Banking on a New World Order

The establishment of a BRICS bank may see a geopolitical shift from developed countries to developing ones

:: Stephen Spratt

The BRICS bank is finally born. After a long pregnancy, the New Development Bank (NDB) is here, carried into the Brazilian sunshine by its exhausted, but relieved ‘parents’. As well as conveying richly deserved congratulations, now seems a good time to reflect on how we got here, and also to consider the prospects for this fledgling bank. Two questions arise. First, as there’s no shortage of multilateral finance institutions, why create another one? And second, given the characteristics of this new bank, and the world it’s been born into, will it be able to fulfil its parents’ ambitions?

G-20 Takes Centrestage

The first question has at least four answers: geopolitical shifts, static voting rights at the World Bank and IMF, shortfalls in financing for infrastructure, and the national priorities of the BRICS countries.

For geopolitics, an historic shift from old to the rising powers is under way. Economically, this can be seen most clearly through long-term growth prospects. Politically, the locus of decision-making is moving from the G-7 to the G-20. Financially, the 2008 crisis has left old-power governments and their banks mired in debt and toxic assets. While growth has slowed in the emerging economies, and prospects brightened in some old powers, few doubt the depth or permanence of this shift.

One purpose of the NDB is simply to reflect this. Had existing institutions adjusted this might not have been necessary, but despite years of tortuous negotiations little has changed. I will not dwell on well-documented injustices, but simply note that Belgium has more IMF votes than Brazil. Tired of waiting for their economic weight to be reflected in international financial institutions, the BRICS countries understandably decided to set up their own.

And there is a real need for finance, particularly in the NDB’s focus areas of infrastructure and sustainability. The annual infrastructure spending gap in developing countries exceeds $1 trillion, and this rises by 15% when climate change adaptation and mitigation costs are factored in. Clearly, anything that increases infrastructure finance in developing countries is a very good thing.

What about national ambitions? It is well-known that there have been tensions about the NDB’s voting based on economic weight would see China dominate; only China and Russia run surpluses for which the NDB might originally have been a conduit; and then there are the questions of where to locate, and whether non-BRICS should be able to join and on what terms.

Capital Constraints

This brings us to the second question: will the NDB be able to fulfil its parents’ lofty ambitions?

As a geopolitical statement, it has already done so. Media interest remains high, the World Bank is increasing spending on infrastructure, and many development finance institutions are engaged in champ offensive in developing countries as they attempt to retain market share.

Whether it will affect the infrastructure funding gap is more doubtful. Subscribed capital is $50 billion, of which $10 billion is paid-in, and authorized (i.e. potential) capital is $100 billion. To put this in perspective, subscribed capital in the World Bank and Asian Development Bank is $223 billion and $162 billion respectively. Nationally, the China Development Bank has assets in excess of $1 trillion, and Brazilian Development Bank $333 billion. Compared to the funding gap the additional lending that the NDB’s capital could add to this mix is a drop in the ocean.

Recognizing this, mechanisms to circumvent the capital constraints have been designed in. As well as lending up to 100% of its subscribed capital and reserves, the NDB may also create or manage ‘special funds’. These are to be separately funded and managed, with restrictions on structure and size vague enough to allow plenty of wriggle room.

For national ambitions, rewards seem quite evenly spread. The bank will be headquartered in Shanghai, with the first regional office in Johannesburg. India gets the first presidency, which then rotates, first to Brazil then Russia. Crucially, voting rights are equal, based on subscribed capital, and as the NDB expands, the total votes for founding members cannot fall below 55%. Big decisions need agreement from four of the five founders. While equality has been brought at the expense of the NDB’s financial clout in terms of total capital, special funds can be used to channel extra funds from some members without upsetting the delicate balance of governance arrangements.

Reaching Out

Regardless of how well this is done, however, the NDB will have to cooperate with other national, regional and global development banks to have a real impact on the infrastructure funding gap. Even together, they will command only part of the finance needed: new ways to leverage private finance will be required.

There is real scope for mutual learning in cooperation. The BRICS have vast experience of funding infrastructure, whereas institutions such as the World Bank bring decades of experience of cross-border lending. And this should not be restricted to finance. Although not perfect, the World Bank and its regional counterparts have learned much about applying effective environmental and social safeguards to their lending. If this could be combined with new perspectives from the BRICS and beyond, we might be on the road to agreeing new, global principles that all could support. We shall see, but if this addition to the family of development banks helps to kick-start such a process of cooperation, the prospects for sustainable and equitable development would be bright indeed.