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# The New BRICS Development Bank and the Aid Architecture

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We examine in this policy brief the role that the New BRICS Development Bank (NBDB) can play in the economic development of developing countries in the current aid situation. The main feature of the current aid situation is the declining importance of aid from traditional sources such as the OECD countries and the multilateral development banks such as the World Bank, Asian Development Bank, the African Development Bank and so on. The question also arises whether apart from its financial contribution the NBDB can provide a new model of governance and a new development model. Furthermore, we explore the implications of the NBDB for the role of China and India in the international economy and how it might affect their relationship.

## Growth Patterns

The pattern of growth among different countries is very mixed. There has been a considerable slowing down of growth in the high income countries since the financial crisis of 2008, with even negative growth in some years. Developing countries have been growing much faster than the high income ones. Low income countries have actually grown faster since the crisis so that, though they continue to grow slower than the middle income countries, the gap in growth rates between the two groups has narrowed. But within the middle income countries, the slowdown has been greater in the lower middle income group than in the upper middle income group. Similarly, in the low income countries, the Less Developed Countries (LDCs) were growing faster than other low income countries before the crisis. However, after the crisis the slowdown has been greater in the LDCs so that they are growing slower than other low income countries. So within each group of the low income and middle income countries the lower income groups have been hit the hardest.[1]

There are considerable variations in the growth achieved by the different BRICS countries and also over time. However, China has grown much faster than the other countries by a very large margin. Per capita

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[1] Low-income economies are defined for purposes of the FY 2015 as those with a Gross National Income (GNI) per capita, calculated using the World Bank Atlas method, of US$1,045 or less in 2013; middle-income economies are those with a GNI per capita of more than US$1,045 but less than US$12,746; high-income economies are those with a GNI per capita of US$12,746 or more. Lower-middle-income and upper-middle-income economies are separated at a GNI per capita of US$4,125.

income in China increased more than seven times between 1991 and 2013; almost tripled in India. But per capita income increased by only 50% in Brazil and barely grew in Russia and South Africa (20%). Growth in the period 2011-13 as compared to 2001-07 (the period before the crisis), has decreased the most in Russia and the least in Brazil and South Africa.

Developing countries and the different regional groups have been able to maintain their investment levels and also the share of exports in their GDP. In this largely positive economic performance, a weak point has been the performance of the manufacturing sector whose share in GDP has declined. Another weak point that we do not discuss here is that developing countries have not been able to increase their share of world exports in the dynamic service sectors of financial services and IT-related services.

## Role of Aid

What is the role of aid in this economic performance? The importance of aid has been declining, particularly for the regions of East Asia and Pacific (EAP) and for Latin America and the Caribbean (LAC) where it now plays a negligible role in supporting either investment or income (Table 1 shows how much of fixed capital formation is supported by aid). But it is still very important for the poorest countries.

As of 2011-2012, aid supports about a third of investment in low income countries, but a surprisingly smaller portion in the least developed countries, though till 2000, aid was a larger share of investment in the least developed countries than in the low income countries. One possible explanation of the greater slowdown in the LDCs after the crisis may be the greater decline in aid support for investment. Furthermore, the share of aid going to production sectors or to sectors that support production has been declining over the years.

**Table 1**

**Regional Distribution of Aid (% of Gross Capital Formation)**

| | *1960-73* | *1974-82* | *1983-90* | *1991-2000* | *2001-07* | *2008-10* | *2011-12* |
|---|---|---|---|---|---|---|---|
| ***LDCs*** | -- | 43.5 | 56.3 | 51.9 | 39.3 | 31.8 | 26.3 |
| ***Low Income*** | 19.6 | 34.6 | 56.3 | 51.9 | 44.4 | 39.8 | 31.6 |
| ***Low & Middle Income*** | 5.1 | 5.5 | 6.1 | 5.0 | 3.8 | 2.4 | 1.8 |
| ***Lower Middle Income*** | 11.0 | 10.2 | 8.5 | 8.6 | 5.6 | 3.5 | 2.7 |
| ***Upper Middle Income*** | 1.2 | 1.1 | 1.4 | 1.2 | 1.0 | 0.4 | 0.3 |
| ***EAP*** | 3.7 | 2.7 | 2.9 | 2.1 | 0.8 | 0.3 | 0.2 |
| ***LAC*** | 2.1 | 1.2 | 2.3 | 1.7 | 1.4 | 1.0 | 1.0 |
| ***SA*** | 10.2 | 11.2 | 7.0 | 5.3 | 3.0 | 2.4 | 2.0 |
| ***SSA*** | 7.4 | 10.4 | 25.3 | 30.8 | 29.2 | 17.5 | 15.8 |

*Source*: 'World Development Indicators', World Bank (several years). SA: South Asia, SSA: Sub-Saharan Africa

The share of aid going to agriculture or industry or infrastructure has also been declining. Change in the sector destination of aid could also have contributed to a diminishing contribution to growth.

The main issue before the World Bank and its soft loan window, the International Development Association (IDA) is how to maintain their level of activities. Many of the large borrowers from IDA will graduate in the next decade or so. A number of options regarding the operations of IDA are being discussed. While middle income countries would have graduated from IDA, they will still have concentrated pockets of poverty. The IDA could therefore, lend for poverty alleviation projects in distressed areas even though the country overall would have graduated. Another option would be to increase the amounts lent to the remaining IDA eligible countries. These would be mainly in Sub-Saharan Africa (SSA). Doubts are however raised about whether these countries would have the capacity to absorb

the increased amounts of aid. A third option could be to lend for projects that supply global or regional public goods. These would be mainly in the areas of either public health or infrastructure. Whether amounts lent to countries in SSA increase directly or indirectly through investments in projects supplying public goods, this would have implications for the operation of the NBDB. A final option is to reduce the size of IDA.
The lending capacity of the World Bank will decrease unless its capital is increased; at the moment the developed countries are not inclined to increase the capital and therefore, it seems likely that lending will decrease. A fall in the lending by the World Bank will open up possibilities for the NBDB.

**Possible Characteristics of the NBDB and their Effect on the Aid Architecture**

The NBDB has been established to mobilize resources for infrastructure and sustainable development projects. It will do so through 'loans for public or private projects, guarantees, equity participation and other financial instruments'. It will also provide technical assistance to projects supported by the Bank. While the NBDB has been set up by the BRICS countries, membership is open to all members of the UN. But it seems that the presidency will rotate among the original members. The subscriptions of the other members and thus their voting power will be determined by the Governing Council. However, the voting power of the original members will not be allowed to fall below 55 percent and those of non-borrowing members to exceed 20 percent.[2] Furthermore, the voting power of a non-founding member cannot exceed 7 percent of the total. These rules may lead to the founding members being charged with running a non-democratic – a criticism that is levelled against the World Bank, too.

The first two subscriptions would be due 18 months after the coming into force of the agreement and would amount to merely US$2 billion. The rest would be paid over a period of five years. This would mean that the operations of the NBDB would be quite small for a number of years and it would not add significantly to the pool of investible resources. While the Board of Directors would be free to fix the rate of interest charged on the loans, this must protect the financial health of the institution. Infrastructure projects tend to be long-gestation projects and do not provide the earnings to service the loan for a considerable period of time. This could create problems of debt servicing for countries borrowing for infrastructure projects. For instance, India started borrowing on a large scale from the World Bank and bilateral creditors in 1958 and such borrowings at near market rates of interest resulted in six restructurings of its debt between1966 and 1976.

Furthermore, as noted above, large resources may be freed in IDA for investment in poorer countries. These countries may then have no incentive to borrow from the NBDB. The NBDB is then likely to cater more to the middle income countries. In addition, China has also been a motive force behind the establishment of the Asian Infrastructure Investment Bank (AIIB) and so Asian countries may not borrow from the NBDB. Therefore, it is likely that the main customers of the NBDB will be the middle income countries of Latin America.

The NBDB can however, make a number of positive contributions to growth in developing countries. The amounts made available through the NBDB could gradually increase. The BRICS countries also do not put any conditions on the amounts they make available through their development cooperation programmes. They might

[2] In essence this limits the voting power of the developed countries if they become members of NBDB.

continue with this policy in the NBDB. There is, however, the danger that lack of conditionality may endanger the viability of the projects. On the other hand, it has been argued that what is important is ownership of the project by the country. If there is ownership, conditionality may not be required. If the projects of the NBDB are successful even with no conditionality, other multilateral development banks will be forced to change their practices. The NBDB thus, has the potential to change the international aid architecture.

That said, the concentration of NBDB on infrastructure may limit its contribution to growth in developing countries. The emphasis on infrastructure investment is not embedded in an overall model of economic growth. As noted above, less of aid is channelled to the production sectors, agriculture and manufacturing. The former is important for food security, particularly as many developing countries will face new challenges because of climate change. Manufacturing is important for generating employment. In fact, one of the characteristics of growth within the developing countries over the past three decades has been the declining labour productivity in the non-agricultural sector in all regions except Asia. This will need to be reversed, if faster income growth has to resume.

**Motivations for China and Implications for India**

Why is China interested in assisting the setting up the NBDB when it could lend on its own? There are several possible reasons. China's development assistance in Africa has drawn criticism, including from Africans; it has been criticized for following a colonial pattern of trade, importing primary goods and exporting manufactures. Also its projects have often been implemented on a turnkey basis because of the lack of capacity in the countries. But while this may have resulted in efficient project execution it has not contributed to capacity building. China may believe that operating through a multilateral agency may deflect the criticism; it is thus basically a trade-off between control of the use of its resources and criticism of its activities. How it sees the trade-off, may largely determine the activities of the NBDB.

As far as India is concerned, it will need to make a fundamental decision. Does it see the NBDB mainly as a source of capital for its infrastructure needs or a vehicle to leverage its influence in other developing countries? We noted above that the amounts available for lending in the initial years would be quite limited. They would be totally inadequate to India's needs. India might also lose some goodwill by utilising a significant share of the available amounts. It would be better for India to refrain from borrowing from the NBDB and to try rather to earn goodwill by helping the development of other countries.

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