

# BRICS: Opportunities and Challenges

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**Abstract-** *The acronym BRICS was a fad among the media and global investors. Now, the acronym sounds passé. However, the group of countries remains important, from both political and economic reasons. They have a large aggregate size, 28% of the global GDP and 42% of the world's population, high growth potential due to the current significant misallocation of resources and relatively low stock of human capital, structural transformation is in progress and one of them, China, is taking steps to become a global power and a challenger to the US dominance. This paper provides a brief overview of the five economies, Brazil, Russia, India, China and South Africa. We focus on some aspects of their history, the Chinese initiatives in international finance and geopolitical strategic moves, their growth experience and structural transformation over the last 35 years, trade and investment integration into the global economy and among themselves, the growth challenges faced by their economies and the potential gains to the Brazilian economy from a stronger integration with the other BRICS. In association with its efforts to be a global power, China aims to become a major player in global finance and to achieve the status of global currency for the renminbi, which would be the first currency of an emerging economy to attain such position.*

**Keywords-** BRICS, Political, Economic, Global, Geopolitics, Strategic.

## I. INTRODUCTION

In 2001, Jim O'Neill, chief economist of the American bank, Goldman Sachs, in a report "Building Better Global Economic BRIC" first coined the phrase 'BRIC' which stands for Brazil, Russia, India and China---the four of then fastest-growing emerging economies of the world. Looking at the features like size of population, demographic dividend and rate of globalization, Goldman Sachs (GS) forecasted that these four countries had the growth potential to replace the European economy in terms of market size. GS also predicted that China, India, Brazil and Russia would become the first, third, fifth and sixth largest economies respectively, by 2050. However, 'BRIC' as an international forum was formalized with the first meeting of the foreign ministers of Brazil, Russia, India and China in New York on the margins of the UN General Assembly in September, 2006. Later in April 2011 (third BRIC summit), South Africa joined this forum and

'BRICS' was formed. The five countries together account for 43 percent of the world's population, 46 percent of the global labour force, 30 percent of the earth's landmass and 25 percent of the world's share of global gross domestic product (GDP). The BRICS countries, apart from complementing their respective economies in terms of resource exchange, are also the major resource suppliers to the industrialized world. However, these countries have very little cultural or political similarity; and their levels of development differ widely. Given that there were no significant prior economic ties among these countries, the creation of BRICS was a major step towards an alternative global economic landscape. The formation of the BRICS was rooted in the long-term common economic interests of the member nations, which include reforming global financial and economic architecture, strengthening the principles and standards of international law and supporting the complementarities of many sectors of their economies<sup>1</sup>.

## II. THE BRICS SUMMIT: A LOOK AT SOME OF THE ISSUES

The ninth annual BRICS summit gets underway in Xiamen from 3 – 5 September 2017, under China's chairmanship. This year's theme is "BRICS: Stronger Partnership for a Brighter Future". President Xi Jinping has outlined four priorities for the summit: 1) deepen BRICS cooperation for common development; 2) enhance global governance to jointly meet challenges; 3) carry out people-to-people exchanges to support BRICS cooperation; and 4) make institutional improvements and build broader partnerships.

What are the key issues that member states should prioritise? Five experts on Brazil, Russia, India, China and South Africa share their views<sup>2</sup>.

### South Africa: Economic growth

South Africa is currently experiencing low economic growth. In 2016, gross domestic product grew at a mere 0.3%, with predictions for 2017 showing **slow recovery at 0.8%**. Latest employment figures (June 2017) also point towards challenges within the economy, with the unemployment rate **at 27.7%** – the highest since 2003. It will be pertinent to

see how South Africa can leverage the BRICS relationship to assist in addressing its domestic economic constraints.

The New Development Bank (NDB) could potentially have a significant impact by providing additional finance to South Africa, which can be leveraged to spur infrastructure investment which in turn creates demand for goods and services and creates jobs. The NDB recently **pledged \$1.5 billion** over the next 18 months to develop infrastructure projects in South Africa.

Other areas of cooperation, such as facilitating greater intra-BRICS investment, will be important. South Africa's recently established investment one-stop-shop should assist in this regard. Actively advertising this mechanism will be important.

South Africa, along with the other BRICS, has signed the World Trade Organisation's Trade Facilitation Agreement (TFA). The TFA aims to improve trade flows between countries by minimising bureaucracy. All the BRICS members except South Africa have also **ratified the agreement**. The country should expedite this process (that is already underway) to take full advantage of the TFA within the BRICS.

For South Africa, challenges facing other African countries will also be high on the agenda – issues such as financing development efforts to meet the SDGs, infrastructure development and peace and security will be pertinent<sup>3</sup>.

#### **Russia: Institutional improvements, economic benefits**

If we look at Russia's involvement in the BRICS and its stake in the institution's future, there are two major aspects to take note of.

The first is Russia's interest in promoting further institutional development of the BRICS. Perceived by some analysts and policymakers as a bulwark against western influence, the BRICS has over the years managed to strengthen its cooperation frameworks across a significant number of policy areas and has begun reaching out to other major developing economies. One of China's announced priorities – “making institutional improvements and building broader partnerships” – is clearly in line with what Russia has in mind for the BRICS.

The second aspect deals with more pragmatic considerations of drawing tangible economic benefits from participation in the group. In this regard, Russia needs to steer the BRICS agenda towards more effective and concrete

cooperation on issues which represent structural bottlenecks for the country's economy. For example, advancements on trade and investment policy coordination within the BRICS could complement and boost Russia's export diversification efforts through fostering small and medium-sized enterprises' access to foreign markets and their participation in global value chains.<sup>4</sup>

The priorities set by China for the 2017 BRICS are conducive to achieving both goals outlined above. The host wants to focus on boosting cooperation on core economic issues by building upon and furthering the implementation of plans such as the Strategy for BRICS Economic Partnership (adopted in 2015 under the Russian chairmanship).

#### **China: Unity**

The most important issue for China at this year's BRICS summit is unity. As President Xi Jinping has put it, the BRICS are like five fingers, each with their own strength; when the BRICS come together, they pack a powerful punch. There are three aspects to this:

First, unity in spite of conflicts. Tensions between China and India, the two most populous countries in the world, recently escalated due to the re-emergence of months-long conflict over the Doklam Plateau. On Monday 28 August the two countries reportedly decided on “**mutual disengagement**” but a permanent solution is still required. At this summit, Beijing and New Delhi need to explore more effective ways of crisis management, since they are the only neighbouring countries within the BRICS with some unsolved historical and geopolitical issues.

Second, unity as one is power. The unity and stability of the BRICS group have been a source of confidence and “positive energy” in China and beyond, and is a kind of rare public good in this chaotic world. In recent years, many big “Black Swan” events have occurred, such as Brexit and Donald Trump's US presidential election victory.

Finally, unity after enlargement. After 10 years of development, the future direction of the BRICS is a hot topic. China's foreign minister Wang Yi stated in March that the country will explore the modality of 'BRICS plus' by holding outreach dialogues with other major developing countries and organisations within them. I believe an expanded BRICS group could surely face more difficult internal integration challenges.

#### **India: Counter terrorism, institutionalised partnerships**

In the wake of the recent Doklam Plateau standoff, India must be careful to uphold its international image and be pragmatic in its position during the summit.

International terrorism is a key issue for India. It will seek strong **co-operation on counter terrorism**, including clamping down on terrorist networks, weapons and financing. In this regard, India will look forward to positive changes in China's position on **Masood Azhar** and India's bid to have him declared a global terrorist by the United Nations.

Another issue of importance for India is its trade deficit with China. In fact, all of the other BRICS countries have a trade deficit with Beijing and India will want to focus on reducing it through multilateral co-operation. India is also keen to see the BRICS rating agency accepted at the summit as it will reduce developing countries' dependency on western credit ratings.

China has proposed a new 'BRICS plus' model, which will incorporate more countries from the global south and strengthen south-south cooperation. Arriving at a consensus on the viability of this concept, and on which countries will be invited to join, will be difficult. Should China try to bring its ally Pakistan into the grouping, India will protest.

The more co-operation and engagement is institutionalised in the BRICS, the lesser the likelihood of its failure. Indian policymakers are well aware that India needs the BRICS more than the BRICS needs India. Therefore, the country looks forward to a new decade of deepened, institutionalised partnership within the bloc.

#### **Brazil: Domestic concerns, sustainable development**

The political and economic turmoil that has engulfed Brazil shows no signs of fading. The 'fight against corruption' led by the judiciary in coalition with segments of the media has backfired into a defensive posturing from all actors in the political system. Amidst polarised positions and a growing feeling of frustration, street activism has been replaced by apathy and resignation.

To guarantee its very own survival, the current government, perhaps the most unpopular in Brazilian history, trades political support for the advancement of the interests of its most conservative allies. The result is a condescending response to and, in some cases, complicity in, serious human rights violations, from mass killings in prisons to massacres of rural workers and attacks against indigenous peoples. For the third consecutive year, Brazil has topped the list of countries

with the highest number of homicides of human rights and environmental activists.

In this scenario of so many internal distractions, the crucial question is how Brazil will influence this summit's agenda. As a democracy (per most of the accounts), Brazil has often been portrayed as a member that would bring to the BRICS bloc a human-centred perspective to sustainable development.

In Xiamen, the BRICS will discuss how a deepened partnership may pave the way for a "brighter future for economic development and social progress of all developing countries". However, with no signs that Brazil is honouring, at home, its own constitutional values and its professed commitments to human rights and environmental protection, the group will be under additional pressure to explain to the international community how they are effectively contributing to the achievement of the 2030 Agenda for Sustainable Development.<sup>5</sup>

### **III. CHALLENGES AND OPPORTUNITIES OF BRICS**

The end of the commodity super cycle, the negative spillovers from financial crises in developed economies and the macroeconomic policy response to these events have contributed to moderate the pace of expansion of the BRICS economies. Growth models implemented in the past, such as the credit-fueled investment in China, are showing signals of exhaustion. The total credit to GDP ratio in China jumped to 282% in 2014 from 158% in 2007 and the productivity of state-owned companies, which are the largest borrowers jointly with local governments, has been declining. Non-financial corporations, that include SOEs and local government financing vehicles, are highly leveraged being responsible for 44.3% of the total debt. A large part of the substantial credit expansion in China is related to the financing of a construction boom since 2008. Nearly half of China's debt is related to real estate. Part of the construction boom was a result of the search for higher returns given that bank deposit interest rates were kept negative in real terms, one of the features of inefficient financial markets. The credit-fueled consumption growth model adopted by Brazil is also exhausted and macroeconomic fundamentals have seriously deteriorated. Uncertainty has elevated, contributing to the postponement of investments and the execution of productivity enhancing moves. Twin deficits re-emerged, reaching 10.9% of GDP in 2014, inflation has been systematically above the target, productivity fell and the growth rate has plunged to 1.5% per year in 2011-2014 from 4.5% in 2004-2010. Repression of electricity, diesel and gas

prices, highway tolls and bus fares was abandoned and a fiscal adjustment program targets to promote a swing from a primary budget deficit of 0.6% of the GDP in 2014 – the largest since 1998 - to a surplus of 1.2% in 2015. The increase in transparency on budget accounting - aiming to regain credibility and to minimize uncertainty - is a key ingredient of the program. Policy makers are also focusing on the restriction to the expansion of subsidized credit by public banks, a source of fiscal disequilibrium and misallocation of resources. Economic activity in Russia is too much concentrated on energy, a potential source of macroeconomic volatility. Large state-owned companies play a key role on the economy as a result of the partial reversal of the privatization of the 90's and rent-seeking practices are deeply rooted. Rent-seeking activities involve in a large extent the transfer of funds from private sector and state-owned companies to politicians and public employees.<sup>6</sup> Their negative contribution to economic growth takes place through resource misallocation, barriers to entry to new competitors, and disincentives to innovation. In addition, the involvement in geopolitical disputes and the resulting economic sanctions from developed economies is another element to lower Russian growth potential. South Africa is trying to diminish the weaknesses of its physical infrastructure through a substantial investment program on energy generation and transportation. Complex labor relations are one of the obstacles to growth in South Africa. Protracted strikes and real wages disconnected from labor productivity produce negative effects on the economy, including the persistence of high unemployment rates, particularly among young workers.<sup>36</sup> China and India are responding to the new scenario through economic reforms to improve resource allocation. In the short term, China faces the risks of transitioning from a leveraged investment-manufacturing growth model to a less leveraged consumption services led model. The Chinese government is committed to a reform agenda set by the twelfth five-year plan that includes: (i) the reform of the hukou system; (b) to give a dominant role to market forces, including the unblocking of several services activities to private sector investment; (c) the restructuring the SOEs; (d) the modernization of financial markets; (e) the reform of the fiscal regime of the provinces. In addition, it has launched a strong anti-corruption campaign, an important move given the misallocation of resources provoked by corruption. So far, the reform agenda has seen progress, which adds credibility. The development of a fiscal reform package to restructure local government debt and the creation of new sources of revenue in order to lessen the reliance on land sales, the liberalization of bank lending rates and the relaxation of the cap on deposit rates, the development of a deposit insurance system to be put into effect this year, the implementation of the SH-HK Connect, the release of rules for deregulation of pharmaceutical prices and the abolition of pre-

registration requirements for new businesses- that allowed for a 45% increase in company formation in 2014 – are good examples. Financial market reform is one of the priorities of the new Indian government<sup>7</sup>. This comprises more competition in financial markets through the creation of new private sector institutions and exposure to external competition, simultaneously to the inclusion of hundreds of millions of people in the banking system. The elimination of subsidies and the development of the energy industry, particularly through the removal of barriers to entry in thermal coal mining, are also key points in the reform agenda. An ambitious program, “Make in India”, was recently approved by the government. Its main instruments are the acceleration of infrastructure investment, deregulation, the strengthening of intellectual property protection and the removal of barriers to FDI. They are aimed to facilitate investment, to stimulate innovation and to build a world-class manufacturing infrastructure. An interesting project, the Aadhaar, that uses biometric technology to solve India's identity crisis, is expected to be a powerful tool to fight poverty. Fingerprint and iris-recognition technologies will allow millions of people to gain access to health care, education, and basic government services, contributing to alleviate poverty, that as we have seen afflicts a large part of the Indian society. It is already beginning to show results, with enrollees opening their first bank accounts, acquiring mobile phones and obtaining more services from public agencies. Until 2014, approximately 600 million people were enrolled, half of India's population. Given the initiatives to remove various sources of resource misallocation, it is reasonable to expect that growth in China and India will continue to run above the remainder of the BRICS bloc, although at a slower pace than in the last decade.<sup>8</sup> The substantial misallocation of resources and the large scope to improve human capital give the BRICS countries a great potential to remain leading global economic growth and to reduce their income differences to the rich nations. Structural changes driven by economic development will create further opportunities to be exploited by Brazil. A clear case is the potential to develop closer linkages with China to exploit the complementary structure of resource endowments as well as the different structure of demand and supply. However, the Brazilian economy badly needs microeconomic reforms in order to make feasible the materialization of the potential gains stemming from these opportunities. For example, even though possessing the largest and the best iron ore reserves in the world, Brazil, the number one exporter until 2007, was largely surpassed by Australia since then. In 2013, Australia sold to the rest of world almost twice the volume of iron ore exported by Brazil. A great deal of the explanation for the failure of Brazilian iron ore exports to keep growing lies on the complexity of the environmental permitting system. This has produced long delays in the

development of iron ore projects, preventing Brazil to have benefitted in a larger scale from the commodity super cycle. Similar delays have been experienced by power generation and oil exploration projects, thus contributing to reduce their private and social rates of return and to aggravate the disequilibrium between demand and supply of energy, which has been met by high-cost diesel fired power plants and oil imports. The urbanization process in China will continue to require large volumes of iron ore over the next ten years, a growth opportunity to Brazilian miners. Per capita income growth in China and India tends to provoke dietary changes towards an increasing consumption of protein, leading to the expansion of demand for grains and meat, products that Brazil is one of the leading global exporters. Investment in infrastructure is key to take advantage of these opportunities. This means the allocation of funds by public and private sources to finance infrastructure building and higher efficiency in project execution as well as in managing operations. Some issues are very important for infrastructure investment in Brazil: the opening of the market for contractors to international competition, greater focus on maintenance, better structuring of auctions for concessions, efficient pricing systems for infrastructure services, availability of detailed engineering projects before starting construction and the simplification of the environmental regulation. The growth of services activities in China as well as the shift of India towards a more open economy to FDI flows offer another set of opportunities to be exploited by Brazilian companies. Unless it is able to engineer major productivity gains in manufacturing, Brazil will continue to lose markets to Chinese products.<sup>9</sup> The dislocation of Brazilian manufactured goods takes place not only in its domestic market but also in the US, Europe, and even in the Mercosur. The imposition of barriers to trade is of course not a solution. As it is well known, such practices lessen competition in the domestic market, which contributes to diminish the efficiency of producers and to raise costs for consumers, a perverse combination detrimental to growth. Although the adoption of an export-led growth model is not an option to Brazil anymore, its economy needs to be much more exposed to international competition, an important channel for the transmission of new ideas and the realization of productivity gains. Brazil does need to improve the quality of education, to increase investment in research and development, to leverage its comparative advantages and above all to learn from the successful experiences of other emerging economies.<sup>10</sup>

#### IV. CONCLUSION

Their importance in global economic and political affairs is also reflected by various other indicators, such as trends in FDI inflows and outflows, trade openness, current

account balance, forex reserves and economically active labour force, which could make BRICS a formidable force to reckon with in the future. Other issues that pose obstacles for the BRICS countries include inadequate infrastructure; a lack of institutionalisation; the heterogeneous nature of the group and lack of cohesive identity; the fragile nature of trade and investment linkages among the BRICS countries; and differences within the group on values, economics, political structures and geopolitical interests. The opportunities ahead and the challenges faced by these countries call for changing how individual member countries view BRICS as a group. A more co-operative and collaborative approach on issues of common and global interests is required, which can perhaps help in actualising the co-operation.

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