WILL THE BRICS BANK & FUND, AND SAARC DEVELOPMENT BANK BOOST GLOBAL SOUTH?

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When discussing "Reshaping Banking for Changing Times" it is essential to look at what is taking place in the world and the region close to Sri Lanka. The announcement of plans to establish a BRICS Banka and a Fund and a SAARC Development Bank during the middle of 2014 can be considered as important turning points in regard to external bank financing in developing countries. Although the plans may take some time to fully materialize, it will be prudent to take a first look at these initiatives.

BRICS Bank and Fund

The 6th Summit of the BRICS took place in Fortaleza, Brazil in the second week of July 2014 with two landmark decisions, viz., to form a BRICS Bank and a Contingent Reserve Arrangement (CRA or the BRICS Fund) and bring them into operation by 2016. Initiated in mid-2009, BRIC became BRICS in 2010 when South Africa joined Brazil, Russia, India and China to form a grouping of 5 large emerging economies. The key objective of the grouping was to have a bigger say in the global financial order which is currently dominated by Western countries. BRICS represent 40% of the global population, 18% of global trade, and possess US$ 4 trillion in combined foreign reserves.

The large foreign reserves of BRICS and many developing economies in Asia have been mostly invested in the US Gilt-edged Securities and Sovereign Wealth Funds over the years. Despite the low yield in such securities and funds, the bulk of the reserve surpluses of emerging and developing economies have been invested in them mainly due to the strength and international standing of the US dollar. Had these reserves been invested in emerging and developing economies, they would have not only bridged the massive infrastructure deficit of those countries but also uplifted millions of people out of poverty.

For instance, the Economic and Social Survey for Asia and the Pacific Report 2010 produced by the ESCAP has estimated that if US$ 800 billion per annum was allocated to the Asia-Pacific region, the infrastructure deficit could have been covered in the region in a couple of years. ESCAP in fact, argues that the rate of return on investing part of the reserves in the region would have been higher than the returns from the US market, and for this purpose only

5% of the US$ 5 trillion reserves in the region could have been used to create an Infrastructure Fund. Such thinking influenced the Chinese and it led to China proposing to set up an Asian Infrastructure Investment Bank on similar lines to Japan taking the initiative to form the Asian Development Bank in 1966.

Such thinking also influenced the BRICS leaders and they were convinced that the emerging and developing economies had enough savings and foreign reserves to establish a development bank that could provide funds for infrastructure projects in these countries and in 2011 the need for a BRICS Bank was mooted. The decision at the 6th BRICS Summit was to aim at US$ 100 billion total capital for the bank with US$ 50 billion made available as start-up capital by the 5 countries at the beginning. The bank will be located in Shanghai with an Indian as the Chairman.

It has been estimated that close to US$ 1 trillion is required per annum to meet the infrastructure deficit in emerging and developing countries. The existing local, regional, and multilateral banks cannot meet this requirement and the new BRICS Bank will be able to supplement the existing banks. The BRICS Bank will benefit from the experience of the currently functioning development banks like the Chinese Development Bank, Brazilian BDNES, South African Industrial Development Corporation, etc. It will not only complement the existing network of banks but also have the late-comer advantage.

The CRA was very much prompted following the outflow of capital from emerging and developing country markets (after mid-2013) which was triggered by US scaling back on monetary stimulus known in US jargon as "tapering Quantitative Easing". The CRA will be a currency swap arrangement allowing for emergency support to BRICS countries experiencing a balance of payment crisis. The CRA will be established with US$ 100 billion with China contributing US$ 41 billion, South Africa – US$ 5 billion, and others filling in the rest with US$ 18 billion each. CRA will have no involvement with the IMF unlike the Chang Mai Initiative Multi-lateralization where 30% of member's quota is accessible (when having an IMF programme) with IMF concurrence. The CRA will complement the IMF.

The launch of the BRICS Bank and CRA will be concerted steps for reshaping the Western dominated international financial system. It will be the first step to challenge the domination of the US influenced World Bank and the IMF and the US dollar. It may be worth recalling that the attempt made by Japan soon after the East Asian Financial crisis to form an Asian Monetary Fund was shot down by the IMF and the US Treasury. Such tactics will become increasingly difficult with the BRICS.

The establishment of two large BRICS financial institutions will also pave the way for BRICS advancing reforms in international financial architecture and tilting it in favour of emerging and developing countries as their voice is still weak in the G-20 dialogue. This weakness is amply demonstrated on the lack of progress in IMF quota and governance reforms which have been in the global debate for some years now.

Needless to say, many questions still remain unanswered. Now that the BRICS Bank is on the pipeline, will China give up its idea of establishing the Asia Infrastructure Investment Bank? Will the BRICS Bank give large loans at a more concessional rate than the World Bank? How much more 'policy space' will the CRA provide compared to the IMF's more liberal conditionalities since of late after the global economic crisis? To what extent will BRCIS represent the interest of all developing countries? Already, Indonesia, Turkey, Argentina, Egypt, Iran, Nigeria and Syria have expressed an interest in joining BRICS. Will they be taken in?

We may find answers to these questions once the two BRICS initiatives start gathering momentum. At least for now, all developing countries will feel that their interests will be represented more effectively by the BRICS in the global financial dialogues. Only time will tell whether this will be the case.

SAARC Development Bank

In the third week of July 2014, the Narendra Modi government mooted the idea of a SAARC Development Bank (SDB) along the lines of the BRICS Bank announced by the 6th BRICS Summit. It was reported that India will propose the SDB at the SAFTA (South Asia Free Trade Agreement) Ministerial Council in Bhutan and later at the forthcoming SAARC (South Asia Association for Regional Cooperation) Summit in Kathmandu, Nepal.

This is not something new. As far back as 1998, the report of the SAARC Group of Eminent Persons (GEP) highlighted the need for a development bank for the South Asian region. The report titled: "SAARC Vision Beyond the Year 2000", strongly argued for a South Asian Development Bank in addition to the South Asian Development Fund of US$ 500 million. It said "The South Asia Development Bank should mainly finance commercially viable infrastructure projects and trade-creating joint venture projects". What the GEP had in mind for the South Asia Development Fund was to play a role to assist the LDCs to achieve higher levels of development, and particularly enhance their export production capacity. A similar Fund operates in EU for economically weaker members like Ireland, Poland, etc., to assist them to catch up with others.

Despite nearly three decades of SAARC and two decades of preferential trade via SAPTA and SAFTA, intra-regional trade in South Asia remains at a low level of 5%. Among other factors, two issues that explain this low level of intra-regional trade is poor infrastructure connectivity in the region, and the lack of a supply base in small South Asian countries to exploit the growing market demand in the large South Asian countries, in particular, India.

Both these problems can be addressed if South Asia could have more funding for physical infrastructure development and improving regional connectivity. In that context, a readily financing SAARC Development Bank can be a key player in stimulating intra-regional trade in the region. Needless to say, to play such a role the SDB should function along the lines of the World Bank and the ADB and should extend concessional financing to SAARC member countries. The details pertaining to the Bank's start-up capital, annual budget, and functioning mechanisms will have to be worked out by the member states.

A recent report released by the World Bank sheds some light on the annual financial resources required and sectors to which such resources should be channelled. The report titled: "Reducing Poverty by Closing South Asia's Infrastructure Gap" was released in early 2014 and according to the report, South Asia has a US$ 2.5 trillion worth infrastructure deficit. The gap is defined as the difference between South Asia's development goals and its actual capability to meet these goals. The said amount according to the report is required to invest in transport, water supply and sanitation, solid waste management, telecommunications, and irrigation to bridge the infrastructure gap over the next ten years. The report says that one third should be spent on transport, one third on electricity, and the remainder on water supply and sanitation, solid waste management, telecommunications, and irrigation.

The SAARC Development Fund was established in 2005 due to the shortcomings of the South Asia Development Fund that functioned from 1996 to 2004. In 2010, the SDF Secretariat was established in Bhutan with three Windows – social, economic and infrastructure, and a total fund of US$ 300 million. So far, only the social window has been active with fund allocations made to various poverty alleviation and social development projects in the region. The other two windows have been dormant, perhaps due to the small capital base and problems of identifying viable projects for funding.

If the SDB comes into operation, it may be prudent to take out the infrastructure window out of the SDF and make it a part of the SDB. The economic window which is defined as non-infrastructure projects related to trade and industrial development, agriculture, service sector, science and technology, etc., can remain under the SDF with more focused areas for fund allocation.

In addition to what the World Bank report has identified, the SDB can focus on highways, ports, etc., that will play a key role in improving the connectivity in the region. SDB can complement the current sub-regional economic cooperation projects funded by the ADB and other multilateral financial institutions in South Asia. It could also draw lessons from existing regional group specific development banks such as Caribbean Development Bank for CARIFTA (Caribbean Free Trade Agreement) where it finances specific projects in national, sub-regional and regional development programmes.

In all probability, the Indian proposal in establishing an SDB will be endorsed at the 18th SAARC Summit in Kathmandu, Nepal scheduled in the last week of November 2014. While the SAARC member states would welcome this initiative, it is disappointing to note that an idea mooted in 1998 never got into the SAARC agenda for 16 long years. And this has happened in a regional grouping which is lagging behind most others and referred to as the least integrated region in the world.

Concluding remarks

The establishment of these two banks and the fund show the desire on the part of the global South to be less dependent on the developed countries in the global North. It also reflects the lack of confidence of developing countries on the plans by G-20 to work out an international financial architecture with new rules and regulations to govern international financial flows. The discussions have gone on for too long in the G-20 with little ground level results. Even the quota reform of the IMF (to have more representation of developing countries in IMF functioning) is at a standstill.

The prime objective of these two banks will be to provide more unconditional loans, especially focused to bridge the infrastructure deficit of the global South. This will certainly give a boost to the global South although some critics have argued that these institutions may be 'too little, too late'. Similar criticisms prevailed during the establishment of the ADB and the African Development Bank and they have been proved to be unfounded. In the global North, there is some fear that the two new banks might have weaker safeguards against environment damage, pollution and other hazards often associated with massive infrastructure projects. If these fears are to be addressed, the Northern countries will have no option but to be more serious on international financial architecture and cooperate with the Southern members of the G-20 to come up with some concrete reforms to allay fears of the global South.