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Yet another development bank: the BRICS bank

By Helmut Reisen,
ShiftingWealth Consulting

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Yet another development bank: the BRICS bank

Bonn, 13 May 2013. In 2000, an influential US Congress Report of the International Financial Institution Advisory Commission (better known as the "Meltzer Commission"), had concluded that development assistance should be administered through performance-based *grants* rather than (soft) *loans*. A year earlier, the heavily indebted poor country (HIPC) initiative had resulted in the cancellation of multilateral debt to a selected group of poor countries. The Meltzer Commission report based its message on the ´equivalence theorem´. Soft loans, as opposed to commercial loans, carry a *grant element* which reflects the financial terms of a loan: interest rate, maturity and grace period. The grant element is a measure of the concessionality, or softness, of an Official Development Assistance (ODA) loan. In principle, a soft loan can be bought up by a private investor and then sliced into a market loan and a grant; hence the *term grant/loan equivalence*. The Meltzer Commission intended to weaken the World Bank; its message implied that multilateral development bank could be closed and be replaced by a mix of grants and private loans. At first glance, the equivalence theorem holds. However, high risk spreads imposed on poor countries, the leverage effect of soft loans per dollar of aid money, and the evidence on stimulating tax revenues and growth advocate in favor of soft loans.

At the recent BRICS summit in Durban finance ministers of Brazil, Russia, India, China and South Africa - the countries that form the BRICS - agreed to form a development bank, but failed to reach consensus on the bank's size or the member countries' contributions to its capital (see Peter Wolff, The Renaissance of the Development Banks). One problem: the size of the bank´s seed capital, targeted at $ 50 bn. South Africa, by far the smallest of the BRICS countries, might be unable to afford her $10 bn contribution. For South Africa – by far the smallest country among the BRICS - $10 bn are the equivalent of 2.5% of its GDP and one tenth of her annual tax receipts. The initial idea was that all BRICS should contribute an equal share of seed capital to avoid, say, China providing a greater share of the funds and winning control of the bank.

Would a new BRICS development bank not just add to an already overly complex system of multilateral development finance? Its creation might add to redundancies, mission creep and overlap beneficial for economists´ and ex politicians´ employment but burdensome for taxpayers and soft-loan recipients. Besides mighty national (bilateral) development banks, such as Brazil´s BNDES, the China Development Bank or the German KfW, a recent list of multilateral development banks counts seventeen in existence already now. Also the mighty export credit banks, such as China´s or India´s ExIm Banks, stand ready to finance infrastructure in poor countries (albeit not through soft loans).

Even Angel Gurria (currently the SG of the OECD), joint with former US Federal Reserve Chairman Paul Volcker a staunch defender of multilateral development bank lending to emerging countries in response to the Meltzer Commission, raised some critical questions with respect to the new BRICS bank. In an interview with The Guardian (9 April 2013) he wondered whether there would be enough policy conditionality (implicitly assuming that this is what improves policy quality, rather than home-grown reform) imposed on prospective borrowers by the new BRICS bank. Gurria also questioned how it would fit into the development landscape. "What kind of niche or blind spot, what is the missing link are the Brics trying to fill?" asked Gurria in that interview.

Gurria´s justified questions can be answered. Indeed, they were given before his interview with The Guardian, notably by G-24 director Amar Bhattacharya (G24), Mattia Romani (Global Green Growth Institute) and former UK chief economist Lord Nicholas Stern (LSE) at the end of 2012, in a report entitled Infrastructure for Development: Meeting the Challenge. While the authors do not openly call for a BRICS bank (it´s none of their business, after all), they deliver some analytical and quantitative elements that would justify the case for a new BRICS development bank. Here is my list:

- Infrastructure remains the growth constraint number 1 in most emerging and poor countries. Green growth, industrialisation and urbanisation need (new sources of) energy, transport, water, information and telecommunication technologies (ICT) for these countries to develop further. 1.4 billion people have no access to electricity, 900 million have no access to safe drinking water and 2.6 billion are without access to basic sanitation. Annual financing needs in those countries are estimated at between $ 1.8 and 2.3 trillion. Annual infrastructure financing from multilateral development banks and overseas development assistance is likely to amount to no more than $40-60 billion, or 2-3% of projected needs.

- In principle, the private sector can finance these basic needs. But beware of disillusion: Long tenors (gestation periods until a bankable rate of return is reached), high upfront cost and unstable credit cycles prevent the private sector to sufficiently finance infrastructure projects other than ICT. Private-public partnerships have repeatedly disappointed the hyped expectations, but create huge contingent public liabilities. Private infrastructure finance virtually collapsed from 2007, partly due to Basel prudential bank capital regulation (Basel III) and banks´ deleveraging.

- A BRICS development bank would catalyse the global development finance scene. Classic ODA, as long as it remains heavily tilted toward grants and is hampered by fragile public finances in DAC countries, is almost irrelevant for infrastructure finance in poor countries. China finances more infrastructure in Africa than the (currently shrinking) ODA and multilateral development banks combined. Multilateral development banks have been seen to be risk averse (the same seems to hold for national development banks, such as BNDES, which tend to finance big companies). The World Bank-IMF Debt Sustainability Framework places too much emphasis on restrictive debt thresholds and too little on the growth impact of infrastructure investment, hence still holding back growth prospects in developing countries, including through co-financing regional development banks. Combining infrastructure financing from different BRICS sources -the new BRICS bank joint with development banks, sovereign wealth funds, and pension funds - would help pool project risks, hence reduce them and attenuate risk aversion.

The recalibration of the world economy toward the BRICS is not yet fully reflected in the global financial architecture. Notably Europe has been a stumbling block toward reform, staying overrepresented in the executive boards of World Bank, IMF and regional development banks. Overrepresented, Europe´s voice is not united and hence weaker than necessary. The normative power that would be unleashed by creating the BRICS bank would probably also improve representation and voice of the emerging and developing countries in the existing Bretton Woods institutions. A new BRICS bank would help close infrastructure gaps, support the process of global income convergence in favor of poor countries, finance global public goods, reduce international current-account imbalances, and direct abundant central bank liquidity into productive uses. The new bank will improve the credibility of the BRICS group itself and hasten badly needed changes in the global governance structure, which would be rebalanced away from its US dependence of the last century. The BRICS development bank deserves our support.

Helmut Reisen
ShiftingWealth Consulting