

# Banking with a Difference

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The establishment of the New Development Bank by the BRICS countries is a significant development which could have some impact on multilateral lending for infrastructure in the countries of the South. But if the new bank is to make a difference and alter the international development finance landscape, democratic forces in the BRICS countries and elsewhere should pressurise their governments to act in ways that differentiate the NDB from the currently dominant global institutions in terms of funding patterns, rules and terms.

The world has one more multilateral development bank, the New Development Bank (NDB) that was established on 15 July 2014. With authorised capital of \$100 billion and initial subscribed capital of \$50 billion, the bank's founding partners are the countries in the BRICS grouping (Brazil, Russia, India, China and South Africa). These five countries, which share equally the paid-up capital in the form of actual equity (\$10 billion) and guarantees (\$40 billion), will remain dominant in perpetuity with their aggregate shareholding never falling below 55%. Organisationally too the BRICS bank seeks to be even-handed: India gets the first chair of a rotating presidency, China gets to host the bank's headquarters in Shanghai, South Africa gets to host the first regional office, the first chair of the board of governors is from Russia and the first chair of the board of directors from Brazil.

In itself, the creation of a new multilateral development bank should not be considered out of the ordinary. A 2009 study from the Association of Development Financing Institutions in Asia and the Pacific estimated that there were over 550 development banks worldwide, of which 32 were in the nature of international, regional or subregional (as opposed to national) development banks. The news that one more has been added to the list should not elicit much excitement.

Yet the news that the NDB had been created was received in some circles with much enthusiasm, in others with disappointment and in yet others with a degree of discomfort. The reason is that it is owned and controlled by the BRICS, an unusual grouping of "emerging" countries that started life as a mental construct of an investment banking analyst, Jim O'Neill, and then became a reality as the countries concerned bought into the idea. Four of their leaders

first met in New York in 2006 and then constituted a formal group at a summit of four of the current five members in Yekaterinburg in 2009. South Africa joined the group in 2010.

Consisting of large countries, considered by some to be characterised by substantial potential for rapid growth, they are seen to be among the possible future giants that would challenge the currently dominant economies in the Organisation for Economic Co-operation and Development (OECD). With two-fifths of the world's population and a fifth of the world's gross domestic product (GDP), the BRICS are indeed a formidable grouping. That makes the NDB different because most existing development banks are in terms of shareholding, voting rights and management dominated by one or the other developed country, especially from among a set defined by the United States (US), Germany, France and Japan. Other countries have been long arguing for a reshaping of these shareholding and control structures to account for the changes in the relative economic and political importance of individual countries in the global order, but progress with such restructuring has been slow and marginal. The creation of the NDB is seen as being a response to the intransigence of countries that dominate the existing multilateral development banking infrastructure, especially the US, and a declaration of the exasperation of emerging nations with the current global financial architecture. Its founding membership also gives it a much greater chance of success than past attempts like that with the Banco del Sur (Bank of the South) in establishing a successful competitor to the currently dominant multilateral development banks.

## Would It Make a Difference?

While these factors make the creation of the NDB a matter of significance, would it make a difference? There are development banks from the South such as the China Development Bank and Brazil's Brazilian Development Bank (BNDES) that are large and have been expanding

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their international lending operations, especially in other developing countries, in recent years. But this is an instance of *multilateral* cooperation among a set of so-called “Southern countries” in the governance of a development bank, which infuses checks and balances into its operations. Moreover, along with the creation of the NDB, the summit at Fortaleza in July this year also established a BRICS-controlled Contingent Reserve Arrangement (CRA) with committed resources of \$100 billion, defined as “a framework for the provision of support through liquidity and precautionary instruments in response to actual or potential short-term balance of payments pressures”. Since that involves entering an area now dominated by the International Monetary Fund (IMF), controlled again by the developed countries led by the US, the perception that the NDB would shift power relations in the multilateral development-banking infrastructure seems corroborated.

It could, for three reasons. First, in a world characterised by substantially enhanced possibilities of mobilising private resources in debt and equity markets, poorer developing countries are discriminated against and kept out of such markets. Since the NDB is owned and backed by governments in a set of “emerging economies”, it is likely to be able to mobilise substantial resources at reasonable cost from private markets and channel them to needy countries. Second, inasmuch as the allocation of these resources would be determined by the representatives of governments from the five BRICS countries, it could direct resources to projects that are more in keeping with the requirements of the Southern countries. Third, with control in the hands of the BRICS governments that are subject to the influence of local democratic forces, the terms on which the institution lends could in time reflect “Southern” requirements and sensitivities. For example, there has been developing country recognition that the kind of policy conditionalities attached to lending by the North-dominated Bretton Woods institutions limits national policy space in ways that favour the dominant nations

and discriminates against the development interests of poorer countries and that of the disadvantaged sections of the populations in them. If, therefore, NDB lending occurs on terms that are more sensitive to the requirements of developing countries the impact can only be positive. In fact, conditionalities could be so set as to distribute a part of the benefits to the poor among developing country populations.

This is particularly important because of the role that development banks play. Unlike conventional banks, they focus on long term financing, and provide credit to more capital-intensive projects, especially of an infrastructural kind. Since such lending involves higher than normal debt to equity ratios, development banks to safeguard their resources closely monitor the activities of the firms they lend to, resulting in a special form of “relationship banking”, with far greater lending influence on the technology and on operations. The expectation is that such influence would be more Southern oriented in the case of the NDB than, say, the World Bank.

### State-Capitalist

But this point should not be pushed too far. In the final analysis development banks are instruments of state-capitalist development. Such specialised institutions are needed because of the shortfalls in the availability of long-term finance for capital-intensive projects in market economies, resulting from the maturity and liquidity mismatches involved. In non-market economies, allocations for such investments can be made through the budget and financed with taxes or the surpluses generated by state-owned enterprises. If the instruments are state-capitalist, they are unlikely to serve non- or anti-capitalist objectives that sacrifice private profit to deliver social benefit. So the best that can be expected of the NDB is that it would serve better the interests of capitalist development in the less-developed countries (with some concern for sustainability and inclusiveness) than would multilateral banks that are dominated by and serve as instruments of the developed countries.

Whether even this difference would be material depends on three factors. The first is the degree to which the emergence of the NDB alters the global financial architecture and perhaps, therefore, the behaviour of the institutions currently populating it. The second is the degree to which the BRICS bank can differ in its lending practices from the institutions that currently dominate the global development-banking infrastructure. And, the third is the degree to which a development bank set up as a tool of state-guided development by governments in countries pursuing capitalist and even neo-liberal development trajectories can indeed contribute to furthering goals of more equitable and sustainable development.

As noted earlier, the establishment of the NDB does make a difference to the global financial architecture. More so because of the relatively large authorised capital base of \$100 billion and the paid-up capital commitment of \$50 billion. Though established as far back as 1944, the capital base of the International Bank for Reconstruction and Development (IBRD) (the core lending arm of the World Bank) is only \$190 billion of which only \$36.7 billion is available as actual equity, the rest being “callable capital” that countries have committed to provide when called upon to do so. So even at inception the NDB seems significant in size compared to rivals still controlled by the developed industrial countries.

### Focus on Infrastructure

Regarding operational practices, there are clear signals that the NDB’s lending is to be focused on large infrastructural projects that are seen as central to the development effort. Both cash-strapped developing country governments and the private sector are unable or unwilling to fully fund the lumpy investments involved in these long-gestation projects, making the role of development financing institutions crucial to development. An infrastructural focus has therefore been a characteristic feature of many of the currently existing multilateral development finance institutions as well. So if the NDB is to

be different from the World Bank or regional development banks like the Asian Development Bank, the difference would have to be reflected in the choice of projects within the infrastructural space, in the terms on which large loans are provided, and in the concern it shows for keeping development sustainable and inclusive. Inasmuch as the institution has been established by a set of emerging nations that do not exercise hegemonic power in the international economy, it is possible that lending behaviour could reflect such differences, which possibly accounts for the discomfort of the currently dominant institutions.

However, the NDB is fundamentally not detached from the global financial system. Being a bank, even if a specialised one, it must ensure its own commercial viability. And it must do so when a large part of the resources it lends would be mobilised from the market. While guarantees from the governments of its shareholding countries would improve the institution's rating and reduce its borrowing costs, those costs will have to be borne. So any form of socially concerned lending that does not yield a return adequate to cover costs and deliver at least a nominal profit will be ruled out. There is only so much an institution whose activities are constrained by market realities can do.

In addition, the procedures finally adopted would be influenced by the nature of the governments that control the new institution, and paths of development pursued in countries that associate with the bank either as providers of finance or borrowers. The NDB does not decide on the projects that come up for lending. It would only choose among projects that apply for lending support. In that choice, the norms that shareholding governments apply in their own contexts would play a role. Moreover, wanting to be seen as respectful of the sovereign interests of borrowing countries, the NDB would be careful not to frame its lending rules in ways that threaten the policy sovereignty of borrowing countries. If the countries that approach the institution are pursuing neo-liberal strategies, there may be

clear limits in terms of what the NDB itself can achieve.

### Mirroring Bretton Woods?

There are other reasons why the NDB may not live up to the expectations it has generated in some circles. To start with, the NDB not only keeps membership open to any United Nations (UN) member, but provides for a category called non-borrowing members, which can as a group acquire, with the consent of the board, shares that gives them voting power of up to 20% of the total. This gives developed countries entry into the bank's decision-making apparatus. Along with the declared possibility that the international financial institutions would be granted the status of observers in the meetings of the board of governors, a presence and voice for the developed countries in the NDB seems likely. They could exploit that presence and differences in the degree of developed country dependence among the BRICS, to reduce the effectiveness of the NDB as an "alternative" institution.

This possibility is signalled by features of Article 5 in the treaty establishing the CRA, which specifies the maximum borrowing limits and the terms of borrowing by members of the arrangement. The article specifies a maximum borrowing limit for each member, which is a multiple of the financial commitment made by the member. Access to 30% of this maximum (the delinked portion) is available to a member based only on the agreement of the "Providing Parties". The remaining 70% (the IMF-linked portion) can be accessed in part or full only if, in addition to the agreement of the providing parties, the Requesting Party can provide evidence of

an on-track arrangement between the IMF and the Requesting Party that involves a commitment of the IMF to provide financing to the Requesting Party based on conditionality, and the compliance of the Requesting Party with the terms and conditions of the arrangement.

This substantially dilutes the role that the CRA can play as an alternative to IMF in offering balance of payments support to a distressed economy. If the CRA is being made a mere extension of

the IMF, the possibility that the NDB can imitate the World Bank is also real.

It may be too much to expect the NDB (as some non-governmental organisations (NGOs) do) to adhere to sustainable development norms that its financing pattern does not permit and the governments backing the organisation do not respect. But, as noted, there are indications that the NDB and the CRA may not be too different from and completely independent of the World Bank and the IMF. Formally these institutions introduce more plurality into the international financial and monetary landscape. But in practice their presence does not guarantee significant difference. The decision of the BRICS to set up mini-versions of the World Bank and the IMF seems to be more a symbolic declaration of resentment at the failure of the US and its European allies to give emerging countries a greater say in the operations of the Bretton Woods institutions. It may also reflect an effort by each member of the BRICS grouping to leverage this show of strength to extract as much benefit as it individually can from any changes in the international system. The desire to redress the obvious inequities in the global financial system seems far less important.

So a first effort of democratic forces in the BRICS countries and elsewhere should be to pressure the governments involved to act in ways that differentiate the NDB and CRA from the currently dominant global institutions in terms of funding patterns, rules and terms. If in the process the NDB is forced to show greater respect for norms of sustainable and inclusive development than the Bretton Woods institutions do, it would be a major advance.

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