The Brics bank is a feeble strike against dollar hegemony

By Benn Steil

The new financial institutions announced by the Brics nations in July – a development bank and an arrangement to share currency reserves – have been compared by many observers to the World Bank and the International Monetary Fund.

There is no doubt that they reflect frustration in the developing world over governance at the multilateral institutions that emerged from the Bretton Woods summit 70 years ago. These remain dominated by the US and western Europe despite their relative economic decline. In truth, however, the new initiatives break little ground.

President Vladimir Putin of Russia has said the Brics countries want to end the international monetary system’s dependence on the policy of US authorities. If so, they are off to a poor start. Whereas only 10 per cent of the World Bank’s paid-in capital was contributed in dollars, all the start-up funding for the Brics bank will be in greenbacks, creating new demand for dollar assets.

Brazil, Russia, India and China could mitigate this problem by pooling the $5.1tn in foreign exchange reserves they hold between them. A shared stock of reserves could be considerably smaller, and still provide an ample buffer against a balance of payments crisis. This would allow participating countries to avoid the conditions attached to IMF loans.

Mr Putin claims the so-called contingent reserve arrangement, under which each country would have conditional access to others’ foreign reserves, “creates the foundation for an effective protection of our national economies from a crisis in financial markets”.

In fact, it is far too small for this purpose, and it is barred from making big loans without IMF involvement. China can borrow $6.2bn without approval from the fund; for the other participants the number is smaller. This is chicken feed. The IMF approved $38bn in loans to Russia in the 1990s, and $15bn in standby credit to Brazil in 2002. Net private financial flows to emerging markets today are about 10 times what they were in 2002, meaning that even larger loans would now be needed in similar crises. Mr Putin knows this, which is why Russia currently holds over $400bn in foreign exchange reserves.

The natural riposte is that the Brics are only just beginning their collaboration. But beefing up the fledgling institutions will not be simple. The 13-member Chiang Mai initiative, created after the 1997 Asia crisis, has yet to commit a dime to mutual assistance – despite in theory having created a pool of $240bn in combined reserves. Members can call on significant funds only if they are subject to the surveillance (and stigma) entailed by an IMF programme. Governments in the region remain hesitant to extend credit to one another during crises. The Brics countries, even more disparate, will share this reluctance.

As for development financing, funds for basic infrastructure and healthcare in poor countries could do much good. But the founders of the new bank risk being carried away by their own hyperbole. India and China are the World Bank’s biggest borrowers – and therefore its biggest beneficiaries. Together with Brazil, they have $66bn in outstanding loans, a third more than the entire initial subscribed capital of the new Brics bank.

The Brics leaders have rightly been critical of the US Congress for failing to reform the IMF. But their own bank is hardly more democratic. The World Bank’s 37 founding members now command less than half of the votes in that institution’s governing body. The Brics bank’s articles of agreement accord its founding members a permanent minimum voting share of 55 per cent – irrespective of how its membership evolves.

This is not to say that the world should be satisfied with the legacy of Bretton Woods. But it does illustrate how difficult it is to improve on it.
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