Guest post: a new BRICS bank to mark global shift

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Leaders of the BRICS (Brazil, Russia, India, China and South Africa) nations are committed to the creation of a new Development Bank for infrastructure and sustainable development. Details of the bank's operations are expected at the forthcoming BRICS summit to be held in Brazil this July.

The bank is set to play an important role in helping to meet needs for an estimated US$1tn or more in annual investments in infrastructure and sustainable development. The future growth prospects of the BRICS countries will depend in large measure on these investments materialising.

What are the likely challenges this institution will face as it moves from the design to the operational stage?

The first involves the scale of lending. The BRICS bank needs to be large enough at the outset to make a meaningful impact. It has been reported that officials from Brazil, the Russian Federation, India, China and South Africa have agreed to an initial capital base of US$50bn of which 20 per cent or US$10bn would be paid-in. This is a good start but further scaling-up will be needed.

While it is desirable for the BRICS to create the bank on their own to facilitate negotiations, there could be a provision for a future broadening of the membership established from the outset. One possible option discussed is that non-BRICS countries (emerging and developing, as well as developed ones) could also contribute capital – after the bank has been established.

Assuming a total capital endowment of US$100bn, of which 20 per cent would have been paid in, the level of annual lending could – according to preliminary estimates we have made – reach, after 20 years, a stock of loans of up to US$350bn, equivalent to about US$34bn annually. The latter amount could be used for investment projects worth at least US$68bn annually, given that there would be co-financing by private and public lenders and investors.

This would be far bigger than World Bank loans.

A second challenge concerns the quality of the loans made. There is a potential trade-off between speed of growth of a portfolio of loans and the quality of loans. Though scale of operations is clearly important, a high quality of loans is a priority as it maximises the likely development impact of the projects and minimizes risk of default. It is also important that a BRICS bank makes profits on its loans, which can be reinvested, allowing an expansion of capital that will facilitate increased lending.

A BRICS development bank would lend to both BRICS countries themselves and to other developing countries. Furthermore, it would be desirable for it to have a balanced portfolio of loans that includes middle and low-income countries from different regions, as this would make the bank more creditworthy, both because middle-income countries may be more creditworthy than low-income ones, and because it would ensure the benefits of geographical diversification.

A third challenge is the degree of financial "sophistication" of the instruments used. Firstly, the more complex the products, the longer they take to be designed and implemented. So-called "plain vanilla" loans can be made much faster than more complicated loan structures. Transactions involving equity take even longer (though they have desirable features, such as capturing part of the "upside" if projects are very profitable).

Secondly, the experience of the global financial crisis indicates that complexity often breeds opaqueness and leads to greater risk and future losses. Indeed, though a BRICS bank may wish to assume greater project risks (e.g. investing in very poor countries or regions) when these projects have potential large developmental or other benefits, it should avoid taking purely financial risks that could lead to substantial losses.

In looking to address these challenges, the BRICS bank can benefit from the experience and expertise of existing development banks, like the Development Bank of Latin America and the European Investment Bank, at a regional level, and the Brazilian BNDES, the German Development Bank, the South African Industrial Development Corporation and the Chinese Development Bank at national level. Furthermore, the BRICS Bank could have a strong research department, which could bring together experiences and expertise from across the South .

The arrival of the BRICS bank will mark a significant shift in the international development finance architecture. It is to be hoped that this can be just the start of more far-reaching reforms to a system that has fallen dangerously behind the financing challenges of an interdependent world.

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For more detailed discussion and policy proposals on the BRICS bank, please see my recent paper on the
subject: **http://www.stephanygj.net/papers/BRICSBankUNWorkingPaper2014.pdf**
Best, Stephany Griffith-Jones

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