



## BRICS: Opportunities and Challenges

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### *Summary*

The BRICS (Brazil, Russia, India, China and South Africa) grouping signifies a welcome development. The member states, having rebounded well from the 2008-09 financial crisis, have shown that they are not just a marketing story but can offer a viable model of resilient growth despite not conforming fully with the “open market, complete trade liberalisation” recipe of the developed world. This Brief outlines the practical and ideational role that BRICS can play as a grouping, in reforming the global financial system and in the norm-setting processes in world politics. The Brief also discusses some challenges BRICS countries are facing to realise their goals in the short to medium term.

## Introduction

There is a perception that investment bankers got it all wrong before the onset of the global financial crisis of 2008. But one of them, Jim O'Neil, was not entirely off the mark when he put together the acronym 'BRIC' (for Brazil, Russia India, and China) a decade ago. However, the BRIC grouping does not conform to the lines of separation created by the French demographer Alfred Sauvy, who coined the phrase 'third world' (originally in French) to distinguish the capitalist first world from the communist second world and from the largely non-aligned third world. Under the BRICS formulation, Brazil, India and South Africa (third world as per Sauvy's original notion) have come together with Russia and China (Sauvy's 'second world' then and now 'state-heavy') to reform institutional structures and norms shaped by the first world. Thus, the lines of separation have become blurred after the end of the Cold War. This is a distinct indicator that globalisation has altered the political and economic muscle of most nation states. The BRICS grouping, therefore, signifies a welcome development.

South Africa is the latest entrant in this informal grouping, which held the third summit meeting of its leaders in Sanya, China. The original four members of BRIC first gave shape to this club in Yekaterinburg, Russia, in June 2009, followed by a second summit at Brasilia in April 2010. Incidentally, BRIC foreign ministers have met annually since 2006. The theme of the 2011 summit was "Broad Vision and Shared Prosperity", with the agenda comprising:

- (i) General discussion on the current international situation;
- (ii) International economic and financial issues (reform of the international currency system, commodity prices, WTO & trade related issues, among others);
- (iii) International development issues (Millennium Development Goals, climate change, Sustainable Development, among others); and
- (iv) Cooperation among BRICS countries.

The BRICS grouping has a practical as well as an ideational role in reforming the global financial system, and in the norm-setting processes within world politics. The practical role for the BRICS resides in the original mandate of this informal grouping, which took shape chiefly after the global financial crisis of 2008. The aim of founding the grouping was to discuss economy and trade, primarily towards reform of the International Monetary Fund (IMF) and the World Bank, in order to enhance the representation of emerging economies in these financial institutions. The grievances of the BRICS were two-fold. Firstly, it was felt that the IMF model of growth (Washington Consensus) contributed to the global financial crisis in the absence of sound financial surveillance. BRICS member

states have managed a visible rebound from the crisis. Secondly, with 40 per cent of the world population and a creditable contribution to world economic output (25 per cent), the BRICS grouping feels it is time to seek political access in global rule-setting processes. Table 1 highlights select indicators on the economic health of the BRICS countries.

**Table 1: Select indicators for BRICS**

Attribute	Gross domestic product based on purchasing-power-parity (PPP) valuation of country GDP	Inflation, end of period consumer prices	Unemployment rate	Current account balance
Country	Current international dollar Billions [2008; 2011]	Per cent change [2008; 2011]	Per cent of total labour force [2008; 2011]	U.S. dollars Billions [2008; 2011]
Brazil	1,995.774; 2,301.275	5.902; 4.834	7.900; 7.500	-28.192; -65.043
China	8,217.399; 11,195.363	2.533; 2.708	4.200; 4.000	436.107; 324.797
India	3,389.998; 4,392.580	9.701; 5.686	N.A.	-25.480; -49.859
Russia	2,276.763; 2,343.139	13.300; 6.800	6.400; 7.300	103.722; 62.055
South Africa	509.021; 549.606	9.500; 5.700	21.860; 24.400	-19.593; -21.096

Source: Generated from the *World Economic Outlook Database*, October 2010, IMF for the following attributes [2011 figures are IMF staff estimates]; April 2011

At another level, the “dollar” no longer seems to be a sacrosanct word for this grouping. They have argued, and rightly so, that change in the valuation of the dollar, for instance the weakening dollar, results in sharp spikes in energy and commodity bills for all. For example, oil is priced in US dollars, like the products traded on the global market and bullion. The trend over the last few years, largely, reflects this weakening of the dollar. Figure 1 highlights the performance of the Dollar against a basket of currencies over different time periods.

**Figure 1: Weakening Dollar****Dollar Index (one year trend)**

[Source: Bloomberg]

**Dollar v/s Euro**

[Source: money.cnn.com]

Note: The graph on the left reflects the USD Index that measures the performance of the US Dollar against a basket of currencies: the Euro, Japanese Yen, Canadian Dollar, British Pound, Swedish Krona and Swiss Franc; the graph on the right gives an indicative break-up for first part of this year for the Dollar-Euro decline.

The Sanya declaration addresses this explicitly in Article 16, where it talks of the need for a “broad-based international reserve currency system providing stability and certainty.” The instrument of choice for the grouping is reform of the existing quota and votes in the Special Drawing Rights or SDRs in the IMF, including a need to discuss change in the composition of the SDRs’ basket of currencies. SDRs are the instrument that the IMF uses to lend funds to countries out of a fund-value of USD 317 billion; these are somewhat akin to “casino coupons” which could be used within the IMF to access foreign currencies in order to readjust the reserves of individual countries when the need arises. Currently, SDR exchange rates are based on a weighted basket of the Euro, the Japanese Yen, UK’s Pound sterling, and the US dollar. In its most recent review (in November 2010), the weights of the currencies in the SDR basket were revised based on the value of the exports of goods and services and the amount of reserves denominated in the respective currencies held by other members of the IMF. Table 2 explains the existing quota and vote-share assigned to the BRICS grouping, contrasted with that of the US, UK and Japan for a better understanding of the inequitable distribution/representation of the BRICS countries in international finance (the next review will take place by 2015).

**Table 2: SDR Quotas and Vote-share**

IMF Member	QUOTA		VOTES		
	Millions of SDRs	Percent of Total	Governor Alternate	Number	Percent of Total
China	9,525.9	4.02	ZHOU Xiaochuan <i>YI Gang</i>	95,997	3.83
India	5,821.5	2.46	Pranab Mukherjee <i>Duvvuri Subbarao</i>	58,953	2.35
Russian Federation	5,945.4	2.51	Aleksei Kudrin <i>Sergey Ignatiev</i>	60,192	2.40
Brazil	4,250.5	1.79	Guido Mantega <i>Alexandre Antonio Tombini</i>	43,243	1.72
South Africa	1,868.5	0.79	Pravin Jammadas Gordhan <i>Gill Marcus</i>	19,423	0.77

Versus indicative set of US, Japan and UK

Member	Millions of SDRs	Percent of Total	Governor Alternate	Number	Percent of Total
United States	42,122.4	17.77	Timothy F. Geithner <i>Ben S. Bernanke</i>	421,962	16.82
Japan	15,628.5	6.59	Yoshihiko Noda <i>Masaaki Shirakawa</i>	157,023	6.26
United Kingdom	10,738.5	4.53	George Osborne <i>Mervyn King</i>	108,123	4.31

Source: IMF database as of April 2011

The BRICS nations believe that this quota and voting allocation need to be re-worked and, secondly, that the SDRs should be transformed into some super-sovereign reserve currency apart from the “dollar”, where the instrument can be converted into whatever currency the borrower requires. They want the valuation processes of the SDRs to include their own currencies, arguing that using SDRs to price oil on the global market, for instance, could help prevent spikes in energy prices that often occur whenever the dollar weakens significantly. There is a lot of economic and political merit to their argument for the reform of the SDRs. They certainly would have found lot of support from Keynes, who had argued after the Great Depression seventy five years ago that the UK Pound Sterling, the then reserve currency, could not possibly provide global financial stability and that a global reserve currency – not just the currency of one country – is needed. Keynes was ignored then and the switch in reserve currency was made - from the Pound to Dollar. The current calls for a broad-based reserve currency are a fairly reasonable demand.

### **Punching above its weight?**

The BRICS, however, seem not too sure how this transition should be made. SDRs can play a limited role in transacting government currency needs, but official SDRs cannot be held, for example, by private entities or individuals. None of the currencies of the existing BRICS groups can, by any leap of imagination, substitute for the “dollar” in the short to medium term – and neither is there a world consensus on replacing the “dollar” as yet. Most trade and reserves are transacted in USD (61 per cent of the world reserves were in dollars in 2010; the same in 2009). Certainly, a handshake-agreement among BRICS countries cannot replace the strong economic fundamentals of the US Dollar, even though the US economy has been under rising debt over the last decade.

Some of the weaknesses are chronic. India and China are facing huge inflationary pressures (Chinese inflation rate reached 5.4 per cent in March 2011); neither country has fully convertible currency (China is managing a gradual appreciation of the Yuan’s peg against the Dollar, but the Yuan largely remains undervalued). Already, China’s Central Bank, the People’s Bank of China, has increased the reserve requirements for its banks, i.e. mopping up excess cash flow that could fuel further inflation, and an interest rate hike in India may occur soon as well. Moreover, unlike the one-sided advantage ascribed to the Chinese holdings of about three trillion dollars, the reality is that if the Chinese shift any substantial part of their existing reserves by selling off dollars, it will result in diminishing the value of the dollar (excess supply offloading). This means whatever dollar reserves are left with the Chinese i.e. what they hold on to after selling off part of their reserves, that will automatically be lower in value. Even without the Chinese Central Bank appreciating the value of the Yuan, the fact that the dollar weakens automatically makes the Yuan stronger and thereby Chinese exports costlier. This is what is generally called the “dollar trap” and the Chinese are trying their best to get out of this (same as other economies which hold large dollar reserves).

One way the BRICS is trying to get out of this is by having the members (designated banks) sign a framework agreement on financial cooperation during the Sanya Summit, which envisages bilateral local currency denominated financing (just financing – not trade, for now). Vnesheconombank, Russia's state development bank, Brazil's BNDES, Export-Import (EXIM) Bank of India, China Development Bank and the Development Bank of South Africa signed the framework accord. But this raises another question. Eventually, what would be the common currency to settle intra-BRICS bilateral trade?

If we examine some economic indicators listed in Table 1 (apart from overall trade volumes), then clearly the Yuan would appear to be the most likely currency to be used under this approach. However, given the opacity of China's financial system, the blurred nature of India-China relations or Brazil and China's contentions over currency manipulation, could the BRICS facilitate the Yuan's push towards this status of "alternate" reserve currency? Another approach could be that five sets of bilateral agreements per member are signed relating to the choice of preferred currency vehicle while invoicing exports (India and South Africa need to agree in their dyad, India and China in their dyad, and likewise). BRICS is an excellent experimental ground for this. The pursuit of a broad-based international reserve currency system is necessary. A more equitably valued SDR is an excellent starting point for addressing the concerns that the BRICS have with the existing financial system. However, the desire of introducing their own currencies as some sort of an "alternate" reserve currency for the global market would be wishful without parallel transparency and reform of the financial systems within these countries.

### **Institutionalisation of trust among member states**

The stability in commodity prices from a broader global reserve currency would benefit all BRICS members, especially China. Chinese efforts to introduce the Yuan in bilateral swap arrangements such as in BRICS or the Association of Southeast Asian Nations (ASEAN) is the first step in making the Chinese Yuan convertible in the long term, and eventually emerge as an "alternate" global trading currency. The interim arrangements, such as in the BRICS, give the Yuan greater geographic reach and would support experimentation in challenging the dollar by the time China moves closer to its mid-century goals. China should appreciate the diffused reciprocity inherent in mechanisms such as BRICS, and the role that countries such as India, Russia, Brazil and South Africa play. It should, therefore, use BRICS for wider institutionalisation of trust in its bilateral relations with countries such as India.

The second role that can be foreseen for the BRICS grouping is that of a consultation and coordination platform to formulate political positions – largely an ideational role. This is also a worthy pursuit given that all BRICS countries serve on the UN Security Council now as permanent or non-permanent members (Brazil and India, in fact, aspire for a permanent seat on the high table), and that they would like political access to influence



the way power is at present exercised in the international system. Again, the text of the Sanya declaration makes this ideational role amply explicit. Article 3 talks of the “overarching objective and strong shared desire for peace, security, development and cooperation”; Article 4 stresses on “promoting coordination on international and regional issues of common interest”, and the declaration also discusses the need to strengthen multilateral approaches and facilitate future coordination on issues under UN Security Council consideration. The interesting aspect of the Sanya declaration is that it carries a distinct ‘Action Plan’, which outlines the various tiers of inter-governmental interaction proposed among members (security, foreign affairs, fiscal and monetary coordination, agriculture, joint statistical publications, among others). The plan also identifies new areas of cooperation (BRICS friendship cities, cooperation at the level of local governments, cooperation in the areas of health, economic and trade issues, among others); and also new proposals to explore (in the area of culture, sports, green economy, technological innovation, among others). Here, BRICS could gain greater mileage if they try and replicate what they usually do in the WTO, where they have quite successfully organised and blocked crucial negotiations to protect their collective interests.

## Challenges

The period until the end of the Cold War had shaped international relations debates largely through a realist paradigm, expecting most people to believe its ‘surgical precision’ in analysing international affairs. However, several dyadic relationships and the strengthening of groupings such as BRICS clearly highlight the relevance of paradigmatic optics such as neo-liberalism in explaining inter-state dynamics. Growing economic interdependence (trade and investment) and improved monetary policy coordination through groupings such as BRICS would most certainly open up several avenues to align the interests and facilitate bargaining among member-states in the coming years (see Gartzke, 2007, pp. 166-191, for a theoretical discussion).

The following are some of the challenges that BRICS as a grouping would have to address in the coming years.

> The ‘BRIC’ seem to have coordinated their political stand on Libya (to implement a no-fly zone over Libya) with the five abstaining votes being that of the BRIC countries and Germany (South Africa voted in favour of authorising use of force). While this may be read as the BRICS grouping being internally democratic, which is welcome, in order to allow flexibility on such issues in the future as well, there is a possibility that a lot of political cohesion that the group is being imbued with may just be overstated. Since the grouping is a self-professed coordination platform, explaining the lack of common coordinated positions in world politics would be the BRICS’ Achilles heel in times to come. Even on the question of Indian and Brazilian aspirations to join the high-table of the UNSC permanent members, Russia and China actually need to dilute their own power to make this possible. There are other dyadic complexities, such as between India and



China for instance. However, many of the challenges may not be insurmountable.

> In letter, the grouping has suggested that it would not be another exclusive “club”. Article 6 of the Sanya declaration highlights the desire that “cooperation is inclusive and non-confrontational. We are open to increasing engagement and cooperation with non-BRICS countries, in particular emerging and developing countries, and relevant international and regional organizations.” How this plays out in spirit would be most vital to watch with big emerging economies such as Indonesia, Mexico, Turkey, Nigeria and Poland expecting to join ranks for more participatory roles in the world political and economic architecture.

> The BRICS economies share some domestic and socio-economic challenges that must be addressed independently of their group activism in order to accomplish their major goals as a group, viz. inequality (economic, social and political), corruption, improvements in health care and education, and human rights, to name a few.

> In addition to BRICS, there is the IBSA (another grouping of ‘democracies’ established in June 2003 named after its members, India, Brazil and South Africa). Unlike BRICS, which, as of now, has only outlined an action plan covering various tiers of inter-governmental cooperation, IBSA has moved towards practical cooperation programmes. One such example is the IBSA satellite programme, which helps South Africa to have high-tech space technology where the satellite bus would come from South Africa, most instrumentation will come from Brazil, and India will execute the launch. With such parallel groupings already at work, a major challenge for BRICS is to neatly manage the overlap in mandates that can arise in such situations.

> The other major challenge for BRICS is to remove the vagueness about what should be changed about the world. Are the BRICS countries trying to strengthen the role of the United Nations and contribute to improving globally negotiated rules or is BRICS going to be a multilateral façade for China, India and Russia to continue emitting tonnes of greenhouse gases (they are among the top five emitters in the world) or scuttle free trade in the name of ‘underdevelopment’? The BRICS have been not too far on the polluters’ path - a path set on historical emissions of the ‘first world’. Hence, there is still tremendous potential for these countries to adhere to a greener development path and instil a ‘green’ architecture of development for the rest of the world to follow. It is in such areas that they should offer an ‘alternate’ model of development.

The ultimate (and realistic) aim for the BRICS should be to take up a leadership role in reforming global financial and political institutions without rendering existing institutions null and void. BRICS need not be shaped as an ‘us versus them’ platform. The actualisation of the next ‘sputnik’ moment for the United States or ‘re-industrialisation’ efforts in Europe cannot be taken lightly over a longer time-horizon. At that stage one would not want the developed world to become some sort of a ‘BRICS’ grouping. Instead, one would like to

see BRICS moving closer to the professed goals of the developed world (institutions of jurisprudence, human rights, fair trade, and other equitable forms of Western global norm-setting). For now, the focus should be on generating more scholarship that could contribute to better understanding among the member states. As the Romanian-French playwright Eugene Ionesco wrote in his absurdist play *Rhinoceros*, “You can only predict things after they’ve happened.”

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