

A new global financial order?

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In July 2014, at the Brazilian seaside city of Fortaleza, leaders of the five most populous nations, which also are the most important emerging-market economies ~ Brazil, Russia, India, China, South Africa, collectively known as BRICS, took a momentous decision to create two new international financial institutions: A New Development Bank (NDB) and a joint monetary fund, to 'reconfigure the system of international economic governance', as Brazilian President Dilma Rousseff said. The NDB, with a capital base of \$50 billion, contributed equally by the five member states irrespective of the sizes of their population or economy and having equal voting rights, will finance their infrastructure and development projects. The bank, to start lending from 2016, will be headquartered in Shanghai. India will be its first president for 5 years, followed by Brazil and Russia. The new bank reflects the growing importance of BRICS, which account for almost half the world's population and about one-fifth of the global economic output. But its capital base of \$50 billion, that might eventually rise to \$100 billion, cannot rival the World Bank's capital base of \$232 billion or even the Manila-based Asian Development Bank's \$165 billion.

The five leaders also agreed to establish a Contingent Reserve Arrangement of \$100 billion to help member states in financial emergencies, especially in the event of acute balance of payment crises. The BRICS countries have the world's largest foreign currency reserves, led by China, and the new institution can invest these savings at a profit. China contributed \$41 billion to its capital stock; India, Brazil and Russia each paid in \$18 billion, and South Africa paid \$5 billion. Each member nation has the right to withdraw different amounts from the CRA ~ China \$20.5 billion; Brazil, Russia, and India \$18 billion each; South Africa \$10 billion. The two institutions ushered in a new era in global financial power structures.

In another July 70 years ago, 730 delegates from 44 allied nations had gathered at the Bretton Woods Resort in New Hampshire, USA, to evolve a new international monetary and financial order that could address the needs of reconstruction in the war-ravaged European nations which were, moreover, staring at the impending demise of their colonial empires and the consequent loss of their own economic might.

Led by the USA, they established a new financial system ~ the Bretton Woods system ~ to prevent recurrence of the problems that had beset the world since the Great Depression of the 1930s, which had given rise to protectionism, with nations controlling access to foreign currencies which they were using to manipulate trade and build a surplus to be used for the purposes of war. The Bretton Woods conference made all currencies freely convertible at fixed exchange rates, while linking the dollar, and hence all currencies, to gold at a fixed exchange rate of \$32 an ounce. To help European reconstruction, the World Bank was established with 28 members; today it is a 188-member body that works for their socio-economic development. To protect countries against devaluation of their currencies, the International Monetary Fund (IMF) was set up, from which members could borrow. IMF is financed by contributions from member states, but decisions are not based on one-country one-vote ~ voting instead is determined by the level of contributions. Thus, the USA controls 16.75% of the votes, the European Union collectively commands 30% and their friendly powers control about 12%. BRICS collectively control only 11% of votes, with China alone contributing 5.76%. In this scenario, western countries always prevail over the developing nations. Leadership of the World Bank has also been reserved for an American and that of the IMF for a European.

The Bretton Woods system worked well till the early 1970s and despite devaluation of various currencies, managed the exchange rates rather successfully. But while the current account transactions were more or less free from currency controls, controls over capital account transactions continued unabated till the 1980s. Throughout, however, the US dollar retained its competitive advantage and US multinationals continued to invest abroad, leading to steady accumulation of capital in the hands of American financial institutions. As speculation built up against the dollar, in 1971, convertibility of the dollar was suspended, and following its devaluation soon afterwards, the fixed exchange rate regime had collapsed by 1973. As weaker developing nations increasingly faced balance of payments crises, the IMF extended finances to them, but in doing so, it actually protected the interests of international financial institutions, to the disadvantage of these countries. IMF loans came with trademark conditions of privatisation, steep increases in taxation, government deregulation and deep cuts in governments' social spending on the poor, in the pretext of stabilising their fiscal and monetary policies. These conditions unfairly opened the vast markets of developing countries to western business interests by removing tariff barriers, in the process destroying local business enterprises and exposing their people to acute hardships.

Every financial crisis is accompanied by high inflation and large government expenditure and corrections are always painful. But the severity of IMF's pro-market conditions in the name of 'structural adjustments' often went much beyond what was necessary to restore equilibrium, making these countries surrender their own development strategies in order to borrow. For implementation of this strategy, authoritarian conditions were required even in a democracy, what Naomi Klein called shock therapy in her book *The Shock Doctrine*. The therapy was applied repeatedly under the authoritarian regimes of Chile, Russia, China, Argentina, Indonesia, Poland, Iraq and across many other countries, often under extreme coercion by an iron-fisted leadership. Growth at the cost of extreme income inequality, poverty and economic exclusion of large swathes of population often resulted from these IMF-dictated policies.

Every nation has the right to pursue their own national interests and international organisations exist only for as long as they serve that purpose collectively. The problem arises only when interests of developed and developing nations clash and the latter, being in economically weaker positions, are forced submit to the will of the rich. Thus when the IMF granted \$23.5 billion to Greece, \$22.9 billion to Portugal and \$19.4 billion to Ireland, the BRICS countries had little to gain in bailing these Euro-area countries out, as these countries' shares in their own trade balances were negligible. Discontent and frustration have been brewing among the developing nations against the hegemony of rich nations in the IMF or World Bank for quite some time. But the US Congress refused to ratify the IMF reform proposal of 2010 to redistribute voting rights by hiking the share of developing nations only by 6%, which would have seen India's quota rising marginally to 2.75% from the existing 2.44%. Now with the BRICS bank, international economic power might undergo a real gradual shift from the developed to the developing world.

Sceptics argue that apart from being major developing countries, the BRICS have little else in common and a BRICS Bank will be non-functional. But there is the precedent of Latin American development bank *Corporación Andina de Fomento*, founded in 1970, which is successfully operating without US influence, and had approved \$12.1 billion of projects in 2013. Taking a cue from the BRICS Bank, India has gone a step further. The eighth meeting of the South Asian Free Trade Area ministerial council in Thimphu in July 2014 approved the proposal, first mooted by India, to establish a SAARC Development Bank to provide access to low-cost capital for financing infrastructure in the eight SAARC countries. There is already a SAARC Development Fund with a paid-up capital of \$300 million to provide financial assistance to social sector and infrastructure projects which can be integrated with the new bank. Last

month, the government set up a committee to examine this proposal due for final approval during the SAARC summit in Nepal next month.

This is a welcome step and may spur other regions to come up with similar institutions to break the dominance of developed nations in a changed world order.

After the collapse of the USSR, in his 1989 article, "The End of History?", Francis Fukuyama celebrated the 'triumph of the West' and 'Western idea', arguing that 'the end point of mankind's ideological evolution' had been reached 'in an unabashed victory of economic and political liberalism', in deregulated markets and western democracy. That world is already cracking, and unless the West is ready to accommodate the emerging nations, Fukuyama's imaginary world would turn upside down.