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The BRICS Development Bank: A New Tool for South-South Cooperation?

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South-South Cooperation

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Summary

Executive Summary

The Sixth BRICS Summit, held in July 2014 in Fortaleza, Brazil, resulted in agreements to establish a New Development Bank (NDB) as well as a Contingent Reserve Arrangement (CRA). This Policy Brief discusses the impact of the NDB on the existing architecture of de-velopment finance, focusing on the bank's potential contribution to the BRICS' South-South cooperation. The first section outlines the BRICS countries' rational for establishing the NDB. In the following section potential development paradigms that are likely to be adopted by the NDB are addressed. Since no decision has been taken on the bank's future governance, this section will be based on the experiences from the BRICS' national development banks. Once the NDB's governance is agreed upon, it will impact whether and to what extent the new bank will cooperate with the existing international system of development finance. A third section discusses the NDB's potential appeal for the Global South. The Global South shares with the BRICS a disappointment with the existing system, and connects specific hopes and expecta-tions with the foundation of the NDB. Examining the Banks effect on South-South cooperation, the section includes prospects on the Bank's capital potential and by that its potential contribution to the prevalent demand for infrastructure financing in developing coun-tries. A final section summarises the points made and aims to put the present perceptions of the NDB in rather cautious perspectives.

The BRICS Development Bank: A New Tool for South-South Cooperation?

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1. From Frustration to Foundation: The New Development Bank[1]

The Sixth BRICS Summit, held in July 2014 in Fortaleza, Brazil, was the first summit begin-ning a new cycle of head-of-state meetings, introduced a closer cooperation of the five emerging economies (Brazil, Russia, India, China and South Africa), and which might have repercussions beyond the closed group of nations. The summit resulted in agreements to establish a New Development Bank (NDB) as well as a Contingent Reserve Arrangement (CRA). Despite doubts raised by critics concerning the political, economic and social hetero-geneity of the countries as well as consequentially diverging interests (Desai 2013), since the idea was first put fourth at the Fourth BRICS Summit in Delhi, India, the BRICS proved able to find a common ground with concrete results. Furthermore, these decisions mark the de-velopment of the club from mere informal meetings and common declarations to a new de-gree of institutionalisation and formal cooperation.

It is no coincidence that this new institutionalisation takes place in form of an International Financial Institution (IFI). The past years have been marked by a disappointment of the emerging economies with the existing IFIs and, in particular, with the Bretton Woods Institu-tions (World Bank Group and International Monetary Fund) on two main grounds. Firstly, the BRICS are frustrated with the fact that the voting system in the global Bretton Woods Institu-tions does not reflect the global shift of power, resulting from the economic development of the five nations in the past decades. Although slightly adapted to the economic weight of the member countries, the voting power in the World Bank Board still represents the world after the Second World War, which does not have much in common with today's economic land-scape. Secondly, the US Congress currently blocks the reform process of the Bretton Woods Institutions [2] which was high on the BRICS' agenda up until the Durban Summit (Prado/Salles 2014: 154-157). The same problem is found in the Regional Development Banks (RDB). In their respective RDBs, not only are

1 The author is grateful for the reviewers' valuable comments and support. Particular thanks are due to Manaíra Assunção, Jurek Seifert and Herbert Wulf.

2 Even the intended Realignment of Voting Power in the IBRD from 2010 would have been a very modest correc-tion. After the second round of adjustments, it would give China (4,42%) almost as much voting power as Germany (4,00%) and increase the total share of the BRICS Group from 11,26% to 13,1%, compared to a decrease of the G7 shares from 42,85% to 39,26% (World Bank 2010: 17ff).

the BRICS underrepresented concerning their economic weight and development, but also are these institutions still dominated by the United States and other OECD members (Langhammer 2014: 530).

Still, the BRICS' disappointment with existing institutions is not the sole reason to undertake the efforts to establish a new multilateral bank. It would have been cheaper and less confron-tational for the BRICS to concentrate on their national development banks (Prado/Salles 2014: 158). However, the two agreements hold high symbolic value to underscoring the BRICS' ability to reach consensus, as well as sending the message towards the developed countries to accelerate the Bretton Woods reforms. Equally, the NDB got an important sym-bolic value directed towards the Global South. The BRICS can use the NDB to 'multilateralise' (cf. Maihold 2014: 6, 7) and by that legitimise their national interests through the strengthening of the South-South ties in trade, investment and development, avoiding the impression of conducting self-interested policies. Thus, beyond targeting projects in the five BRICS countries, the NDB gives the BRICS the chance to present themselves in the Global South as an alternative source of finance to the existing international development system with different development paradigms (cf. Abdenur 2014: 90).

This Policy Brief will discuss these points in detail. However, since the CRA is closely con-nected to the IMF system and only includes the BRICS countries (See BOX 2), its potential to affect the international financial structure is minor when compared to the NDB. This paper will therefore focus exclusively on the NDB. A second section will discuss the NDB's possible governance and development paradigm. The following section will scrutinise the NDB's po-tential to be a new tool for South-South cooperation, before a last section sums up the points made and attempts to put the present perceptions of the NDB in rather cautious perspectives.

BOX 1

The Organisational Structure of the New Development Bank:

- The initial subscribed capital of the NDB will be US$ 50bn., while each BRICS country will start with the same paid-in share of US$ 10bn. (Art. 7c).
- An initial authorised capital of US$ 100bn. allows member countries to subscribe addi-tional shares. Additional 'shares shall be issued at par', unless the NDB's Board of Governors decides differently (Art. 7a, 8b).
- The capital stocks may be increased at the request of the Board of Governors, while no member country is obliged to subscribe for additional shares (Art. 7d).
- The voting power of each member is proportional to its subscribed capital shares. Since all founding member countries initially subscribed the same amount of shares and further shares will ordinarily be issued at par. This is initially equivalent to equal voting powers (Art. 6a).
- With exceptions, decisions in the Bank are affirmed by a simple majority. A 'qualified majority' requires two thirds of the total voting power of all members, while a 'special majority' demands the consent of four of the founding members (Art. 6b).
- The Board of Governors stipulates the number of shares, which can be subscribed by new members and which translate into voting power. However, neither can the voting power of the BRICS be reduced below 55%, nor the voting power of all non-borrowing members be surpass 20%, nor is it allowed that any country other the founding mem-bers acquires more than 7% of the total voting power (Art. 8c)
- These regulations on majorities and share quorum in the NDB do not only prevent one member to act as a veto or blockading power (like the US in the World Bank), but they also allow the BRICS to keep control of important issues; e.g. membership or capital in-crease.
- The membership of the NDB is open for borrowing and non-borrowing countries, which are UN members. Admission of new members is subject to terms and conditions set in the Board of Governors by a special majority (Art. 5).
- NDB's Headquarter will be in Shanghai. The first regional office will be in Johannes-burg.

- The NDB's President is elected by the Board of Governors from one of the founding members on a rotational basis and for a five years term. The first President will be an Indian, supported by one Vice-President from every founding member country (Art. 11,11,13). First Chair of the Board of Governors will be a Brazilian, first Chair of Board of Directors will be a Russian. All staff of the NDB will 'owe their duty entirely to the Bank and to no other authority', also acquitting them from any national obligations or interests (Art. 13f).

(Source: NDB Agreement 2014)

2. A Shift Without Rupture: The NDB's Potential Governance and Its Effect on Cooperation with Established IFIs

Although the BRICS' Agreement on the New Development Bank reached in the Fortaleza summit includes the first decisions on NDB's organisational structure (see Box 1), questions remain over the bank's future governance as well as its paradigm of development coopera-tion. The NDB will be the first actual global alternative to the World Bank Group, controlled by emerging economies (Prado/Salles 2014: 151). However, it will only constitute an alternative or an added value to the current global supply of 17 multilateral development banks and ad-ditional national development banks (Reisen 2013), if it innovates in procedures and objec-tive of its future lending. Likewise, the NDB's operative governance will affect the potential for collaboration between the new bank and established IFI's, which is heralded in the agreement document: '[The NDB is authorised] to cooperate as the Bank may deem appropriate, within its mandate, with international organizations, as well as national entities whether public or private, in particular with international financial institutions and national development banks' (NDB Agreement 2014: Art 3, iii).

A point of reference for first assumptions on the future governance can be the BRICS' na-tional development cooperation practices as well as their respective national development banks, although it is not clear to what degree these domestic approaches will be integrated into a common one. Nevertheless, the first broad characteristic will most likely be a shift in the NDB away from the neoliberal blueprint policy of the World Bank group and the RDBs (Weeks 2014), known as the 'Washington Consensus', which frames development as eco-nomic growth through deregulation, market-liberalisation and privatisation[3]. On the one hand it can be argued that the BRICS benefited from the liberalisation of their own markets, and thus will not challenge the global consensus on a liberal economic order within the NDB (Chen 2014). On the other hand, the BRICS' development did include a stronger role of the state and government in a paradigm, which can be described as 'managing markets' (Culpeper 2014). Allowing stronger regulations and government interventions in the market, this paradigm neglects market-driven policies or structural adjustments within development co-operation (cf. Dossani 2014). Therefore, one would expect that the BRICS' collective rejec-tion of the Washington Consensus and the neoliberal development paradigm (Desai 2013), will be translated into the NDB's governance. At the same time, it is rather unlikely that the NDB will diverge from the approach of OECD-influenced institutions in terms of measuring development with GDP-coefficients as macro-economic growth (Dossani 2014).

Connected to this paradigm shift will be the likely reduction of political or 'value-based' condi-tionality

3 It shall be noted that neoliberal policies were never implemented homogenously. Additionally, in the recent decade the World Bank is undergoing a change in their own policies, away from the strong market fundamentalism and structural adjustment policies of the 1980s and 1990s.

and a rupture with the current consensus to include institutional reforms in develop-ment financing. Based on their strict understanding of national sovereignty, the BRICS and China in particular tend not to include political conditionality in their lending procedure (Mwase/Yang 2012: 5). It is therefore unlikely that the NDB will condition lending to indicators like good governance, human rights, corruption, or environmental and social impact of the financed projects (Dossani 2014; Green 2014: 3; Maihold 2014: 3). As value-based condi-tions for credits are expected to be minor or absent, the likelihood that the NDB will adapt a paradigm of institutional development is also very low. The current approach of the Interna-tional Bank for Reconstruction and Development (IBRD) includes tools of direct financial support for institutionally reforms (including an a priori set legal framework of implementa-tion), institutional based conditionality and technical assistance to improve institutions (Pra-do/Salles 2014: 167f). On the other side, experiences from Brazilian and Chinese develop-ment cooperation show, that they either work within existing institutional contexts (Brazilian model)[4] or even try to circumvent them, if they represent obstacles for the financed output (Chinese model) (Prado/Salles 2014: 169f, 178f). Therefore, a pro-active institutional devel-opment paradigm is rather unlikely to be established within the NDB.

What seems to undermine the development agenda of existing IFIs, in particular the IBRD, could also be seen as the NDB's comparative advantage (Green 2014: 3; Farnsworth 2014). Countries from the South expect 'faster, simpler and cheaper' (Gumede 2014) loans from the new bank (see also Nataraj/Sekhari 2014, Spratt 2013). This implies a novel, more flexible approach to avoid the negative associations with 'old' conditionality, e.g. interference in do-mestic politics or delays of tranches. Moreover, it has been argued that the Chinese paradigm has an added value for development, where alternative finance would otherwise not be available, e.g. in post-conflict situations or fragile/failed states (Prado/Salles 2014: 184; Xiaoyun/Carey 2014: 15). Notwithstanding, even if the NDB is ideologically willing to take those higher risks and reduce conditionality, and even though this risk would be shared in a multilateral bank (in contrast to a national development bank), it would still have to follow international bank standards of lending during its first years. These include 'prudential condi-tionality', which ensures that loans are used purposely and repaid (Green 2014: 2). Conse-quently, it is likely that the bank will require a similar bureaucratic effort from borrowing coun-tries, as does the World Bank System (Weeks 2014)[5]. If the NDB does not follow such standards, it will risk its own rating on the international financial market and by that the nec-essary ability to raise its capital stock (Maihold 2014: 2). On this point, the current NDB agreement only states vaguely, that '[t]he operations of the Bank shall be conducted in ac-cordance with sound banking principles' (NDB Agreement 2014: Art. 3).

A third field in which the NDB has the potential to amend the international architecture of fi-nance and which would influence the NDB's governance is the BRICS' unique expertise in their own developmental past. The BRICS could transfer their experiences in e.g. health, education, urbanisation, agriculture, industrial transformation and even environmental issues, out of the national contexts and national development banks into the new bank. The existing BRICS working groups on several of these issues will also serve as a basis for a coherent paradigm (Abdenur 2014: 88-90; Hochstelter 2014: 5; Xiaoyun/Carey 2014: 6,15). Nonethe-less, the hopes, that the NDB could establish an alternative development paradigm, chal-lenging

4 Prado and Salles describe the Brazilian model as 'Compliant Passiveness', based on the lending governance of the Brazilian Development Bank in sub-national and foreign projects. The Brazilian institute does not follow its own agenda in infrastruc-tural development finance, but gives priority to the alignment with the existing institutions and legal framework of the recipi-ent party (Prado/Salles 2014: 169f). In contrast to that, the Chinese model is characterised by 'Consistent Pragmatism'. Besides the absence of an institutional agenda, Chinese Institutions have a clear output orientation for their financed projects. Con-sequently, they might ignore or circumvent existing legal frameworks, if necessary for the desired output (Prado/Salles 2014: 178f).

5 Here, a possible counter-argument could be that the Chinese model of development finance includes lower standards and obstacles to loan approval: 'Neither CDB [Chinese Development Bank] nor the Exim China Bank follow the steps of the pro-ject cycle adopted by other development banks, which include technical project evaluation, social and environmental project assessment, governance and management appraisal, etc.' (Pra-do/Salles 2014: 186).

the western-dominated development narratives (Dossani 2014), or even incorporate a 'Knowledge Bank' competing with the World Bank must be kept in perspective (cf. Xiaoyun/Carey 2014: 15). These plans demand vast capacities and resources, which will not be available in the early years of the new bank . Therefore, in order to reduce the costs and to be able to operate during the first years, the NDB might have to draw on the modi operandi and expertise of existing IFIs (Prado/Salles 2014: 190,191; Kahn 2014).

To be able to add value to the existing supply of IFIs, the NDB would have to create an alter-native paradigm as well as novel modus operandi of development finance. Nonetheless, it is not only highly probable that the NDB will rely on existing (regional) expertise and strategies (cf. Griffith-Jones 2012: 15), but there will also be an operational need to cooperate with the World Bank and the RDBs. As will be argued in the following section, the capital stock of the NDB will initially be limited. Thus, to guarantee a concessional part of loans to borrowing countries compared to market rates, the NDB will most likely be constrained intp co-financing projects in cooperation with other IFIs (Maihold 2014: 2; Reisen 2014). For this necessary cooperation, the expected institutional blinders of the bank might be an obstacle, albeit the likelihood of a total rupture with the existing system as well as a comprehensive comparative advantage will be unlikely, since the BRICS themselves are still recipients of the World Bank (Prado/Salles 2014: 195; Robles 2012).

3. Hopes and Disillusions: NDB's Potential Role in South-South Cooperation

Since the early plans to establish the NDB, developing countries expected the bank to broaden its future operation beyond the BRICS countries as well as provide a valuable alter-native to the unpopular Bretton Woods system and northern-dominated IFIs. South-South cooperation and capital transfer between developing countries is no novelty (Griffith-Jones 2012: 8), though some proponents claim that this kind of cooperation emphasises 'equality, solidarity, and mutual development and complementarity' (Mwase/Young 2012: 4). At first sight, the NDB agreement seems to answer those hopes of developing countries: 'The Bank shall mobilize resources for infrastructure and sustainable development projects in BRICS and other emerging economies and development countries, complementing the existing ef-forts of multilateral and regional financial institutions for global growth and development' (NDB Agreement 2014: Art. 1). Thus, the NDB embeds in previous plans to strengthen South-South cooperation, like the co-financing agreements for Africa and for Sustainable Development signed at the 2013 Durban Summit (Xiaoyun/Carey 2014: 15). The decision to locate the NDB's first regional office in South Africa an also be seen as a signal for the developing countries.

Despite these intentions, the expectation that 'the New Development Bank will give greater voice to the perspectives and interests of those in developing countries and emerging mar-kets' (Stern/Bhattacharya/Romani/Stiglitz 2013) might be found in concrete projects financed by the bank. It is, however, clearly disappointed in the NDB's organisational structure (see Box 1). For instance, key positions, the conditions to subscribe or the quorum of voting pow-er, show that the NDB is and will be a BRICS-led Bank and no 'Bank of the South'. While this reflects the legitimate national interests of the BRICS, it at the same time misses the opportunity to institute a more democratic organisational structure than the one of the World Bank, as well as to create a common bank and forum of the South (cf. Maihold 2014: 7,8).

As the previous quote from the NDB agreement points out, the new bank will initially focus on the financing of infrastructure projects. Not only the South but also the North expects the NDB to show its main engagement in this field. The demand of emerging and developing countries for investment in infrastructure is estimated to be US$ 1 trillion per year[6], posing a significant obstacle for growth (Griffith-Jones 2014: 1). Private institutions, but also 'traditional donors' are reluctant to finance infrastructure projects with long-term loans due to the high risks (Kahn 2014, Hochstelter 2014: 3). Thus, the NDB could be an additional financial re-source for the BRICS' infrastructural engagements. At the same time, the resulting projects could also entail a similar record of doubtful sustainability. Projects financed by the BRICS countries have often been accused of making the same mistakes as 'traditional donors' (especially the World Bank during the 1960s/1970s), concentrating on big and prominent 'greenfield investments' (Hochstelter 2014: 6)[7], which are criticisable for problems of maintenance (Mwase/Yang 2012: 8) and their lack of a pro-poor impact (Abdenur 2014: 97, 98). Besides negative impacts due to missing safeguard and monitoring principles (Oxfam 2014: 16,17), there are often macro-economic risks, i.e. transaction costs of capital inflows, the disadvantage of local companies linked to 'tied aid'[8] or the over-indebtedness of the recipient country (Mwase/Yang 2012: 15f). The latter can be related to BRICS' focus on individual projects instead of a long-term debt analysis and strategy (Watson/Younis/Spratt: 2013; Mwase/Yang 2012: 9, 15). Eventually, if the NDB neglects institutional development, as argued in the second section, the NDB's infrastructure engagement might be overshadowed by its unsustainability (cf. Voorhout/Wetzling 2013: 5,6).

Assuming that those concerned are eliminated by innovative governance, the NDB's restrict-ed capital poses, still, a major obstacle for a significant contribution to the demand for infra-structure financing . The equal voting power and share subscription limit the option to in-crease the NDB's capital stock by the considerable national reserves of the BRICS countries (especially China's) or new member countries (Reisen 2014). If the BRICS are unwilling to remove such restrictions, the NDB will have to resort to refinancing by issuing bonds on the international capital markets. This would allow the access to cheap capital under the condition of a high rating of the NDB. With a good rating and an early profit rate of the bank of 5%, Stephany Griffith-Jones estimates an annual lending potential of US$ 3.4bn after 10 years and US$ 9bn after 20 years (Griffith-Jones 2014: 9, 10). To put those numbers in perspec-tive, the loans of World Bank and RDBs in 2012 mount up to 20bn US$, or 39bn US$ if con-cessional disbursements are included (Xiaoyun/Carey 2014: 14). Nonetheless, a high rating depends on the condition that the loan portfolio of the Bank is broadened, whereby the NDB's lending to Least Developed Countries (LDCs) as well as high-risk loans (see second section) will have to be limited. If the NDB neglects a high rating for the sake of a higher initial lending capacity, the concessional part of its loan will have to be reduced and by that the financial advantage for LDCs diminishes (Griffith-Jones 2014: 10; Langhammer 2014; Maihold 2014: 2).

Despite these disenchantments, one should not underestimate the fact, that the South-South cooperation of the BRICS countries is usually connected with a package of trade and foreign direct investments, including significant growth spill-overs into LDCs (Mwase/Yang 2012: 14,15). Thus, the NDB can be a valuable contribution to this portfolio, whereby it takes a cat-alyst or middleman role, managing the co-financing with other development banks or private institutions (Gumede 2014; Griffith-Jones 2014: 14; Marsh 2014).

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6 Stern et alt. estimate an annual demand between 800 bn. and 2 trill. US$, while currently only 2-3% of this demand is supplied by multilateral banks (Stern/Bhattacharya/Romani/Stiglitz 2013, see also Reisen 2013). Spratt claims that the BRICS alone will need 4,5 trill. US$ over the next five years, while the demand in Africa is estimated to be 50bn US$ per year (Spratt 2013).

7 A 'Greenfield Investment' is the finance of (infrastructural) projects, where the operational facilities are absent. It can be distinguished from 'Brownfield Investments', where a basic operational structure already exists and has to be further developed or renovated.

8 'Tied Aid' means the restriction of goods and services included in the projects to the supply from the donor country or a specific region. Since this supply does not always guarantee the most suitable or cheapest solution, the tying of aid is disapproved by the OECD Development Assistance Committee and the Paris Declaration.

BOX 2

The Contingent Reserve Arrangement (CRA) - No Challenging of the IMF:

- The CRA is a 'contingent reserve arrangement to forestall short-term balance of payments pressures, provide mutual support and strengthen financial stability' (CRA Agreement 2014).
- Although it is often referred as 'Mini-IMF', the CRA is not an actual pooling of re-sources through a fund. In fact, the CRA is a mutual promise to provide liquidity by the central bank of the 'providing parties'; e.g. via currency swaps (Romero/Nissan 2014). This applies especially in cases of massive capital outflows and the consequent currency fluctuation of the 'requesting party' (Griffith-Jones 2014: 2; Maihold 2014: 3)
- The commitments to the CRA differ between the BRICS summing up to a total amount of US$ 100bn : China provides US$ 41bn, Brazil, Russia and India provide US$18bn each, while South Africa provides US$ 5bn (CRA Agreement 2014: Art. 2).
- The guaranteed access to currency is also rated between the BRICS via particular multipliers: China 0.5; Brazil 1; Russia 1, India 1, South Africa 2 (CRA Agreement 2014: Art. 5a)
- In case of a request, the parties of the agreement will only provide 30% of the guaranteed access to the CRA. The remaining 70% will be linked to the IMF (CRA Agreement 2014: Art. 5c,d). Thus, the aim of the CRA is not to circumvent or chal-lenge the criticised IMF conditionality, embedding into the existing system of short-term loans and having a potential to be an additional safety net (McDowell 2014; Watson/Younis/Spratt 2013)
- To assess the future role of the CRA one can refer to the similarly constructed Chiang Mai Initiative (CMI) of the ASEAN countries, China, Japan and South Korea. The CRA might follow the CMI in its severe monitoring and surveillance problems (Desai/Vreeland 2014; Robles 2014). Moreover, the CMI remained unused during the financial crisis of 2008. This might also be connected to the conflict of interests between providing and requesting parties (e.g. doubts on debt service), a conflict potential that is also contained in the CRA (Eichengreen 2014; Wat-son/Younis/Spratt 2013).

4. Concluding Remarks

The NDB already represents a success of the BRICS group in showing their potential for con-sensus, institutionalisation and closer cooperation. Nevertheless, the NDB's current aim is to put pressure on the Northern nations to adapt the current IFIs in their institutional structure to the tectonic power shift in the international order. Beyond this symbolic value, the impact of the NDB as a so-called 'game changer' or as a new tool in South-South cooperation depends on its future governance, development paradigm and capital potential.

Experiences from each of the BRICS nations show that development finance by the NDB will likely be free of political conditionality. Thus, the NDB will certainly be more attractive for de-veloping countries in the South, which are dissatisfied with the interventionist governance of the World Bank and the RDBs. The Global South hopes for a significant engagement of the new bank in alternative financing of infrastructure projects. Since there is currently no coher-ent alternative development paradigm from the BRICS, lower standards for lending might be problematic concerning environmental, social and economic impacts in borrowing countries. At the same time, in the absence of functional institutions, the sustainability of potential infra-structure projects is disputable as such. Also, the initial capital stock and lending capacity will not allow the NDB to be a real alternative to the existing IFI architecture, as it is expected by the LDCs, especially from Sub-Saharan Africa. There are further reasons to expect that the NDB will at least initially cooperate with the current RDBs and the World Bank system.

While the improvement and reform of the current IFI architecture is surely necessary, the hopes that the NDB be a game changer will have to be toned down, at least for the next dec-ade. The same goes for fears the NDB could undermine existing efforts and standards by established sources of development financing, e.g. good governance and environmental pro-tection. Furthermore, if the BRICS and consequently the NDB are willing to build up a real alternative to the current development paradigm, including an actual contribution to sustaina-bility, this must not only include the South-South principles of development partnership, but must also avoid the 'traditional' lenders' past mistakes.

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