bn. Each country will pay in $10bn, giving them a theoretically equal say. The bank will be based in Shanghai, a sop to Beijing, which clearly intends to wield influence. Yet the presidency will be rotated, starting with India. China will not have a turn until 2021.

By contrast, the five countries will contribute to the CRA swap line according to size, with China pitching in $41bn to South Africa's $5bn. The contingent reserve is a safety net for times of financial stress, for example if one country's currency comes under speculative attack. It is modelled on the Chiang Mai Initiative, a $240bn Asian currency swap arrangement concluded after the 1997 Asian crisis when the region's proposal to launch its own IMF equivalent was squashed by Washington.

The Brics bank, too, was born of frustration. The IMF in particular is disliked in much of the developing world. In the 1990s, its rigid adherence to market reforms led many to see it as an instrument to keep poor countries down, not to lift them out of poverty. In Asia, it is regarded as hypocritical. In 1997, it insisted on ruinous austerity in countries such as Indonesia. Following the 2008 financial crisis it has happily embraced monetary and fiscal laxity in the west.



[illegible] changed its spots it has not changed its structure. Its quota system, which determines what each country pays in and how many votes they are given, fails to reflect the reality of a changing world. The Brics nations, which account for more than a fifth of global output, h[illegible] per cent of [illegible]. European countries, by contrast, are allocated 27.5 per cent for just 18 per cent of output. To add in[illegible] IMF [illegible] reserved for a European, while that of the World Bank routinely goes to an American. Refo[illegible] 20[illegible] e [illegible] e I[illegible] api[illegible] $72[illegible]n and transferred 6 percentage points of quota to poorer countries. That this did not go far enough is a moot point. The reforms were never ratified by the US Congress.

From [illegible]tive, the g[illegible] financial system is stacked against them. Raghuram Rajan, governor of the Reserve Bank of India, h[illegible]n countries of pursuing selfish policies with no thought of their impact on emerging economies. The fact that the US Federal Reserve, without warning, announced plans to “taper” its bond purchases showed it was willing to turn the monetary spigots on and off even at the expense of turmoil in poor countries.

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One reason to welcome the new bank is that it will bring competition. China’s lending in Africa has drawn valid criticism that it is not tied to good governance or environmental standards. Yet the presence of alternative Chinese funding in Africa has been a net positive. The same should be true of the new Brics bank, given the huge number of roads, power plants and sewerage systems that need funding. “Any new institution that is adding to long-term capital has to be good for the world,” says Urjit Patel, deputy governor of India’s central bank, who was in Fortaleza.

The new bank is no panacea. As critics point out, it is relatively small. Ben Steil and Dinah Walker of the US-based Council on Foreign Relations note that, between them, China, India and Brazil have borrowed $66bn from the World Bank alone, more than the entire subscribed capital of the Brics bank. Similarly, while the idea of conditionality can be overdone, it would not be a good thing if the new bank lent willy-nilly to dictators intent on ransacking their countries’ natural resources. Nor is the Brics bank necessarily as democratic as it makes out. Its articles ensure the founders will never see their voting rights drop below 55 per cent, no matter how many countries join.

Still, the Bretton Woods institutions reflect the realities of a receding age. The world has changed, mostly for the better, as poor countries close the gap on rich ones. The Brics bank encapsulates this. It is a glimpse of the future.

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Letters in response to this column:

If the old order won’t adapt they will simply be passed over / From Dr Judith Tyson

Brics bank ought to be welcomed by poorer countries / From Prof Robert H Wade and Dr Jakob Vestergaard

Hey presto – a Bretton Woods institution in all but name / From Mr George Magnus