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## BRICS INSTRUMENTS: SPECIFICS OF OBJECTIVES

### “IN SEARCH OF STABILITY, SECURITY AND GROWTH”

#### BRICS AND A NEW WORLD ORDER

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The current international development financing system has its roots in the Bretton Woods Conference. The world's most important international financial institutions – the International Monetary Fund and the International Bank for Reconstruction and Development – were created at Bretton Woods in 1944. Over more than 50 years many new development finance institutions were created. The largest existing regional development institutions are the Inter-American Development Bank (founded in 1959), the African Development Bank (1964), the Asian Development Bank (1966), the European Bank for Reconstruction and Development (1991). Also there are important development institutions on a country level such as Brazilian Development Bank (1952) and China Development Bank (1994). All of these institutions are designed for planning, financing and evaluating development projects. This also includes cooperation with local and foreign governments, international institutions, private and state-owned companies. The operations of the banks are linked with many fields such as energy efficiency, higher education, transport, healthcare, information technologies, climate issues, biotechnology. Development institutions may contribute to strengthening cooperation between countries in such fields. This perfectly corresponds to the current objective of the BRICS Group.

In 2006 the first meeting of BRIC members took place, and though cooperation among countries deepened since that time, it still exists merely in the form of meetings of the leaders of the countries, ministers, regional authorities, commercial banks representatives, business forums and research center conferences. If BRICS members are to play a bigger and more unified role in global politics and economics, the Group definitely needs more institutionalization. BRICS Development Bank could act as this kind of a unifying institution and play the role of facilitator of strategic high-tech projects in BRICS countries. The leaders of the BRICS countries directed their finance ministers to examine the idea of the BRICS Development Bank in detail. On the early stage of the discussion on BRICS Bank members of the Group look at this opportunity in different ways. Each of the BRICS countries has its own view on objective and structure of the Bank.

Most of the experts suppose it is the right time to establish BRICS Development Bank due to the impact of the recent financial crisis on existing development institutions. At the same time, economic growth of the developing countries could be a basis for the global economic recovery. The final decision is to be made only when the BRICS Group arrives at a common conclusion on the establishment of the BRICS Bank after an accurate

studying of the priorities of all the member states. The generation of the common opinion on key points is essential to avoid possible controversial grounds. Voices distribution, capital formation, selection of the projects to be financed, elections of the president of the Bank are those points which are to be studied most carefully.

Experts also note that even now there are many issues on operational activities of the Bank. For instance, the financing source of the Bank. Project financing could come in a form of equity, bonds issuing, soft loans or all of the above. Possible proportion of these sources is also an issue. Concerning debt structure of the Bank, one of the key questions is capability of the Bank to borrow on international markets – ratings of the member states would not allow the Bank to borrow on the international market at favorable rates.

Postponement of the decision making could result in missing the favorable moment for creation of the Bank. At the moment the BRICS Group is on the eve of changes and all the members agree on necessity of further deepening of cooperation and institutionalization of the system of annual summits. One of the possible ways is to establish a common database, working groups on common problems such as energy efficiency, urbanization, healthcare, BRICS Bank or BRICS Investment fund.

### **BRICS Bank or South-South Bank**

One of the key questions is whether the future Bank should be exclusively funded by the BRICS countries or also include other developing countries. Some experts consider establishment of the BRICS Development Bank as a unique opportunity to jointly develop a new framework for assistance to developing countries, make the existing models created by the developed countries more flexible. Thus, the South-South Bank, which will be designed to provide development aid and humanitarian assistance, is to be established to serve this purpose. This will create a platform for framing new principles for emerging donors, such as Brazil, India, China. These countries seek to bound long-term development to short-term assistance, and this approach may form a base for the new framework. Moreover, establishment of the South-South Bank would strengthen cooperation between the BRICS countries and other developing nations.

We consider BRICS Development Bank primarily as an institution which should be designed to upgrade the general level of economic development and technology intensive industries of BRICS countries rather than solve issues such as poverty and urbanization. In our opinion, BRICS Development Bank should not duplicate existing banks for development such as the World Bank or regional development banks and should boost inter-BRICS investment volumes. The past decade witnessed a sharp increase of FDI flows to and from BRICS countries (Appendix, Table 4). Total inflows of the foreign direct investment in BRICS countries increased 3-fold between 2000-2010, total outflows during the same period surged 20-fold. The peak was reached in 2008 (BRICS countries reached 15% of world FDI inflows and 8% of world FDI outflows). In 2009 BRICS FDI flows began to fall, but this was followed by recovery in 2010. However inter-investment between BRICS countries remains at a low level close to zero, even though cooperation between countries

has deepened since the first meeting in 2006. FDI flows from China to Russia in 2010 account for only 1,4% and 0,8% of Russian FDI inflows and Chinese FDI outflows accordingly. FDI flows from India to Russia are even smaller compared to the total sum: 0,7% and 0,5% of Russian FDI inflows and India's FDI outflows accordingly. This strong underinvestment which remains between BRICS countries can be overcome through strengthening cooperation between BRICS countries on a bilateral and multilateral base.

To boost inter-investment processes between BRICS members, we suggest to co-finance high-tech projects in BRICS countries. To begin with, development agencies for identification of the pilot projects should be established in the near future. These agencies should start working on studying existing and greenfield projects in BRICS priority fields in each country, which could be developed as joint BRICS projects, and mapping of BRICS countries fields of expertise. Working agency could act as an ancestor for department of BRICS Bank, which will work on development strategy of the Bank.

### **Compatibility of the BRICS Development Bank and Other Development Institutions**

Relations between the future BRICS Bank and existing development institutions is one of the key issues. Western countries are unwilling to reflect increasing role of the high-growth developing countries in existing financial structures. This situation forces the latter to think seriously about establishment of their own Development Bank. Of course, the BRICS Group, should not set an objective to put the future Bank against existing institutions. As was mentioned above, BRICS Development Bank should not duplicate the World Bank or other existing regional development Banks. There are many existing financial Institutions which serve their purpose well. Thus, there is an opinion that at the moment the best decision will be to focus on cooperation with the existing institutions instead of creating a new one. Ministry of Finance of India is considering an option to invest 300 mln. USD in Inter-American Development Bank. China Development Bank successfully invests in international projects. At the end of 2010 its accrued international investment made 136 bln. USD.

There is an opinion that having a common BRICS candidate for the World Bank presidency could be an alternative to the establishment of the BRICS Development Bank. Last year, BRICS members failed to introduce a common candidate for the World Bank presidency. Thus, before discussing the establishment of the BRICS Development Bank the BRICS countries should show that they are able to agree on a common candidate. But in our opinion the objective of the BRICS development Bank should be an increase in inter-BRICS investment and strengthening the influence of the BRICS countries in the World Bank would not serve this purpose. Increase in the role of the BRICS Group in IMF and IBRD could not count as an alternative to the establishment of the BRICS Investment Fund or the BRICS Bank.

## Key projects of the BRICS Development Bank

This is one of the key questions related to the establishment of the BRICS Bank: what projects are to be financed by the BRICS Bank. There is an opinion that the priority projects should include those upgrading the general level of economic development. Special attention should be paid to the cross-border or cross-regional infrastructure construction projects, development or transfer of high technologies or environment protection technologies in developing countries and regions. All of the above should contribute to meeting challenges of poverty, climate change, grain safety and strengthen the coordination between BRICS countries in the fields of economy, development, finance and money market. In existing development institutions such projects stand among first on the list (Table 1). Public Sector Management projects are on the top position by its share in the loans volume in IDB (21,5%) and IBRD (18,4%). Transport and ICT projects are the most common in Asian Development Bank (33,4%).

**Table 1. Loans of some Development Banks allocated by sector, 2010, % to total loans.**

	EBRD	IDB <sup>1</sup>	ADB <sup>2</sup>	IBRD
<i>Agriculture and Natural Resources</i>	17,6	10,7	5,4	4,5
<i>Education</i>	-	7,2	0,6	8,4
<i>Energy</i>	10,9	10,7	21,4	16,9
<i>Finance</i>	38,6	8,1	11,0	15,6
<i>Health and Social Protection</i>	-	13,1	1,5	11,6
<i>Industry and Trade</i>	10,8	5,7	0,0	2,1
<i>Public Sector Management</i>	3,1	21,5	7,8	18,4
<i>Transport and ICT</i>	12,8	12,6	33,4	15,3
<i>Water Supply and Other Municipal Infrastructure and Services</i>	6,1	10,3	5,3	7,0
<i>Multisector</i>	0,1	0,1	13,5	0,2
<i>Total</i>	100	100	100	100

Source: Annual reports of EBRD, IDB, ADB, IBRD

We think that BRICS Development Bank is a combination of an investment bank and research facility (and foundation) for defining priorities and issues of development. BRICS Development Bank is to contain a specific mechanism of expansion of priority high-tech projects for BRICS countries. The priority fields for BRICS countries may include: Energy Efficiency, Higher Education, Pharmacology, Information and Telecommunication Systems, Transport, Aviation, Space Technology, Climate and Environmental Issues, Biotechnology.

R&D expenses in BRICS countries lie on the low level comparing to developed countries (Table 2). In BRICS countries R&D expenses-to-GDP ratio stands at 1% level, while in developed countries this figure is close to 2% or higher. Thus BRICS Development

<sup>1</sup> Inter-American Development Bank

<sup>2</sup> Asian Development Bank

Bank should pay special attention to hi-tech projects. Joint projects could come in a form of creating new technologies or mass production of existing advanced technologies.

**Table 2. Key technology development indicators for BRICS members and some developed countries, 2007**

	R&D Expenses to GDP, %	Employed in R&D, % of population	High-tech exports, % of manufactured exports	Patent applications, thousands
<b>BRICS</b>				
<i>Brazil</i>	1,1	0,1	11,9	21,8
<i>China</i>	1,4	0,1	26,7	245,2
<i>India</i>	0,8	0,0	6,4	28,9
<i>Russia</i>	1,1	0,4	6,9	39,4
<i>South Africa</i>	0,9	0,1	5,6	10,8
<b>memo</b>				
<i>Japan</i>	3,4	0,6	18,4	396,3
<i>Germany</i>	2,5	0,5	14,0	61,0
<i>South Korea</i>	3,2	0,5	30,5	172,5
<i>UK</i>	1,8	0,5	18,9	25,0
<i>USA</i>	2,7	0,5	27,2	456,2

Source: World Bank

The BRICS Development Bank may act not only as a financial institution but also as a strategic research facility for BRICS countries. Research department may examine new technologies, develop projects, offer consultations to the members of the Bank on various strategic issues, study new development trends. For example, EBRD releases a wide range of publications which are designed to provide deep insight in development problems and issues of transitions economies and also to broadcast understanding of these problems. IBR studies various subjects including climate change, development issues, infrastructure, which are linked to the projects financed by the IBR.

### **BRICS Bank Financing**

Discussion on BRICS Bank financing and corresponding voice distribution could be a source of disagreement in BRICS Group, according to some experts. There is an opinion that foreign exchange reserves of the BRICS countries could be a source for Bank initial capital, because they lie on a high level (Table 3). One of the key questions is liabilities structure and its formation. Suggested debt-to-equity ratio may amount to about 90%.

**Table 3. Foreign Exchange Reserves of the BRICS countries, 2010 г., bln. USD**

	ForEx holdings, total	Alloc. Res.	USD	UK Pounds	Jap. Yen	Swiss francs	Euros	Other ccy	Unalloc. Res.
China	2 847	1 115	650	62	31	1	315	56	1 733
India	268	105	61	6	3	0	30	5	163
Russia	433	170	99	9	5	0	48	9	263
Brazil	276	108	63	6	3	0	31	5	168
South Africa	35	14	8	1	0	0	4	1	22
<b>BRICS, total</b>	<b>3 824</b>	<b>1 497</b>	<b>873</b>	<b>83</b>	<b>42</b>	<b>1</b>	<b>423</b>	<b>76</b>	<b>2 327</b>

Source: IMF, REA estimates

Financial contributions from the member states and other interested parties, acceptable for the members, may serve as a base for initial capital requirements and operational expenditures of the BRICS Development Bank. Decision-making system should consist of two tiers. First range of issues, which is to be defined, should be adopted only by general consent or by absolute majority of 90% of votes of the Board of Directors. This range should include elections of the president of the Bank. Other questions may be settled by simple majority of the votes. These decisions require less strict regulations. This may apply to selection of the relatively small projects, which are to be financed by the Bank. Bank may borrow on the open market to cover additional capital requirements.

In the case of dealing with the large project the Bank could act as a strategic partner and co-finance the project with the engaged country and other partners. For example, one of the countries with limited borrowing capacity on the international markets is to finance large infrastructure project. Budget constraints reduce government's ability to finance large projects by itself, and it may decide to draw the necessary funds from the international markets and involve the BRICS Bank as a strategic partner. In this case the BRICS Bank will be engaged in negotiations with potential investors such as banks, agencies, companies, funds and also co-finance the project.

BRICS Development Bank could have large permanent partners, for instance, other Development Banks or non-BRICS governments for co-financing the projects. Such partnership might be mutually beneficial. For the partners it can be an opportunity to take part in large high-profitable projects of development countries. For the BRICS Bank and its members it is an opportunity to get additional financing and mitigate the risk, which could lead to decrease in the interest rate.

## Conclusion

At the moment no common decision on establishment of the BRICS Bank was achieved, though the leaders of the BRICS Group directed their finance ministers to study the idea in detail. On the early stage of the discussion each member of the BRICS Group has its own opinion on time, objectives, volume, financing and structure of the future BRICS Development Bank.

We think that BRICS Development Bank should not duplicate the World Bank or other existing regional development Banks. It should be designed as a combination of an investment bank, research facility (and foundation) for defining priorities and issues of development of the BRICS countries. The priority projects of the BRICS Bank may include projects on Energy Efficiency, Higher Education, Pharmacology, Information and Telecommunication Systems, Transport, Aviation, Space Technology, Climate and Environmental Issues, Biotechnology. Financial contributions from the member states and other interested parties, acceptable for the members, may serve as a base for initial capital requirements and operational expenditures of the BRICS Development Bank. Two-tier decision-making system may help to avoid excessive one sided influence on the process of decision-making or on operational activities of the bank. There should be the range of the decisions which are to be adopted only by general consent or by absolute majority of 90% of votes of the Board of Directors. Other questions may require only simple majority. BRICS Bank, as other Development Banks, may have large permanent partners

Establishment of the BRICS Development Bank could strengthen the position of the BRICS Group in the global economy and politics, increase inter-BRICS investment and general level of economic development of the BRICS countries.

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## Appendix.

**Table 4.** Foreign Direct Investment Inflows and Outflows, 2000-2010, USD bln

	USD bln	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	
Inflow	<b>BRICS</b>												
	<i>Brazil</i>	33	22	17	10	18	15	19	35	45	26	48	
	<i>China</i>	41	47	53	54	61	72	73	84	108	95	106	
	<i>India</i>	4	5	6	4	6	8	20	25	43	36	25	
	<i>Russia</i>	3	3	3	8	15	13	30	55	75	37	41	
	<i>South Africa</i>	1	7	2	1	1	7	-1	6	9	5	2	
	<b>memo</b>												
	<i>Japan</i>	8	6	9	6	8	3	-7	23	24	12	-1	
	<i>Germany</i>	198	26	54	32	-10	47	56	80	4	38	46	
	<i>South Korea</i>	9	4	3	4	9	7	5	3	8	8	7	
	<i>UK</i>	119	53	24	17	56	176	156	196	92	71	46	
<i>USA</i>	314	159	75	53	136	105	237	216	306	153	228		
Outflow	<b>BRICS</b>												
	<i>Brazil</i>	2	-2	2	0	10	3	28	7	20	-10	12	
	<i>China</i>	1	7	3	3	5	12	21	22	52	57	68	
	<i>India</i>	1	1	2	2	2	3	14	17	19	16	15	
	<i>Russia</i>	3	3	4	10	14	13	23	46	56	44	52	
	<i>South Africa</i>	0	-3	0	1	1	1	6	3	-3	1	0	
	<b>memo</b>												
	<i>Japan</i>	32	38	32	29	31	46	50	74	128	75	56	
	<i>Germany</i>	57	40	19	6	21	76	119	171	77	78	105	
	<i>South Korea</i>	4	2	3	4	6	6	11	20	20	17	19	
	<i>UK</i>	233	59	50	62	91	81	86	272	161	44	11	
<i>USA</i>	143	125	135	129	295	15	224	394	308	283	329		

Source: UNCTAD