

# THE INTERNATIONAL JOURNAL OF BUSINESS & MANAGEMENT

## The New Development Bank of BRICS Nations: An Analysis

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### **Abstract:**

*The New Development Bank (NDB) is a multilateral development bank established by the BRICS countries as an alternative funding option to the existing multilateral development banks. This New Development bank will focus on current and future development needs, with its policies structured to consider the global economic shift happened in recent years. It also promises to make the lending process simpler, faster and cheaper as opposed to the existing development bank including the World Bank group. The bank would be a well source of finance for meeting the infrastructure requirements and sustainable economic development. New Development bank is also going to face the same challenges that the existing multilateral development banks face due to the political, financial and development tensions inherent in their own organization model. The operational and governance policies adopted by the New Development Bank will have far reaching consequences and only the time will tell how effective it was. But it's sure that the initiative by BRICS countries will create a path for other like-minded countries to follow.*

**Keywords:** *New Development Bank (NDB), BRICS, Multilateral Development Bank, global economic shift, World Bank, infrastructure requirements, Sustainable economic development*

### **1. Introduction**

The acronym BRICs was introduced by Jim O'Neill, an employee in Goldman Sachs in a 2001 paper titled "Building Better Global Economic BRICs", a report on the growth prospects of the economies of Brazil, Russia, India and China (O'Neill, 2001). The term has been widely used to indicate a global economic power shift to developing nations from the G7 developed economies. For attending the General debate session of the UN General assembly in September 2006, the foreign ministers of initial four members of the BRIC countries (Brazil, Russia, India and China) gathered in the city of New York, and it marked the beginning for a series of high level dialogues. The first formal meeting of the BRIC nations took place in Yekaterinburg, Russia on 16<sup>th</sup> June 2009. The then Prime Minister of Russia Dmitry Medvedev was the host leader. The focus of the meeting was on ways to enhance the world economic situation and to refine financial institutions. Discussion was also on the ways through which the four countries can better co-operate in future and how developing countries, including BRIC nations can actively engage in world affairs.

Since 2009, the group has held annual summits and the hosting is done based on turn. The second summit of the BRIC nations was held in Brazil on 15<sup>th</sup> April 2010. South Africa started trying for Membership during 2010 and the formal admission process started in August 2010. On December 24, 2010, South Africa was incorporated as a member nation, formally being invited by China and other countries in the group. Thus the acronym has changed to BRICS to symbolize the five country membership, with an addition of 'S' in the former acronym BRIC to indicate the membership of South Africa (Smith, 2011). Third summit of the group has taken place, in China on April 2011 and it was the first meeting held after the inclusion of South Africa in the group. Fourth summit took place on 29<sup>th</sup> March, 2012 in India. South Africa Chaired the fifth summit of BRICS countries from 26-27 March 2013, during this meeting, BRICS nations decided to form a global financial institution which is ultimately a rival to the western-centered World Bank group and IMF (Brics5.co.za, 2013).

Finishing the summit, the BRICS quoted that they are planning to materialize the arrangements for this New Development Bank by 2014. Disputes connected with capital sharing and location of the reserve made the process slow, and the plan to finalize the arrangement for New Development Bank by 2014 had to postpone. In between several dialogues took place among the BRICS nations regarding the initial capital and each country willingly quoted their share towards the pool according to their capabilities. It was on the sixth summit of BRICS countries held in Fortaleza, Brazil from 14-16 July 2014, the much anticipated agreement to create the US\$100 billion New Development Bank and a reserve currency pool valuing over US\$100 billion was signed (Brics6.itamaraty.gov.br, 2014). Hopefully, the initiative by BRICS countries will create a path for other like-minded countries to follow.

## 2. Objectives of the Study

- To analyze the situations or driving forces that led BRICS nations to create a New Development bank.
- To study how this New Development Bank is different from other development banks functioning globally
- To analyze opportunities and challenges in front of the New Development Bank.

## 3. Methodology

The study is analytical in nature and proceeds through the data collected from various secondary sources which include books, journals, websites, magazines, newspapers etc. To analyze the general and economic environment prevailing in the BRICS countries, various world economy reports have been referred, which includes the reports of International Monetary Fund, current as of April 2015. General information on BRICS countries have been collected from their respective official websites and reports published by government agencies from time to time.

## 4. Driving Forces behind the Creation of a New Development Bank

To analyze the driving forces behind the creation of a new development Bank, it is necessary to understand the general and economic environment prevailing in BRICS countries.

### 4.1 Overview of BRICS Nations

Brazil is the fifth largest country in the world, by geographical area and population and is one among the seventeen mega diverse nations, and is the focus of discussion regarding environmental protection and deforestation. As of 2015, Brazil's economy is the eighth largest in the world by nominal GDP and in terms of GDP (Purchasing Power Parity) it is seventh largest. Brazil is the largest producer of coffee for the last 150 years. Mostly engaged in manufacturing, service and agricultural sectors Brazil strikes a labour force of over 1107 million (6<sup>th</sup> in worldwide ranking) and 6.2 % of unemployment (64<sup>th</sup> in worldwide ranking). The economy of this nation had been booming until 2010, stagnation followed and a recession is on the way, side with charges of corruption and inflation.

Factors Considered	BRICS Nations				
	Brazil	Russia	India	China	South Africa
Population	202,768,562	143,975,923	1,210,193,422	1,357,380,000	54,002,000
Area	8,515,767 km <sup>2</sup>	17,098,242 km <sup>2</sup> (Crimea not included)	3,287,590 km <sup>2</sup>	9,596,961 km <sup>2</sup>	1,221,037 km <sup>2</sup>
GDP (PPP) Total	\$3.259 trillion	\$3.458 trillion	\$7.997 trillion	\$18.976 trillion	\$725.004 billion
GDP (PPP) per capita	\$15,941	\$24,067	\$6,266	\$13,801	\$13,215
GDP(Nominal ) Total	\$1.904 trillion	\$1.176 trillion	\$2.308 trillion	\$11.212 trillion	\$323.809 billion
GDP(Nominal ) Per capita	\$9,312	\$8,184	\$1,808	\$8,154	\$5,902
Human Development Index(HDI)	0.744	0.778	0.586	0.719	0.658

Table 1: Overall analysis of BRICS nations

Russia is the world's largest country taking more than 1/8th of the inhabited land area of Earth. It is ranked ninth in terms of population with approximately 144 million people with reference to 2015 data. In terms of Nominal GDP, Russia ranks 15<sup>th</sup> in the world and is the sixth largest by Purchasing power parity as on 2015. It is one among the largest producers of oil and natural gas in the world. Russia finished its ninth straight year growth by 2008, with the fall in price of gas and oil. According to the Corruption Perceptions index, Russia holds the second rank in corruption after Ukraine among European nations. By late 2013, economy of Russia started stagnating, and with the war in Ukraine, is in potential fear of entering slow growth and inflation. If we closely assess the period from October 2013 to October 2014, Russian currency ruble has been collapsed by 24 %, a level which needs the Russian central Bank intervention to make the currency position better. An article in Bloomberg Business week of October 2014 issue, quoted that as a result of the financial tensions caused by Ukraine crisis and Western economic sanctions, Russia has begun to change its course of economy towards china.

India stands seventh-largest in terms of nominal GDP and third-largest in terms of purchasing power parity (PPP). After the 1991 economic reforms, India has transformed to one of the fastest growing economies in the world. According to the reports of International Monetary Fund, the nominal worth of Indian economy is US\$2.306 trillion, and in terms of market exchange rates, India stands seventh largest economy in the world. Based on Nominal GDP per capita, India stands 140<sup>th</sup> in the world and 129<sup>th</sup> in terms of GDP per capita. As per the data available in 2011, India stands second in the labour force (486.6 million). The contribution of

various sectors to the GDP is as follows: Service sector 55.6 %, industrial sector 26.3% and agricultural sector 18.1%. On the other side private investment continued it's not so good path requiring more attention. The decline in exports due to the global economic slowdown and softening of crude, metal and commodity prices will definitely have an impact in the much expected growth rate of 7.5 % by IMF. Capital Account Deficit may also get wider in this scenario. But the Make-in-India Strategy and other policy reforms could make the economy more competitive and may bring more foreign investments.

China ranks first in the world, in terms of population (over 1.35 billion) and by land area it is the second largest country in the world. It is one of the fastest growing economy in the world, since the introductions of economic reforms in 1978. By 2014, China has ranked 2<sup>nd</sup> in terms of total nominal GDP and largest in terms of purchasing power parity. It has to be noted that China ranks first based on the exports and ranks second in terms of imports<sup>[17]</sup>. China depends on coal to meet more than 70 % of its energy needs, and overcame US to become the largest Oil importer in the world in September 2013. In the beginning of 2010, China's growth began to slow due to internal credit troubles and global economic slowdown. It is also a known fact that China has been criticized much for its production of counterfeit goods. According to the reports of consulting firm McKinsey, China's total outstanding debt has been increased from \$7.4 trillion (2007) to \$28.2 trillion (2014) which is almost 228 % of its GDP. Main reason behind China's slow growth is said to be sluggish property sector and slow public infrastructure spending. But the government has already started to introduce apt economic measures focusing on a balanced economic at the expense of the so called rapid economic growth.

South Africa has been termed as a newly industrialized nation, and is categorized as an upper-middle income country by World Bank. It is the second largest economy in Africa and ranked 34<sup>th</sup> in the world. Poverty and Inequality being a big concern, nearly 1/4<sup>th</sup> of the population is unemployed and living on US\$1.25 per day. South Africa is considered as a middle power in world affairs. The important sectors that contribute to the economy's GDP are manufacturing, retail, financial services, communications, mining, agriculture and tourism. After 1994, policy reforms scaled down inflation and attracted foreign capital, growth was still away. From 2004 onwards, economic growth picked up, and slowly employment generation and capital formation increased. Skill shortage is also a growing concern. A significant amount of revenue is earned from the Tourism sector. South Africa is facing problems caused by labour-disputes and energy shortages which leave its mining sector without electricity. The National development plan put forward by the authorities focuses on eliminating poverty and scale down inequality by 2030. Important trading partners of South Africa other than African countries consists of United States, China, Britain, Spain, Germany and China (Imf.org, 2015).

#### *4.2. Key Drivers behind the Creation of a New Development Bank*

Since the establishment of World Bank in 1944, several multilateral development banks started to function globally and regionally. At present, a minimum of 20 multilateral development banks operate globally, which includes the World Bank group, Regional development banks (Ex. Asian Development Bank, Inter-American Development Bank etc), and other specialized banks. Many nations consider that, the existing development banks are not aptly facing the challenges caused by the global economic slowdown and changing business environment. There comes the relevance of new development banks, which could focus on the regional financial problems clearly and will be able to study from the existing Multilateral Development Banks to improve its performance. New development banks are needed because of several reasons.

Many countries need massive quantity of development finance for building the basic infrastructure facilities. The existing sources, both public and private, have not been able to cope with these massive financial requirements. Approximation of investment needs in vary considerably from 1.3-1.5 trillion dollars per year to 1.8-2.3 trillion dollars or even \$3 trillion in developing countries. Which estimate correctly defines the situation, is not our concern. The current spending level by development banks is not enough to narrow down the present infrastructure gaps, then how can we expect it's reverse in future is the question. The type of finance being provided is important and has its impact in the development projects as well. Many development banks are facing problems due to fiscal restrictions imposed by the shareholders. A new development could structure its policies suitable to the changing economic environment and can provide sophisticated funding options to development projects.

The mode of governance prevailing in most of the multilateral development Banks, especially World Bank Group dates back to its formation after the Second World War. When the World Bank was established, U.S.A, Japan and other European nations dominated the global economy, but now the situation has been changed. Combined Gross Domestic Product of BRICS nations has recorded a growth of more than 500 % since 2000, where as it is 64 % for the G7 nations (Humphrey, 2015). Also the share of BRICS nations in global economy increased from 8 to 22 %, whereas the G7 nations share decreased by 20 percentage points. This gradual shift in economy is not reflected in the governance of MDB's, especially in voting rights.

It can be inferred from the following table Japan has higher voting share in the World Bank Group (Worldbank.org, 2015) and Asian Development Bank compared to China (Asian Development Bank, 2014), even though the latter's economy is more than two times larger than Japan's economy. U.S.A and Japan individually have more than 12 % voting rights in ADB which make them to have effective veto power, whereas India and China individually have voting rights around 5 % . It's not easy to reform the existing multilateral Development Banks, in accordance with the change in economic situation. Traditional economies may not allow developing countries to contribute more to the capital, since it may weaken their own voting rights. Also the volatility in exchange rate of these economies Thus emerged the need of a New Development Bank focusing on current and future development needs, with its policies structured to consider the global economic shift happened in recent years (Jones, 2015).

Country	Voting power (percent of total) in Development Banks (including constituents of WB group)			
	IBRD	IFC	IDA	ADB (as of Dec 31 2013)
U.S.A.	16.20	21.48	10.49	12.47
U.K	3.94	4.59	6.05	1.939
Japan	7.51	6.15	8.47	12.835
Russian Federation	2.84	3.90	0.33	Not a Member
France	3.94	4.59	3.79	2.168
China	4.85	2.36	2.12	5.474
Germany	4.39	4.89	5.48	3.773
India	3.06	3.91	2.97	5.384
South Africa	0.80	0.69	0.28	Not a member

Table 2: Voting power of Selected Nations in Development Banks

### 5. New Development Bank: Differentiating Aspects and the Way Ahead

To study how New Development Bank is different from other development banks functioning globally, it is necessary to analyze the Salient features of the former. New Development Bank is a multilateral development Bank established by the BRICS countries. The bank is formed to promote financial as well as development cooperation among the five regions. It was on 15 July 2014, 1st day of the 6th BRICS summit took place in Fortaleza, Brazil, and the emerging economies signed the agreement to create the BRICS Development Bank with \$100 billion capital— with an initial subscribed capital of \$50 billion. Also Agreements for enhancing cooperation between BRICS export credit agencies and to promote cooperation on innovation were signed.

The Headquarters of New Development Bank will be in Shanghai, China and an African regional center will be established in Johannesburg .It was announced that the first president of the bank will be from India and the Initial Chairman of the Board of Directors will be from Brazil and the initial chairman of the Board of Governors will from Russia..On 11 May 2015, K. V. Kamath was appointed as President of the Bank. The main objective of the bank is to fund for infrastructure projects, with an authorized lending up to \$34 billion annually. Initial capital of the bank will be \$50 billion, with capital increased to \$100 billion in due course of time. Each of the BRICS nations will contribute \$10 billion to make the starting capital to \$50 billion .Share of capital of member cannot be increased without the consent of other four members. It was a requirement put forwards by India. Other countries can also take membership in the bank, but the BRICS capital contribution won't be allowed to fall below 55 %. In New Development Bank, each member country will have only one vote, unlike World Bank, where voting power is based on the capital share. No member country will have veto power either.

New Development Bank has limited capital base compared to the World Bank's \$232 billion and Asian Development Bank's \$165 billion. Each of BRICS nations will make equal contribution to the initial capital which makes it different from other multilateral development organizations. Unlike other Multilateral Development Organizations, where voting right is based on the capital share, in the New Development bank each of the member country will have only one vote and none of the countries will have veto power. The nature and governance of the New Development Bank will be less bureaucratic compared to the present Multilateral Development Banks, which may make the loan borrowers attracted to it.

New Development Bank shall provide loans, guarantees, equity participation and other financial instruments to assist public or private projects. It may also join hands with international organizations and other financial institutions to give technical assistance for works to be assisted by the Bank. The membership of the bank will be open to borrowing as well as non-borrowing members. Non founding member can't have voting power more than 7 % of total voting power. On a rotational basis president of the Bank will be elected and will be a minimum of one Vice President from each of the other founding members, where as in the World Bank group the five nominated and elected twenty members of the executive board are the electors responsible in the selection of the new president. Here also five members having the largest number of shares including U.S.A have major voice in the decision.

#### 5.1. Opportunities and Challenges

It is definitely a positive move that the BRICS nations initiated to establish a New Development Bank that will provide an alternative funding facility for developing economies. The existing multilateral development banks are not enough to narrow down the fund gap and there comes the relevance of this New Development Bank. Since the governance mode is considered to be less bureaucratic, the development finance may come without much constraints and conditions. Also it promises to make the lending process simpler, faster and cheaper as opposed to the multilateral development Bank including the World Bank group. The bank would be a well source of finance for meeting the infrastructure requirements and sustainable economic development.

The bank should tightly focus on the infrastructure needs that will allow the development of focused knowledge of value to borrowers. And the adoption of nonpolitical and merit oriented policies will make a good reputation among the potential members, investors and borrowers. To increase the developmental impact of the bank's activities, it should also tie up with other financial institutions and external sources there by leveraging the financial commitment. Co financing and other techniques may prove to be much useful. Communicating the policies and maintaining transparency in the lending activities will definitely make the New Development Bank in a better position and will make its place in the shareholders mind. New Development Bank has got the real advantage that it from the beginning itself, it can design apt administrative and financial policies, that ultimately going to benefit the entire world economy.

New Development bank is also going to face the same challenges that the existing multilateral development banks face due to the political, financial and development tensions inherent in their own organization model. Contribution by each of the BRICS nation towards initial capital is made equal which may bring a unified feeling in each of the member countries. This will make the New Development Bank's capital smaller due to the financial constraints on the smallest economy of BRICS, which is South Africa, where as other development banks allow differentiated contributions according to the capacity of the concerned nations. The New Development Bank may also face problem due to lower bond rating, based on the ratings of BRICS nations. Only time will prove, how this New Development Bank is going to position it differently compared to the World Bank Group and other development banks.

## 6. Conclusion

The BRICS New Development Bank symbolizes a strong step towards reforming the present global system of development finance institutions. The existing development banks are not in a position to change their governance model with the gradual economic shift happened in recent years. Fund requirements are increasing and the existing development banks are not capable to narrow down the gap. So essentially, the establishment of a New Development Bank is a positive move, and may indicate the beginning of a new chapter in multilateralism and development finance. New Development bank will also face the same challenges faced by existing multilateral development banks, but they can come up with viable solutions by increasing the cooperation and financial ties with member as well as non member countries. Ultimately the New Development Bank should complement rather than substituting the existing development banks to make a sustainable and active world economy. Its establishment will also strengthen the voice of developing economies in the system of development finance framework .The operational and governance policies adopted by the New Development Bank will have far reaching consequences and only the time will tell how effective it was. But it's sure that the initiative by BRICS countries will create a path for other like-minded countries to follow.

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