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Emerging economies: Taking a stand

By Robin Harding, Joseph Leahy and Lucy Hornby [Author alerts](#)

The Brics are creating their own development bank. But critics warn the group is bound by frustration



The airport of Fortaleza, Brazil's northeastern beachside city, looked like a parking lot this week for the powers that are changing the order of the world economy.

Official aircraft from Russia, South Africa and China were lined up on the tarmac, alongside an Air India jet, as the leaders of the so-called Brics nations arrived for their sixth and most important summit yet.

After first being brought together as an acronym invented by Jim O'Neill of Goldman Sachs to brand his investment thesis about the growth opportunity in large emerging markets, the Brics are finding their political voice. This week, they agreed to their first bricks-and-mortar institutions, committing \$100bn into a development bank and a pool of currency swaps.

The Brics' development bank is a potential rival to the World Bank, and the currency swaps will work in parallel to the International Monetary Fund, the two Washington-based institutions that embody the US-led economic order created at Bretton Woods in 1944.

The Brics now make up a quarter of the global economy, with China poised to overtake the US as the world's leading economy, based on domestic purchasing power, this year. Together, these countries are seeking to use their clout to create institutions that reflect their new status.

Guido Mantega, Brazil's finance minister, said one of the big differences between the Brics' vision of a new global financial architecture and the existing US-centred system was the principle of equality among the stakeholders. "In the Brics bank, we will have equal power," he says. "This is a fundamental point." Unlike the IMF, whose leadership is always European, and the World Bank, whose president is chosen by the US, the Brics bank will have a five-year rotating presidency, with each country getting a turn.

The rise of the Brics marks the first true shift of power in the global economy since Bretton Woods. Japan, a US ally of manageable scale and few geopolitical aspirations, was easy to slot in, but now the system needs to accommodate a new set of powers that do not necessarily accept its basic assumptions.

The creation of the Brics bank shows what could happen if they are not accommodated: the fragmentation of world economic governance into multiple centres of power, competing for influence, and less able to work together in delivering global economic and financial stability.

The biggest rationale for them to act together is how little global economic governance has advanced

But it would be a mistake to think this has already happened. The Brics are not as united as they appear and the new institutions they are setting up face formidable operational challenges. The moves being touted this week in Brazil are driven as much by frustration with the lack of US leadership as by a desire to supplant it. Tension with the existing system is on the rise – but the system has not broken yet.

“I never dreamed they would get together as a political group,” Mr O’Neill says of the Brics. “But I always thought the biggest rationale for them to act together is how little global economic governance has advanced.”

The most immediate complaint is the failure of the US Congress to ratify reforms to IMF voting power. Those changes would have given big emerging markets a say at the fund more in keeping with their weight in the global economy.

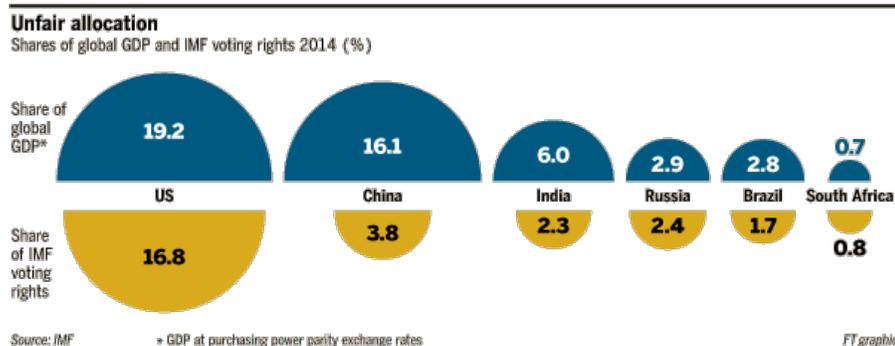
“We had a ‘half success’,” says Mr Mantega. “But we have still not been able to cement this because of the US Congress.” The result is that the Brics languish with 10.3 per cent of the votes at the fund compared with their 24.5 per cent stake in the world economy.

To be thwarted by the US in this manner – particularly after it originally pushed for the reforms – is galling. But it is in keeping with a political climate in the US dominated by budget worries and anti-government sentiment. The rise of China’s aggressive policy banks have already proven an attractive alternative to the World Bank for many nations; the US debate revolves around whether its own Export-Import Bank should be shut down as a form of crony capitalism.

The Obama administration avows its will to lead the world economy but has little credibility when it cannot muster domestic support. It does not help that the Senate has not confirmed candidates for two top international jobs at the US Treasury; nor has it confirmed a US director or an alternate to the IMF. It is hard to lead the global economy without staff.

“Other countries are often more conscious of US global power and influence than we are ourselves,” says Daniel Price, managing director of Rock Creek Global Advisors, and a former G20 sherpa in the George W Bush administration. “This may help explain their deep disappointment when US actions diverge so markedly from its rhetoric or ideals, whether on security, human rights or international trade.”

All the Brics are disappointed about the IMF reform but with a more engaged and reliable US, their obvious internal differences might come to the fore. The Brics, after all, are a disparate group bound more by frustration with the existing system than strong shared interests; they did not coalesce behind a rival candidate when Christine Lagarde was nominated to the IMF, for example.



Chinese leader Xi Jinping sees a geopolitical role for the Brics as part of his new push to set up an alternative to US “hegemony”. Mr Xi has embraced a vision of China as a leader of nonaligned nations, first developed in the 1950s, even as he has taken a more aggressive stance on disputed maritime borders.

“China wants to go on being taken, especially among its Asian neighbours and in Africa and Latin America, as one of them, as a power from the south, a developing nation,” says Marcos Troyjo, co-director of the BRICLab forum at Columbia University. “This bank will end up providing a service for China in that regard. It gives China a sort of still-emerging nation status when in reality it is a major economic superpower.”

China is motivated by “unmet expectations” over the big multilateral institutions such as the World Bank, IMF or Asian Development Bank, says Zhao Xijun, deputy director of the School of Finance at Renmin University in Beijing. But it is also looking for better returns for its vast pile of foreign currency reserves, most of which are invested in US Treasuries, and risk losing value.

Russia has obvious reasons to support new Brics institutions at a time when it is exposed to US-led sanctions following its occupation of Crimea.

Brazil, India and South Africa are likely borrowers to finance their infrastructure needs. The Brics bank could become a welcome

alternative to the bureaucratic and highly conditional lending of the World Bank and IMF. It also offers a way to strengthen economic ties: getting Indian and South African support for a global trade deal, for example.

Brazil has staked its future on reviving multilateral trade talks, says Oliver Stuenkel, assistant professor of international trade relations at the Getulio Vargas Foundation in São Paulo. The country has not signed bilateral agreements and risks being left behind if it cannot get the Bali trade deal done.

Getting the Brics bank up and running will not be easy, however. “The agreement deserves applause,” says Douglas Rediker at the Peterson Institute for International Economics in Washington, “but it’s a small first step in creating a new institution on the global stage worthy of being spoken about in the same breath as the IMF and the World Bank.”

The fund and the bank embody a set of rules that members know they must operate by, Mr Rediker says, and have a strong capacity both to monitor their borrowers and to enforce conditions on their loans. The test of the new Brics institutions will come when one of the members runs into trouble and demands a big loan. How will its counterparts react?

That highlights the fundamental issue for the Brics as potential leaders of the global economy: trust.

“Despite all the fulmination about the US, fundamentally, over the long-run, other countries do trust the US to do the right thing,” says Eswar Prasad, professor of trade policy at Cornell University. “With other countries there is not that trust.”

“There is no question we are not leading as we could or should,” says Mr Rediker. “But the US is still the first among equals in the international financial system. It is the intellectual leader, the political leader and the economic leader.” The rest of the world, including the Brics, is still counting on an acceleration in US growth to drive the global economy forward this year and next.

Against that backdrop the Brics bank appears in a slightly different light: as a new player in the global financial system, yes, but not as a vanguard set to dispute its commanding heights. Having to look over their shoulders could spur the IMF and World Bank to greater efficiency.

“The additional competition will push multilateral institutions to improve,” says Mr Zhao. Mr Prasad agrees. “I actually think that competition is very good, even when it comes to the international financial architecture.” The early months are likely to be critical. If the Brics bank can get off to a strong start, says Mr Troyjo, establishing a staff and making positive loans, it could become more than a talking shop.

If it falters, it could go the way of innumerable other initiatives to establish an alternative voice for developing nations, such as the Latin American Free Trade Association, which fizzled out. The high hopes in Fortaleza show the international financial system is changing. However, the familiar bastions of Bretton Woods look set to stand for some years to come.

Brics bank: Equal partners will sidestep colonial legacy

After the talk shop in Fortaleza had finished late on Monday, Brazil’s finance minister Guido Mantega took time to spell out just how different the vision for the new institution being created by the Brics would be from its Bretton Woods counterparts, *writes Joe Leahy*.

Everything, at least in the Brics bank if not in their proposed \$100bn reserve fund, would be done on a completely equal basis, he said. The aim is to avoid what the Brics see as the galling colonial legacy of the International Monetary Fund, in which four European countries – Britain, France, Germany and Italy – have a combined share of votes of 17.6 per cent while commanding only 13.4 per cent of the global economy. The Brics, by contrast, have only 10.3 per cent the IMF vote and yet up to nearly one quarter of the global economy.

Mr Mantega said each country will contribute the same amount of funding to the banks – an initial \$2bn each to be injected over seven years – and have an equal vote. The remainder of the subscribed capital of \$50bn will be in the form of guarantees.

The bank’s president, a position that will rotate equally between the members, will be assisted by four vice-presidents and answer to a board of directors consisting of senior bureaucrats from each of the countries.

There will also be a board of governors that will decide the big strategic issues.

Brazil will provide the first chairperson of the board of directors and Russia first chairperson of the board of governors. The Brics’ contingent reserve arrangement, meanwhile, will be divided according to financial strength, with China providing \$41bn of the fund, Brazil, Russia and India \$18bn and South Africa \$5bn.

Decisions to approve requests for liquidity support from a country will be taken by a simple majority using “weighted voting”. More involved decisions will be taken by consensus, implying a veto for each country.

Letter in response to this report:

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