

## **BRICS Instruments: Specifics of Objectives**

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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 since then, many new development finance institutions have been 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), and 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 (comprising Brazil, Russia, India, China and South Africa).

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 institutionalisation. The proposed BRICS Development Bank (From here on referred to as BDB) could act as a kind of a unifying institution and play the role of facilitator of strategic high-tech projects in BRICS countries. The leaders of these countries directed their finance ministers to examine the idea of the BRICS Development Bank in detail. In the early stage of the discussion on establishing the BDB, the members of the Group look at this opportunity in different ways. Each of the countries has its own view on the objective and structure of the Bank.

Most of the experts suppose it is the right time to establish the BDB 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 Bank after an accurate study of the priorities of all the member states. To share a common opinion on key points is essential for avoiding possible controversies. Strategy analysis, capital formation role, selection of the projects to be financed, elections of the president of the Bank are the points that need to be studied most carefully.

**Примечание [МАК1]:** If I understand it right, we can't share a common opinion if there is no common opinion at the moment. We first have to create it, that's what is to be stressed.

**Примечание [МАК2]:** we also mentioned voices distribution. It's one of the key questions, we can't skip it.

Experts also note that even now there are many issues on operational activities of the Bank, as for instance, the source of its finance. 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 the capability of the Bank to borrow on international markets – ratings of the member states would not enable the Bank to borrow on the international market at favorable rates.

Postponement of the decision making could result in missing the right moment for creation of the Bank. At the moment the BRICS Group is in a state of transition and all the members agree on the necessity of further deepening the 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 and healthcare, as also the setting up BDB 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 should include other developing countries. Some experts consider establishment of the 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, this proposed South-South Bank, which will be designed to provide development aid and humanitarian assistance, should be established to serve this purpose. This will create a platform for framing new principles for development leaders/donors, such as Brazil, India, and China. These countries seek to bind long-term development to short-term assistance, and this approach may form a base for the new

**Примечание [МАК3]:** by saying "emerging donors" one can distinguish these countries from developed countries-donors.

framework. Moreover, establishment of the South-South Bank would strengthen cooperation between the BRICS countries and other developing nations.

We look at the Bank primarily as an institution which should be designed to upgrade the **over-all** level of **socio-economic** development and technology **level, especially** intensive industries of the five countries rather than for dealing with specific issues such as poverty and urbanization. In our opinion, the Bank should not duplicate the tasks of banks 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 and the outflows rose 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 stands 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. 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. This minimal investment among BRICS countries can be overcome through strengthening cooperation among them on a bilateral and multilateral basis.

Примечание [МАК4]: overall?

To boost the inter-investment processes, we suggest co-financing of high-tech projects in the five countries. To begin with, **identification agencies** should be set up for pilot projects as soon as possible. These agencies should start studying the existing and Greenfield projects in the countries' priority fields and develop them as joint projects, besides mapping each countries' fields of expertise. **A departmental agency could be set up in the BDB to work on its development strategy.**

Примечание [МАК5]: identification of the pilot projects agency

Примечание [МАК6]: these agencies could act as a pattern for a future strategy development department of the BDB

### Compatibility of the BDB and Other Development Institutions

Relations between the Bank and existing development institutions would be a key issue. Western countries are unwilling to increase the role of high-growth developing countries in existing financial structures. This situation forces the developing countries to think seriously about establishing their own Bank. Of course, the BRICS Group should not aim at making it an objective to setup the future Bank against existing institutions. As was mentioned above, BDB 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 would be to focus on cooperation with the existing institutions instead of creating a new one. India's Ministry of Finance is thinking of investing 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 was 136 bln. USD.

There is an opinion that, having a common BRICS candidate at 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 post. Thus, before discussing the establishment of the Bank, it 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 the increase in inter-BRICS investment and strengthening the influence of the five countries in the World Bank would not serve this purpose. Increase in the role of the BRICS Group in IMF and IBRD cannot be 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 Bank: what are the projects that should be financed by the BRICS Bank? Some say 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 and the development or transfer of high technologies or environment protection technologies in developing countries and regions. All of the above would contribute to meeting the challenges of poverty, climate change, grain safety and strengthen the coordination among BRICS countries in the fields of economy, development, finance and money market. In the 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 ones in Asian Development Bank (33.4%).

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

	<b>EBRD</b>	<b>IDB<sup>1</sup></b>	<b>ADB<sup>2</sup></b>	<b>IBRD</b>
<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. The Bank needs to establish a specific mechanism of expansion of priority high-tech projects in the fields of Energy Efficiency, Higher Education, Pharmacology, Information and Telecommunication Systems, Transport, Aviation, Space Technology, Climate and Environmental Issues and Biotechnology.

R&D expenses in BRICS countries are very low compared to those of developed countries (Table 2). The countries' R&D expenses-to-GDP ratio stands at 1% level, while in developed countries this figure is close to 2% or higher. Thus the 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**

	<b>R&amp;D Expenses to GDP, %</b>	<b>Employed in R&amp;D, % of population</b>	<b>High-tech exports, % of manufactured exports</b>	<b>Patent applications, thousands</b>
<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

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

<sup>2</sup> Asian Development Bank

<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 Bank may act not only as a financial institution but also as a strategic research facility. The [proposed] research department may examine new technologies, develop projects, offer consultations to its members on various strategic issues and study new development trends. For example, EBRD releases a wide range of publications which are designed to provide a deeper insight into development problems, issues of transition economies and to broadcast the 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 the Bank's initial capital, as they are on a high level (Table 3). One of the key questions is liabilities structure and its formation. The estimated debt-equity ratio may amount to about 90%.

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

	<b>ForEx holdings, total</b>	<b>Alloc. Res.</b>	<b>USD</b>	<b>UK Pounds</b>	<b>Jap. Yen</b>	<b>Swiss francs</b>	<b>Euro s</b>	<b>Other ccy</b>	<b>Unalloc. Res.</b>
<i>China</i>	2 847	1 115	650	62	31	1	315	56	1 733
<i>India</i>	268	105	61	6	3	0	30	5	163
<i>Russia</i>	433	170	99	9	5	0	48	9	263
<i>Brazil</i>	276	108	63	6	3	0	31	5	168
<i>South Africa</i>	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, accepted by the members may serve as a base for initial capital requirements and operational expenditures of the Bank. Decision-making system should be two tiered. First the range of

issues to be defined should be adopted only by general consent or by absolute majority of 90% vote of the Board of Directors. This process should include the election of the Bank president. Other questions may be settled by simple majority vote. These decisions require less strict regulations. This may apply to selecting relatively small projects, and the Bank may borrow in the open market to cover additional capital requirements.

In dealing with large projects, the Bank could act as a strategic partner and co-finance the project with the engaged country and other partners—for example when one of the countries with limited borrowing capacity in the international markets needs to finance a large infrastructure project. Budget constraints reduce a 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 Bank will be involved in negotiations with potential investors such as other banks, agencies, companies, funds, besides co-financing the project.

~~The~~ The new Bank could ~~connect tie up~~ with ~~other~~ large permanent partners, such as other development Banks or non-BRICS governments for co-financing projects. Such partnership might be mutually beneficial. For the partners it can be an opportunity to take part in large, high-profit projects of developing countries. For the 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.

Примечание [МАК7]: the?

### **Conclusion**

To date, there has been no unanimous decision on the establishment of the BRICS Bank, though the group's leaders directed their finance ministers to study the idea in detail. In the early stage of the discussion each member of the group had their own opinions on time, objectives, volume, financing and structure of the proposed Bank.

We think that BDB 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 five countries. Its priority should be on Energy Efficiency, Higher Education, Pharmacology, Information and Telecommunication Systems, Transport, Aviation, Space Technology, Climate and Environmental Issues and Biotechnology. Financial contributions from the member states and other interested parties, acceptable to 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. The more important decisions should be adopted only by general consent or by absolute majority of 90% votes of the Board of Directors. Other issues can be decided upon by a simple majority vote. Like other banks, the BRICS Bank can 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 1. Foreign Direct Investment Inflows and Outflows, 2000-2010, USD bln

Примечание [МАК8]: please note that this table has landscape, not portrait orientation.

	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			
	<i>China</i>	41	47	53	54	61	72	73	84	108			
	<i>India</i>	4	5	6	4	6	8	20	25	43			
	<i>Russia</i>	3	3	3	8	15	13	30	55	75			
	<i>South Africa</i>	1	7	2	1	1	7	-1	6	9			
	<b>memo</b>												
	<i>Japan</i>	8	6	9	6	8	3	-7	23	24			
	<i>Germany</i>	198	26	54	32	-10	47	56	80	4			
	<i>South Korea</i>	9	4	3	4	9	7	5	3	8			
	<i>UK</i>	119	53	24	17	56	176	156	196	92			
<i>USA</i>	314	159	75	53	136	105	237	216	306				
Outflow	<b>BRICS</b>												
	<i>Brazil</i>	2	-2	2	0	10	3	28	7	20			
	<i>China</i>	1	7	3	3	5	12	21	22	52			
	<i>India</i>	1	1	2	2	2	3	14	17	19			
	<i>Russia</i>	3	3	4	10	14	13	23	46	56			

	<i>South Africa</i>	0	-3	0	1	1	1	6	3	-3	
	<b>memo</b>										
	<i>Japan</i>	32	38	32	29	31	46	50	74	128	
	<i>Germany</i>	57	40	19	6	21	76	119	171	77	
	<i>South Korea</i>	4	2	3	4	6	6	11	20	20	
	<i>UK</i>	233	59	50	62	91	81	86	272	161	
	<i>USA</i>	143	125	135	129	295	15	224	394	308	2

Source: UNCTAD