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THE BRICS INITIATIVES IN THE CURRENT GLOBAL CONJUNCTURE: AN ASSESSMENT IN THE CONTEXT OF THE IMF RULINGS FOR GREECE

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It is heartening to observe that developing countries, led by China and other BRICS members (Brazil, Russia, India, and South Africa), have been successfully organizing alternative sources of credit flows, aiming for financial stability, growth, and development. With their goals of avoiding International Monetary Fund (IMF) loan conditionality and the dominance of the US dollar in global finance, these new BRICS-led institutions represent a much-needed renovation of the global financial architecture.

The nascent institutions will provide an alternative to the prevailing Bretton Woods institutions, loans from which are usually laden with prescriptions for austerity. For countries that have implemented such loan conditions, it is not difficult to observe their disastrous consequences in terms of the contractionary effects on output and employment. We refer here to the most recent example in Europe, with Greece currently facing the diktat of the troika (the IMF, the European Central Bank, and the European Union [EU]) to accept austerity as a precondition for further financial assistance.

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It is rather disappointing that Western financial institutions and the EU are in no mood to provide Greece with any options short of complying with these disciplinary measures.

Limitations, such as the above, in the prevailing global financial architecture bring to the fore the need for new institutions as alternative sources of funds. The launch of financial institutions by the BRICS—when combined with the BRICS clearing arrangement in local currencies proposed in this policy note—may chart a course for achieving an improved global financial order. Avoiding the use of the dollar as a currency to settle payments would help mitigate the impact of exchange rate fluctuations on transactions within the BRICS. Moreover, using the proposed clearing account arrangement to settle trade imbalances would help in generating additional demand within the BRICS, which would have an overall expansionary impact on the world economy as a whole.

BRICS-led Financial Institutions

The financial institutions that have already been launched at the initiative of the BRICS include the BRICS or New Development Bank (NDB), the BRICS-led Contingent Reserve Arrangement (CRA), the (just inaugurated) Asian Infrastructure Investment Bank (AIIB), and the Silk Road projects.

Through equal contributions from all BRICS members, the NDB will begin with \$50 billion in capital, to be increased to \$100 billion over time. No member can increase its share of capital without consent from the others. While countries from outside the BRICS can join in as new members of the NDB, the capital share of the initial members is not allowed to fall below 55 percent. It may be pointed out that the shares of capital stock in the NDB not only represent the equity share held by the contributing member, but also indicate the country's direct representation in the decision-making process of the bank (Eichengreen 2014). In addition to providing liquidity to its members to meet balance-of-payments crises, the BRICS bank aims to provide protection against global liquidity pressures—say, in the wake of the United States' exit from its expansionary monetary policy under quantitative easing.

As for the CRA, scheduled to start lending in 2016, the five BRICS members collectively agreed to earmark \$100 billion from their foreign-exchange reserves to be used for swap lines by members. Out of the initial capital, China is to contribute \$41 billion, Brazil, Russia, and India \$18 billion each, and South

Africa another \$5 billion. Thus, unlike the NDB—contributions to which are equally shared—the CRA is being funded more by China.

While controversies relating to the propriety of the NDB have fizzled out to some extent, the installation of the AIIB portal at the end of June has rekindled the debate about the legitimacy of these institutions—particularly with respect to the relatively important role of China.

The AIIB's initial capital of \$100 billion, while funded by contributions from the BRICS, is open to additional contributions in the future from non-BRICS members, which include both advanced and developing countries. This makes for 57 founding AIIB members at present, despite opposition from the United States and Japan.¹

The AIIB, as with the other BRICS institutions, aims to avoid the norms set by the Bretton Woods institutions, which include conditional financing. The AIIB is designed to provide vital credit for infrastructure projects in developing countries, the annual need for which may be between \$1.8 trillion and \$2.3 trillion by 2020 (Bhattacharya, Romani, and Stern 2012). The above facilities are expected to reduce the dependence of developing countries on official sources of financing for their infrastructural needs—the availability of which is in any case rather meager (Griffith-Jones 2014).

Reservations have continued to be expressed regarding the feasibility as well as the desirability of the BRICS institutions. Admitting non-BRICS nations to membership in the newly instituted AIIB has raised concerns that the group will ultimately include countries that are rather dissimilar, both in size and governance. The possible link of infrastructure projects to the proposed Silk Road creates an additional target for critics, especially regarding the potential for China to play a hegemonic role. Finally, doubts have been expressed as to whether CRA loans in particular can be managed without conditional clauses. Similar to the AIIB, the diversity of political and economic systems among CRA members has raised concerns. And as Barry Eichengreen (2014) has pointed out, “In contrast to development finance, the incentives of potential lenders and borrowers are not aligned [for potential CRA loans].” Related examples of failed attempts, as in the case of the Chiang Mai Initiative, have been cited in this context. While accepting the commendable goal of attempting to offer short-term liquidity that is not tied to conditionalities, Eichengreen suggests that the CRA may remain “empty symbolism.”

More broadly, however, opposition to the BRICS institutions from the advanced countries arguably reflects resistance on the part of the Bretton Woods institutions and their patron, the United States, to altering the asymmetric power relations in the prevailing structure of the global finance system. In addition, critiques of the BRICS institutions tend to harp on the major role China is supposed to play in their management. The reason behind this lies in the disproportionate economic strength of China in the region, both as the second-largest economy in the world and as a country that has amassed massive volumes of official reserves—at \$3.69 trillion in June 2015. Supported by its twin trade and capital account surpluses, China’s ability to maneuver in the geopolitical sphere has been strengthened.

A Proposal for a Clearing Arrangement within the BRICS Using Local Currencies

Attention may be drawn here to the recent tendency on the part of the BRICS countries to trade in local currencies, by relying on swaps and other bilateral payments arrangements. Such practices, subject to the scale of the transactions, may change the prevailing structure of external payments and their settlement in the world economy, while challenging the status of the US dollar as a unit of account in trade and payments. For BRICS nations, the practice will also be of help in mitigating the vulnerabilities that arise from dollar-dominated global financial transactions.

Suggestions for setting up a clearing account among developing countries, in line with the schemes originally proposed by John Maynard Keynes and William Francis Forbes-Sempill, can be found in the literature (Kregel 2015). Keynes’s clearing account proposal, advanced in the context of addressing the need for reconstruction following World War II, was ultimately unacceptable to the creditor nation at the time, the United States (Keynes 1980, 42–66). However, as recently pointed out (Kregel 2015), the clearing account plan still has the potential to alleviate some of the problems faced by developing countries, especially for those with chronic trade deficits.

Relying on the clearing account proposal and extending it further, we propose a scheme for the settlement of payments among BRICS members. While avoiding the use of the US dollar or any other currency as a numeraire, this clearing account scheme follows what Keynes called the “banking principle,”

which he defined as the “necessary equality of debits and credits, of assets and liabilities.” As Keynes pointed out, “If no credits can be removed outside the banking system but only transferred within it, the Bank *itself* can never be in difficulties” (Keynes 1980, 44). Keynes’s clearing union framework, in which “credits were automatically made available to debtor countries to spend” (Kregel 2015, 8), did not, however, come to fruition, largely due to the conflict of interest between the United Kingdom, which was a major debtor country at the end of World War II, and the United States, the major creditor.

A similar clearing account system could be set up for countries within the BRICS group. Each of these nations would settle their respective bilateral trade surpluses and deficits *within* the group, and without involving the use of non-BRICS currencies. The prevailing cross exchange rates of currencies for individual countries, at current dollar rates, would be used to settle the two-way transactions, while the net balance, denominated in the respective currency of the surplus/deficit country, would remain with the BRICS bank, to be offset by transactions by one or more countries. Problems in using surpluses in one currency (say, the Chinese RMB) to meet deficits in another may be sorted out by using the cross rates prevailing at the moment. In fact, the cross rates could be frozen by forward contracts, in order to ensure they were not affected by exchange rate variations in the major non-BRICS currencies.²

A matrix of the bilateral trade balances between individual BRICS members is provided for 2014 in Table 1. The individual bilateral balances and their aggregates are in US dollars. A separate column provides the balance in local currency units (LCUs) using the nominal exchange rate for each currency in US dollars. As suggested in our clearing account proposal, individual members’ aggregate bilateral balances within the BRICS—in LCUs at a specific point in time—could be utilized by those nations to settle their trade balances. The balance in LCUs would be obtained by using the cross exchange rates vis-à-vis the dollar, which are frozen by using forward rate contracts. It is expected that the measure would generate additional demand for goods within the BRICS while restraining, say, the use of Chinese trade surpluses to purchase dollar assets like US Treasury bills.

The anomalies in bilateral trade data in the table, reported on a gross basis, indicate the need to qualify the above by looking at trade data on a value-added basis at the domestic source. The problem can be detected in the discrepancy between the bilateral trade balances reported by the respective trade partners. Efforts

Table 1 Net Bilateral Trade Balances within the BRICs, 2014

Trading Partners	Trade Balance (in billions of dollars)					Total Intra-BRICs Trade Balance (in billions of dollars)	Nominal Dollar Exchange Rate	Total Intra-BRICs Trade Balance (in billions of LCUs)
	Brazil	China	India	Russian Federation	South Africa			
Brazil	—	8.68	-3.22	0.29	1.11	6.86	2.35	16.12
China	-18.40	—	31.46	9.93	-1.27	21.72	6.16	133.80
India	2.48	-32.79	—	-1.35	-1.60	-33.26	61.00	-2028.86
Russian Federation	-1.52	-17.88	0.95	—	-0.49	-18.94	38.38	-726.92
South Africa	-0.63	-3.75	-2.31	0.002	—	-6.67	10.85	-72.37

Sources: UN Comtrade Database; World Bank, WITS Database³

made by the World Trade Organization to draw attention to the issue in their “Made in the World” initiative (Maurer 2011) offer some data that may help to narrow down such discrepancies. We are unable, at this stage of our research, to look beyond gross trade data, despite their limitations.

Conclusion

The BRICS financial institutions, along with the clearing account we have proposed, could herald a new financial architecture that would be beneficial, not just for the BRICS, but for the global financial system at large. Since those settlements would cease to rely on the dollar or other major currency as a unit of account, exchange rate fluctuations in the major currencies would not impact the cross rates between the individual BRICS currencies, as long as those rates were kept frozen with forward contracts renewed over time. Moreover, arrangements to use the trade surpluses of individual BRICS members by those in deficit would add to demand within the BRICS by creating new channels for intra-BRICS trade. The transfer of surpluses to meet deficits could even be treated as a loan from the NDB to the deficit member, and the sum adjusted against other transactions in the NDB. For example, China’s bilateral trade surplus with India could stay in RMBs with the NDB, and be used by the NDB to provide a loan to India or other member nations that have a bilateral trade deficit with China. The modalities of the loan repayment could be worked out within the BRICS. With the above device, trade surpluses earned by individual members (say, China) would remain within the BRICS as financial assets and would not be used to buy US Treasury bills in US dollars, as at present, thus avoiding further sources

of vulnerability. Finally, the BRICS could devise ways and means to channel trade in a manner that strengthened this new set of financial institutions and generated real demand—for example, with infrastructure development—rather than being funneled into spurious activities of a speculative nature.

Notes

1. In what was described as a “rare public breach in the special relationship,” the United States openly noted its displeasure with the United Kingdom’s decision to join the AIIB, with the White House “raising concerns about whether the new body would meet the standards of the World Bank” (Watt, Lewis, and Branigan 2015).
2. In the interwar period, bilateral clearing arrangements provided a solution for some European countries, including Germany, to settle their external payments imbalances with one another. Likewise, the “rupee payments arrangements” between India and Eastern European countries, including the erstwhile Soviet Union, during the 1960s considerably facilitated intercountry transactions by opening up new channels of trade and its settlement (Sen 1964).
3. Data collected by Zico Dasgupta is gratefully acknowledged.

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