GEGAFRICA
RESPONSIVE AND EQUITABLE ECONOMIC GOVERNANCE FOR AFRICA AND THE GLOBAL ECONOMY

BRICS INSIGHTS PAPER 2

NEW SOUTH–SOUTH CO-OPERATION AND THE BRICS NEW DEVELOPMENT BANK

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INTRODUCTION

The establishment of the BRICS New Development Bank (NDB) marks a milestone in BRICS co-operation and is a symbolic achievement in the reform of global financial governance. It will help to promote the financing of infrastructure among developing countries, improve global governance and propel the revival of the global economy. From China's perspective, the NDB will be the first international financial organisation to be headquartered in China and will help promote China's influence in the international development system while raising its profile as a responsible power.

At present, there are a number of misperceptions surrounding the role of the NDB. Some mistakenly view it as an institution whose objective is to challenge the post-Second World War international economic order, reverse the Bretton Wood System, overturn the US' finance hegemony, and eventually plunge global finance governance into chaos. Rather, as the first international development finance institution proposed by several developing great powers since the Second World War, the foundation and strategic positioning of the NDB lies in new South–South co-operation. Its purpose is to act as an innovate international financing mechanism to better serve the needs of developing countries in terms of infrastructure and sustainable development, rather than challenging or replacing the existing multilateral development institutions.

WHY ESTABLISH THE NDB?

Developing countries face enormous investment and financing gaps to fund infrastructure development. These have only worsened since the global financial crisis in 2008. The failure by the multilateral development banks controlled by developed countries to make up the gap prompted BRICS to establish a new development bank. The gap between the demand for and supply of infrastructure finance in developing countries stems from the difficulties in securing long-term financing. According to the G24, which represents the interests of 24 developing countries, the annual capital needs of developing countries in infrastructure construction are $1,800 billion, while existing investment amounts to about $800 billion, resulting in an annual financing gap of about $1,000 billion. Before 2020, the annual capital needs of low- and middle-income countries for infrastructure construction will reach $93 billion. In 2013, South Africa's President Jacob Zuma stated that the financing gap for the BRICS countries in the next five years would amount to $4,500 billion.

Faced with such an enormous financing gap, developing countries are calling for support from developed countries and the multilateral development banks they control. However, the impact of North–South co-operation in solving the financing problems of developing countries has been limited thus far. Under these circumstances, the establishment of a new development bank, through new South–South co-operation among developing countries, is an important element of the BRICS co-operation agenda.

NEW SOUTH–SOUTH CO-OPERATION AND THE STRATEGIC ROLE OF THE NDB

New South–South co-operation embraces the massive rise of emerging economies and the new international economic system. It insists on the substantive characteristics of South–South co-operation, namely mutual respect, equal treatment, mutual benefit, win-win results and joint development, thus contrasting sharply with the existing inequalities in North–South economic relations. At the same time, the overall strength of emerging economies has been greatly enhanced, meaning that they can now receive financial, technological, managerial, marketing and other developmental support through new South–South co-operation, whereas before these were only available through North–South co-operation. In this way, a new international economic system is being formed based on investment, trade, finance and industrial transfers between emerging economies.

Whereas traditional South–South co-operation has strived for reasonable rights for developing countries in the international economic system, thus aiming for the reform of international mechanisms (or mechanism reform), the aim of new South–South co-operation is to establish a new international economic system that belongs to developing countries. Consequently, new South–South co-operation corresponds with the establishment of a new international mechanism (or mechanism establishment). The purpose of mechanism establishment is not to cut off relations with the previous economic system but rather to supplement and complete it. The establishment of the NDB is an integral part of this process.

Developed countries have taken over multilateral development banks such as the World Bank and the Asian Development Bank. Not only are they worried that the enlargement of the scale of financing may dilute their own power in these banks, but they are also unwilling to deeply involve the multilateral development banks in sensitive and complex infrastructure projects. This has exacerbated the long-term financing difficulties compromising the infrastructure projects of developing countries. Against this backdrop, the establishment of the NDB can both increase the amount of financing available to developing countries and break the monopoly of developed countries over the international financial architecture. In this way, it will help to establish a new mechanism for international development financing that is more beneficial to developing countries.

There are several reasons why the NDB has been christened a new development bank. Firstly, it has new financing sources. Whereas as the funds provided through North–South co-operation originate in developed countries, the financing of the NDB will come from the world's major developing economies, which means that finance from one developing country to another can be realised within the framework of new South–South co-operation. Secondly, it has new financing fields. Multilateral development banks such as the World Bank and the Asian Development Bank are largely devoted to reducing global and regional poverty along with many other priorities, which seriously limits the finance available for infrastructure development. In contrast, the NDB is largely devoted to meeting the financing needs of developing countries for infrastructure development. Thirdly, it has new financing mechanisms. In North–South co-operation, financial flows from developed to developing countries usually have rigorous loan conditions attached, and the patterns of lending belong to the donor–recipient category, which has contributed to the politicisation and bureaucratisation of the existing multilateral development banks. New South–South co-operation, however, emphasises a more equal and balanced development partnership in the relations between major developing countries and with their smaller developing counterparts. The NDB is going to use market-oriented operations to reduce loan costs and provide innovative loan facilities, so that developing countries will have a more robust, flexible and customer-oriented development finance service. Thus, as a platform for infrastructure investment and financing among developing countries, the NDB differs significantly from traditional multilateral development banks in terms of financing sources, fields and mechanisms.

The establishment of the NDB represents an international mechanism innovation in the field of international development financing. The purpose of this mechanism innovation is not only to better meet the needs of developing countries for development financing but also to force the existing multilateral development banks to reform and transform.

RECOMMENDATIONS FOR THE INSTITUTIONAL DESIGN OF THE NDB

Institutional design is important for the NDB because the period from the declaration of establishment to the preparation for operation is critical. The arrangement of the mechanisms underpinning the NDB will have to deal with three important relations: first, relations among the five large developing countries that comprise the BRICS grouping; second, relations between the BRICS countries and the bank's future borrowers, which involves relations between large and small developing economies; and third, relations between the BRICS countries represented in the NDB and developed countries.

From the starting point of new South–South co-operation, which is the basic property and strategic position of the NDB, five principles should be prioritised in its mechanism design: fair governance; market-based operation; non-intervention but adherence to high standards; localisation; and constructive supplement. Of these, the principles of fair governance and market-based operation mostly manage relations among the BRICS countries. In turn, the principles of non-intervention but adherence to high standards and localisation mainly deal with relations between the large and smaller developing countries. Finally, the principle of constructive supplement mainly deals with relations between the large developing economies and their developed counterparts.

FAIR GOVERNANCE

Despite concerns over China's far greater economic power, the mechanism arrangement of equal fund and discourse power demonstrates the substantial international mechanism innovation capability of the BRICS countries, as well as the political will and determination of China to hold its own power in check and push for new South–South co-operation. The NDB reflects a principle of fairness. It boasts an innovative governance structure in that its stock rights are divided equally among the BRICS countries, thus delinking the division of stock rights from the proportion of BRICS countries' gross domestic product (GDP) in global GDP. This innovative attempt needs to be confirmed in practice. The BRICS countries share the view that fairness must be shown in the governance structure of the NDB. This is an attempt to democratise international relations in international finance, and its success depends on the BRICS countries maintaining this and promoting a co-operative spirit.

There is no denying that the model of fair governance will also have an impact on the operational efficiency of the NDB. If the bank takes a political operation model, the fact that all of the founding countries have equal discourse power and shares may result in some difficulty in making collective decisions when there is a divergence of interest among the BRICS countries. However, if the bank takes a market-based operation model, which involves avoiding political intervention from member countries to the greatest extent possible, and provides senior management with enough autonomy and discretion to take charge of daily operations based on the rules of the market, the NDB may become a professional and efficient financing and investment platform for infrastructure.

MARKET-BASED OPERATION

As a platform for new South–South co-operation, the NDB should work hard to avoid becoming politicised and stick to the market-based operation model. It should focus on making full use of professionals, and building a reasonable business operation model and risk control systems and mechanisms. A market-based operation model will enable the bank to diversify sources of capital by including capital drawn from the market and other channels aside from the BRICS governments. It will also enable the NDB to introduce governance structures used in modern companies, such as a board of supervisors. In addition, the bank can consider market-based recruiting to attract the best international talent.

NON-INTERVENTION BUT ADHERING TO HIGH STANDARDS

There may be some adverse consequences if the NDB does not attach any loan terms or adopts a non-intervention approach to borrowing countries. First, smooth money-back cannot be guaranteed. If borrowing countries implement improper economic policies or engage in corruption, there may be a situation in which loans and funds are wasted. Second, if the NDB does not attach any terms to its loan terms, borrowing countries may invest the funds in projects that compromise international environmental standards and human rights.

At the same time, the NDB's mission is to achieve mechanism innovation in the field of international development financing and to explore the establishment of a more equal and balanced new global partnership for development. Therefore, it should insist on the principle of non-intervention, respect the rights of developing countries to choose their own development paths, and ensure that developing countries have the necessary policy space. That said, the bank should include high-standard safeguard clauses that are both strict and feasible. It should also improve on some of the safeguard clauses of existing multilateral development banks, which are tedious, unpractical and have little relation to their business, with a view to cutting costs and increasing the operational efficiency of the NDB.

LOCALISATION

From the perspective of new South–South co-operation, the NDB should insist on equal communication and mutual learning. Moreover, it can also be used as a platform for sharing and communicating experiences among countries, which will help to achieve the organic synthesis of both fund- and wisdom-gathering.

The NDB should avoid repeating the mistakes of the World Bank, which neglected the development needs of developing countries and imposed the development experience of developed countries onto developing economies. In this way, it can build an international image as a new development bank that belongs to developing countries. At an operational level, the NDB should strengthen co-operation with other development banks in developing countries such as the Brazilian National Development Bank and the Indian National Development Bank.

CONSTRUCTIVE SUPPLEMENT

Finally, as an incremental element of the international development financing system, the major value of the NDB is mechanism innovation, in the sense that it can serve as a constructive supplement to the existing multilateral development banks, rather than as competition. Given the huge financing gap faced by developing countries for infrastructure development, funds from developed or emerging economies alone cannot meet the huge need. Moreover, emerging economies still actively support the development and reform of existing multilateral development banks. In the future, the World Bank and the NDB may look to co-operate by co-financing specific projects and by learning from each other's ideas and experiences, so that they can build a new international development financing system that is better equipped to meet the needs of developing countries.

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The GEGAfrica Project is managed by the South African Institute of International Affairs and the University of Pretoria, and supported by DFID.

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