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INDEPENDENT NEWS FROM RUSSIA

Faced With Western Freeze-Out, BRICS Bank Is a Coup for Russia

By Peter Hobson

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President Vladimir Putin arriving at the Planalto Palace in Brazilia Monday.

Top of the agenda at the sixth summit of the BRICS developing nations beginning Tuesday is the founding of two multilateral financial institutions designed to erode the dominance of the World Bank and International Monetary Fund as arbiters of the global economic system.

For Russia, the creation of a $100 billion BRICS development bank and a reserve currency fund worth another $100 billion is a political coup. Just as the West freezes Russia out of its own economic system as punishment for its politics in Ukraine, Russia is tying itself into the financial superstructure of the next generation of economic heavyweights: India, Brazil, China and South Africa.

The World Bank and the IMF have come under criticism from the rapidly developing BRICS, who together account for 20 percent of global GDP and 40 percent of the world's population. In their view, the two financial institutions are dominated by the rich nations of the G7 and attach stringent conditions to their lending that impinge on the economic sovereignty of its members.

Far from assuaging their complaints, efforts to reform the 70-year-old institutions have stalled. Proposed updates to the IMF that would grant increased influence to developing economies have been languishing in the U.S. Congress since 2010 and were blocked once again in April.

If the framework agreements due to be signed at the BRICS summit in Fortaleza, Brazil, are ratified at home, the new bank and the reserve fund could ease some problems for the BRICS countries. U.S. tightening of the dollar supply starting last year has caused a wave of crises in developing nations as the cash inflows of the past decade begin to reverse themselves.

Meanwhile, the World Bank estimates the annual need for infrastructure investment in low- and middle-income nations at $1 trillion dollars and rising — far beyond its own capacity. The World Bank reports that it gave out $52.6 billion in 2013, not all of which went to infrastructure projects.

The New Order

Last week, Russian Finance Minister Anton Siluanov shed some light on the mechanics of the fledgling institutions.

The BRICS bank will have starting capital of $50 billion, made up of $10 billion in cash and $40 billion in guarantees, Siluanov told RIA Novosti. Each BRICS country will contribute $2 billion to the starting capital pot. In the longer term, capital will rise to $100 billion.

The bank is to be named the New Development Bank, Siluanov said, signifying that other developing countries are welcome to join, although the BRICS countries' share will not be allowed to fall below 55 percent.

Likely headquartered in Shanghai, the bank is expected to make its first loans in 2016 and will focus on bi- or multilateral development projects involving companies from participant countries. According to a report for the UN released in March by Columbia University economist Stephany Griffith-Jones, the bank could could ramp up lending to $34 billion per year within 20 years.

While the New Development Bank will be based on equal shares, the $100 billion contingency dollar reserve fund, which Siluanov referred to as a "mini-IMF," will factor in China's extra weight. China will contribute $41 billion to the total pool; South Africa will give $5 billion; and Russia, Brazil and India will contribute $18 billion each.

However, a system of multipliers will compensate for the imbalance in contributions — China will be able to use half of what it put in, or $20.5 billion; South Africa will have access to double its contribution, or $10 billion; while Russia, India and Brazil will be able to receive the sum that they committed, Siluanov said.

Each country would hold the amount in their own reserves. In the event of a crisis, the pool would be used to buy up the unlucky country's local currency to staunch the outflow of capital.

The five countries will be able to receive a third of their contributions on request. But, perhaps in an indication that it is not easy to escape the existing international financial system, further aid will depend on the existence of an IMF stabilization program for the country.

The BRICS countries will be represented by their finance ministers or Central Bank chiefs, who are to sit on the governing body of the contingency fund. The fund will be steered by representatives of the participating countries' Central Banks under the supervision of a BRICS nation, selected on the basis of an annually rotating presidency.

Will It Work?

Just before flying to South America, Russian President Vladimir Putin repeated his well-worn line about the emerging multipolar global order, but if the aim of the new institutions is to rival the rich world's international financial infrastructure, the BRICS are an odd group to take on the task.

Lumped together in an acronym by Goldman Sachs economist Jim O'Neill in 2001, 13 years on the BRICS countries are an amorphous bunch with little to bind their aims, said Maxim Osadchy, head of analysis at Moscow-based Corporate Finance Bank. Politically, economically and geographically, the countries have little in common.

Beyond that, there is China's overwhelming economic force within the group. China's economy is bigger than those of all the other BRICS combined. And it is growing faster. At its current rate, China will add a new Russia to its economy within 2 1/2 years. India, with its vast population, is the only other BRIC with the obvious potential to play in the same ballpark.

By virtue of this imbalance, "first fiddle [in the new institutions] will be played by China and India," Osadchy said, and these two will likely gain the most.

But given the incoherence of the group, he added, the bank may well be "stillborn."

Financially, Russia may not even need the new structures. Even amid a series of economic blows this year, including capital outflow resulting from the Ukraine crisis, a global redistribution of capital toward developed markets and the likely reluctance of multilateral lenders to finance new Russian projects, the country is well equipped to defend itself. Russia is sitting on foreign currency reserves worth a whopping $480 billion and is looking forward to a healthy oil revenue-funded budget surplus this year.

As for the infrastructure projects that development banks typically fund, the Russian government already spends billions of dollars on financing infrastructure each year.

But access to funding alone may not be the point: If the New Development Bank is able to match the efficiency of the World Bank and the IMF, it could be a more effective financier of infrastructure projects than the Russian government, which is often accused of wasteful spending, said Alexander Morozov, chief economist for Russia at HSBC.

According to Morozov, excessive Chinese sway over the institutions is precluded by the equality written into the agreements: It is "far from domination," he said. Indeed, Russia stands to gain from roaring Chinese growth, as it generates demand for new infrastructure between the two countries.

No Polarization

Russia's recent experience over Ukraine has shown that the West is ready to eject politically unruly countries from its economic system. If they are able to successfully establish themselves, the BRICS's inauguration of multilateral financial institutions rooted outside the reach of Western oversight could provide insulation from Western economic clout to countries like Russia and China, whose growth threatens to put it at odds with Japan, a U.S. ally and G7 member.

However, there is no reason to think that the BRICS newbies must clash with their older cousins provided the desire to cooperate is there, Morozov said.

"The more good development banks, the better," he concluded.

See also:

[Putin Calls on BRICS Countries to Play Bigger Role in Opposing West]

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