

**Financial and Banking Service Market**

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**BRICS NEW DEVELOPMENT BANK:  
TECHNOGRAPHY OF DEVELOPMENT****Abstract**

The Fortaleza Declaration and the environment of the global financial and credit institutions, including the BRICS of New Development Bank are analyzed. The theoretical and practical aspects of overcoming the economic imbalances and political risks of BRICS countries in making appropriate decisions in global finance are accumulated.

**Key words:**

BRICS, Fortaleza Declaration, New Development Bank, the pool of foreign exchange reserves, beneficiary countries, donor countries.

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## Introduction

Creation of BRICS was one of the most significant geopolitical events of the beginning of the XXI century. BRICS countries (Brazil, Russia, India, China, and South Africa) play a significant and growing role in world politics and international relations. Since the establishment of association was called BRIC. First time the term «BRIC» used in the report of the investment bank «Goldman Sachs» in November 2001, dedicated to global economic outlook in the middle of the XXI century. Author of the term is an American economist John O'Neill, who used it for the group of developing countries – Brazil, Russia, India and China – considering the group as a new investment proposal. The current name of the association used in international practice since 2011 – after the accession of South Africa (December 2010). In a short period the «emerging economies» – China, Russia, Brazil and India – have become regional leaders. They stated that the modern international relations mechanism does not meet the realities of the XXI century and offered to build a new world order based on international law and cooperation.

Theoretical aspects concerning the formation, operation and development of BRICS in the world economy has long story of research by such famous foreign and domestic researchers and economists as: A. Bykov, A. Bobrovnikov, M. Bousler, R. Greenberg, S. Johnson, S. Ivanovsky, L. Kadyshch, L. Mahalhes, A. Marchenko, T. Moy, Y. Moseykin, K. Mortishd, J. O'Neill, M. Pasmor, N. Reznikova, S. Ryazancev, D. Sinkavash, H. Tabuchi, M. Titarenko, T. Uschapovskyy, N. Firzli, M. Hara, T. Halpin, K. Haub, P. Yakovlev and others.

Actuality of this problem is caused by financial imbalances of the global economic system and its role in regulation by global financial institutions, the practical importance of which defines the main goal – to research the particularities of BRICS «New Development Bank». As a part of this goal we can identify the following objectives of this article, in particular, to outline background of the BRICS «New Development Bank», its financial options and advantages, goals of functioning and weaknesses in the context of economic imbalances of BRICS countries and their development prospects.

## Results and discussion

### Background of the BRICS «New Development Bank»

In August 2014, Russia started talking about creating a new financial structure without developed countries – Bank of Shanghai Cooperation Organization, which also includes China, Kazakhstan, Tajikistan, Kyrgyzstan and Uzbekistan. Meanwhile, before the conference in Brazil just after the World Cup clarified outlines of a similar bank – based on semi-virtual association BRICS (Brazil, Russia, India, China, South Africa). The most famous example of global financial institutions is the World Bank (WB) and International Monetary Fund (IMF), created by developed countries after World War II. The main objective of the WB is poverty, and the IMF is mitigating economic crises. There are also various regional banks: Asian Development Bank, the Andean Development Corporation, the European Bank for Reconstruction and Development, the Eurasian Development Bank, Inter-American Development Bank and others. Some of them are more successful than the global counterparts. Thus, the Andean Development Corporation (CAF) as of 2012 loaned to its members (mostly in Latin America) more loans than the World Bank and Inter-American Development Bank taken together (Neyaskin, 2014).

Declaration on creation of BRICS Development Bank was signed by member-countries as the results of the summit in Fortaleza, held from 15 to 17 July, 2014. The Bank will mainly specialize in infrastructure projects in areas of BRICS member-countries. Also a pool of foreign exchange reserves (as IMF competitor) was created. In the first phase, capital of BRICS development Bank will be \$ 10 billion. Headquarters planned to be organized in Shanghai, and the first president of the bank will be the citizen of India (BBC, 2014). The organization could become a competitor the World Bank and similar regional funds. Thus, the «BRICS Development Bank» or «New Development Bank» (NBI) – an international financial institution, development bank, which was created and will be managed by BRICS member-states (Brazil, Russia, India, China and South Africa), the beginning of its work is planned for the 2015-2016.

Taking into account the prehistory of researched financial institution, we should note that the creation of bank was agreed by leaders at the V Summit of BRICS, held in Durban, March 27, 2013 (Powell, 2013). One of the reason for the creation of researched financial institution was criticism of the World Bank and the IMF by BRICS members, because in making the of most important decisions in these organizations BRICS member-countries do not have adequate, in their

opinion, number of votes. In this case, possibility to influence on decisions of NDB for BRICS countries is multiple higher than in the ADB or WB, because the number of votes of the member-countries will be at least three times more than the number of votes in the World Bank and ADB. In addition, developed countries have no representation in BRICS bank, which greatly reduces the political risks during the financial decision making.

The document on the establishment of the Development Bank was signed in July 15, 2014, the first day of VI Summit of BRICS in the Brazilian city – Fortaleza. BRICS countries agreed that the "paid-in capital" of the bank will be \$ 10 billion and can be distribute proportionally between the members. Countries also agreed that the amount of Bank authorized capital will \$ 100 billion, and initial capital – \$ 50 billion. (Kliment'ev, 2014). In particular, Russia expressed their intention to contribute in the bank \$ 2 billion during seven years. It decided to place the headquarters in Shanghai city as result of competition between New Delhi, Johannesburg and Shanghai. The first president of the financial institution will be the citizen of India, Chairman of the Board of Directors will be from Brazil, and the first Chairman of the Board of Governors will be a representative of Russia. Country-coordinator in the pool will state that the Presidency of the BRICS.

### **Financial options and advantages of NDB**

So New Development Bank (NDB) – analogue of the World Bank. Its initial capital will be \$ 50 billion, and gradually will be increased to \$ 100 billion. The NDB will finance infrastructure projects and projects of «sustainable development». In such settings bank will annually make loans of \$ 3 billion and include the loan portfolio of \$ 16 billion (estimation of Russian CMASTF). It is several times less than the World Bank or the Asian Development Bank. The bank's capital will be formed by 2020 (see. Table. 1). The amount of loan that can annually provide the NDB is three times less than for ADB. In particular, limiting funding of NDB per «equally to all» is several times less than the amount the World Bank for all BRICS countries except China (\$ 31.9 bln.) and India (\$ 51.7 bln.). In addition, a key point is urgency of provided funds – priority opportunity of funding NDB for periods more than 10 years, which in turn will greatly depend on access to international financial markets (and funds of investors in developed countries).

*Table 1*

**NDB compared with other development banks, \$ billion (Neyaskin, 2014)**

	World Bank	Asian Development Bank	New Development Bank (estimate)
Assets	328,8	115,9	35,6
Volume of loans, per year	10,5	10,2	3,1
Loan portfolio	151,3	53,1	16,3
Capital on balance	40,2	17,1	5,3
Paid-in capital	13,8	8,2	2,5
Initial capital	228,5	162,8	50,0
Authorized capital	278,4	163,8	100,0

As for the Pool of conventional foreign exchange reserves, the so-called «mini-IMF», with a fund of \$ 100 billion, of which the BRICS countries will be able to get help when needed. In crisis time, participants will be able to claim a portion of the fund, but now their credit limits (lending limits) lower than limits in IMF (see. Table 2). So creating the Pool of conventional currency liabilities can be called as agreement on mutual lending of the central banks of BRICS countries. In this case, in the state of a threat to stability of the balance of payments its central bank will be able to access foreign currency financing other CB BRICS. In addition, Pool of contingent liabilities increases the stability of the balance of payments. The Pool of contingent liabilities will considered as part of exchange reserves of all member-countries, as well as short-term stability the balance of payments will increase and will increase short-term stability foreign exchange markets in the BRICS (stability criterion «Reddy» – by 0.1–0.2). The basic advantage will be a significant mitigation of the financing conditions compared with the IMF program «stand-by». The decision on funding will take Standing Committee of the Pool, which will include representatives of all five countries; any conditions for economic reform for this type of loan is not expected (like mechanism for the IMF – Flexible Credit Line (FCL)); access to finance will not be given the government but to the central bank directly; countries outside the Poole, have no effect on lending decisions.

*Table 2*

**Credit limits and share capital BRICS countries in the IMF and NDB, \$ bln.**

(Neyaskin, 2014)

	Pool SFER	IMF	Shareholder Pool SFER	Shareholder IMF
China	20,5	71,9	41,0	12,0
India	18	44,2	18,0	7,4
Russia	18	45,1	18,0	7,5
Brazil	18	32,4	18,0	5,4
SAR	10	14,6	5,0	2,4

For the participating countries it will be easier to get help and loans from the NDB than the IMF and World Bank where the developed countries have the majority of votes. The South Africa, which has the least stable balance of payments, will benefit the most from the participation in the Pool of conventional foreign exchange reserves. While for Brazil, India and South Africa it is particularly difficult to attract long-term investment in infrastructure, China, by contrast, is ready to invest money for this projects (Chinese construction companies are interested in participating in these projects). Overall, priority-lending of NDB will be the infrastructure. This vector is very promising, because according to the World Bank the potential of such investments is high. Thus, 1) volume of underinvestment in infrastructure for low and middle-income countries, according to the World Bank, is \$ 1 trillion. 2) increase infrastructure investment by 10% points corresponds to additional GDP growth by 1% point. 3) every dollar of infrastructure investment in developing countries increases exports from developed countries on 35 cents. 4) it is an opportunity for construction companies (in particular – Chinese) get more international orders. 5) will be created in the future «Infrastructure Investment Fund» of BRICS that will make procedure of access to private and sovereign capital investment in infrastructure more simple.

Along with its headquarters, in South Africa will be established African Regional Centre of New Development Bank. A Memorandum of Understanding on cooperation between institutions BRICS due to lending export and insurance of lending export, which will help to create more favorable conditions for expansion of trade between countries is also signed. Within the framework of Fortaleza Declaration signed Agreement on cooperation in innovation of inter-bank cooperation mechanism of BRICS countries and held first negotiations about a possible merger market of insurance and reinsurance BRICS countries (The Sixth BRICS Summit, 2014). In Fortaleza there were also signed documents on cooperation between the export credit agencies of the BRICS and cooperation agreement in the field of innovation.

### **Goals of functioning and weaknesses of NDB**

As for the main goals of functioning, the bank will specialize in infrastructure projects in BRICS member countries. However, as was stated by Minister of Finance of Russia – A. Siluanov, the bank is open to new members from the UN countries. However, there is an agreement between countries that share of the BRICS members in authorized capital will not decrease below 55% (Powell, 2013). Also among goals of the bank is to mobilize resources to finance infrastructure projects to support sustainable development in the BRICS and other emerging economies. Created Pool of conventional foreign exchange reserves, the initial volume of which will be \$ 100 billion (China will contribute \$ 41 billion, Brazil, Russia and India – \$ 18 billion each one, South Africa will contribute \$ 5 billion. (OECD, National Bureau of Statistics of China, 2014)), formed with purpose to protect the national currencies of the volatility of the financial markets (Neyaskin, 2014). The Bank will also provide assistance to other countries affected by economic instability as the result of expansionary monetary policy of the US (BRICS bank to benefit developing countries: Brazilian president, 2014).

However there are some weaknesses. Thus, according to L. Carroll (Neyaskin, 2014) BRICS has no global idea, except dissatisfaction with the existing rules of the game. World Bank and IMF were created to prevent World War and the Great Depression. In addition, the BRICS countries are very different (in terms of GDP per capita, growth rate of economy, infant mortality rate) as developed countries, which founded the IMF and the World Bank. However, fans of BRICS bank appeal that institution created with the aim of not repetition of «horrors» like the Great Recession and crisis in Argentina caused by the implementation of the recommendations of the IMF. Functions of BRICS bank are largely duplicated from functions of the IMF and World Bank, and the functions of private multinational companies. The new bank will not be able to compete with the World Bank and the IMF, because it will have less access to «long money» than the institutions that exist for a long time and have formed a reputation (such as the Asian Development Bank established fifty years ago). For the same reason the BRICS bank will have lower financial lever and lower access to expertise. Therefore, a more realistic scenario is cooperation with other similar organizations.

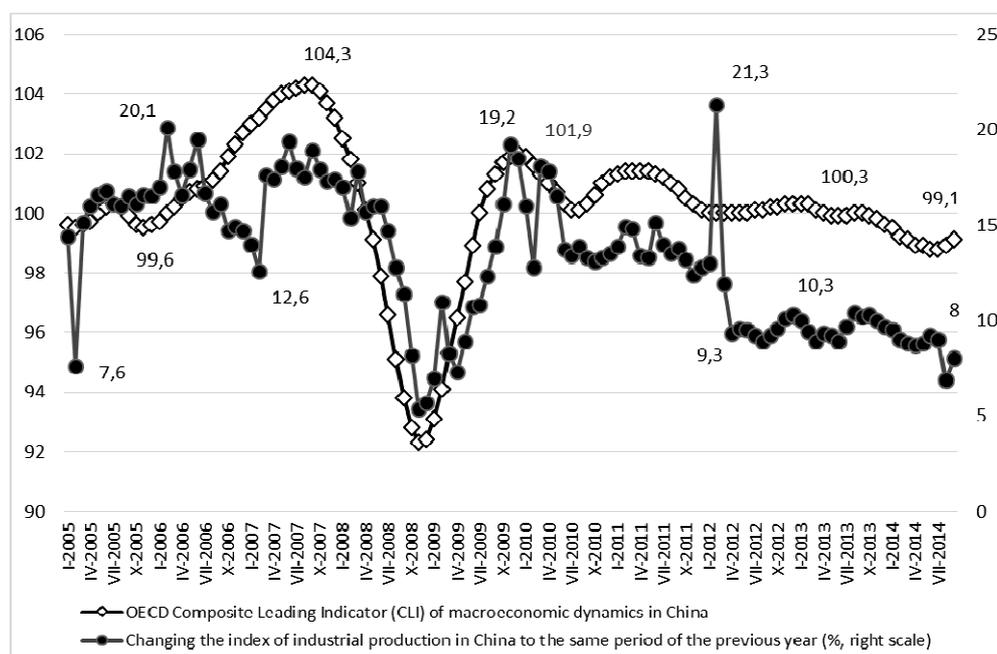
### **Economic imbalance of BRICS countries**

Observers point out that currently a certain economic imbalance exists within the BRICS. Thus, for China has more than half of total GDP BRICS, i. e. more than the total GDP of the four other countries-members. However the first half of 2014 shows the trend of slowing of Chinese economy this year. Thus, the

IMF announced a reduction in forecast of growth of the Chinese economy in 2014 to 7.4% versus 7.5% (according to the forecast from April 2014). In particular, GDP growth in the II quarter 2014 was 7.5%. These GDP growth rate (7,4–7,5%) is a record low for the Chinese economy from the crisis in I quarter 2009. In the first half of 2014 the lowest growth rates were observed in the sectors of mining industry (3.9%) and real estate (2.5%). Also there is continuing decline in consumer activity. The growth rate of retail trade turnover in the first half of 2014 was 0.5% lower than in the first half of 2013 (12.1% vs. 12.6%), the rate of growth in car sales – 3.9% (8.4% versus 12.3%). Also there is a trend to reducing activity in the housing market. Housing prices are moving to decline – in June 2014 house prices fall relative to May which was noted in 56 of the 70 largest cities in China (May to April – 35 of 70). Activity in the construction sector also reduced – growth rate of cement production in the first half of 2014 fell to 4.5% against 9.1% in the first half of 2013. As well as OECD Composite Leading Indicator (CLI) of macroeconomic dynamics of China reduced from March 2013.

Figure 1

**Main indicators of economic growth in China**  
(OECD, National Bureau of Statistics of China, 2014)



Russia's GDP in volume is slightly behind the Brazil, but slightly ahead of India. The five BRICS countries also agreed to intensify cooperation in the energy sector – in particular by creating in the future of special energy bank. Russia has offered to create an energy association of BRICS countries and to create a Reserve Bank of Fuel and Energy Policy Institute. According to Russian experts, these steps will strengthen energy security of member-countries. The Russian government insists that one of the leitmotifs BRICS existence is the desire to prevent a unipolar world, by which we mean the geopolitical and economic dominance of the United States. However, in the world there are several poles – the European Union, BRICS. But, as analysts note, global modern world is not only rivalry and confrontation, but rather the world of cooperation and mutual consideration of interests. At the same time, sanctions against Russia in 2014 dramatically worsened its financial position. Devaluation of the ruble during the year was 30%, which is for the country that has reserves of \$ 500 billion, is too much. Moreover, for Russia the access to international capital at a time when the banking system needs to spend \$ 150 million only to support balance of its largest state banks is blocked.

## Conclusions

Thus, the existence of the New Development Bank will largely depend on which projects it will finance. The success of the CAF is mainly because of it gives money not only on roads and dams, but also on short-term and profitable projects. Therefore, BRICS bank for the gradual development needs to attract new members for the capital increase; likely candidates are Argentina and Indonesia. As for the competition between NDB and other institutions of development, it is unlikely, because the existing institutions of development have procedures and expertise of project evaluation and technical assistance. In addition, the need for long-term investments is so high that competition of lenders in this market is virtually impossible, and risk of sharing in joint projects is profitable for all development institutions. Meanwhile, Pool of contingent liabilities will allow slightly increasing the short-term stability of the balance of payments. Funds are likely to become an alternative to the IMF loans to member-countries (the funds of Pool get for participants cheaper and simpler than funds of IMF), although cooperation is possible because the largest beneficiary of Pool is South Africa, where the balance of payments among all of the BRICS countries is the least stable, and to a lesser extent, India will be a beneficiary.

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