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BRICS INSIGHTS PAPER 1

INDIA'S EXPERIENCE WITH MULTILATERAL FINANCIAL INSTITUTIONS: INSIGHTS FOR THE BRICS NEW DEVELOPMENT BANK

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INTRODUCTION

In the wake of India's economic growth in the past two decades, the country has played an increasingly prominent role in providing foreign assistance to low-income countries, particularly in Asia and increasingly in Africa. The Indian government sees development co-operation as an integral component of its foreign policy, reflected in the growing scope of its assistance in both geographic reach and sectoral terms.

From the 1950s to the 1980s, strong ideological and political motivations provided the impetus behind India's development co-operation. For this reason, Indian development co-operation is supported by historical and nationalistic references and based on six main conceptual pillars: i) sustainable and inclusive growth; ii) sharing India's domestic developmental experience; iii) no conditionalities; iv) demand-driven support; v) mutual gains; and vi) its contribution to India's soft power. Framed first and foremost as South–South co-operation, India's development co-operation is shaped by its colonial history and its sense of solidarity with other former colonies.

After India's economy underwent liberalisation in the 1990s and moved away from a mixed, state-led economy towards a capitalist and market-oriented approach, its foreign policy became increasingly influenced by geo-economic considerations accompanied by growing aspirations for a bigger say in the international political sphere. India has made numerous calls for greater representation for emerging and developing countries in a number of multilateral forums, including the World Bank and the International Monetary Fund (IMF).

It was within this context that the BRICS members decided to establish the BRICS New Development Bank (NDB). The launch of the NDB has marked a paradigm shift in the global financial system towards a new economic order in which the voices of developing countries have greater representation. It has also heralded a new dawn in the efforts of BRICS members to carve out their own policy space within the global economic architecture. Given this context, this policy insight tries to understand India's engagements with multilateral financial institutions and its development co-operation. It also focuses on India's development finance institutions and the role development co-operation can play in the context of the newly created NDB. Finally, it gives insights into the power dynamics within BRICS, as well as the rise of China in South Asia and the strategic and security implications of this for India.

INDIA AND MULTILATERAL FINANCIAL INSTITUTIONS

India was one of the 44 original signatories to the agreements reached at Bretton Woods that paved the way for the formation of the International Bank for Reconstruction and Development and the IMF. India was also one of the founding members of the International Finance Corporation (IFC) in 1956 and the International Development Association (IDA) in 1960. In light of its huge investment needs following independence, India has always viewed its relationship within these multilateral institutions through a North–South prism. In this sense, as a borrower, India has requested greater resources at minimal costs, both in financial and non-financial terms.

India's engagement with multilateral and regional development financial institutions has only recently evolved; and today it is far less dependent on multilateral funding agencies than in the past. Its recent actions reflect a shift in its approach towards these institutions from that of a 'borrower' to that of an 'owner'. Nevertheless, some of its actions portray a somewhat contradictory approach. This can be attributed to the dichotomy that is the Indian state: while India boasts one of the largest economies in the world, it is also home to almost a quarter of the world's poor.

This tension was evident in 2011 when India informally agreed to graduate from the IDA before later reversing its decision, arguing that although, on average, it is a lower middle-income country it still has a significant proportion of poor people. Similarly, in spite of India's 'Look East' policy, when it was invited to join the Asian Development Fund (which required a nominal contribution of $10 million) it declined on the grounds that it would adversely affect its claims to the IDA. These actions indicate that India's strategic view on multilateral financial institutions has not fully adjusted to its new economic situation, primarily because of its enormous domestic needs.

INDIA'S DEVELOPMENT FINANCE INSTITUTIONS

Unlike some of its BRICS counterparts, India does not have a single institution that oversees its national development finance. After gaining independence in 1947, India nationalised the Reserve Bank of India (RBI) and launched a national development strategy that sought to speed up its industrialisation process. Over the next 50 years, the RBI established development finance institutions (DFIs) with the aim of financing the country's infrastructure needs and reducing the developmental gap that separated it from the world's advanced economies. This saw the establishment of almost 30 national DFIs.

With the advent of financial sector reform in the 1990s, the operating environment for DFIs changed substantially. The supply of low-cost funds was withdrawn and, as time progressed, the intermediary role of DFIs became obsolete as banks and bond markets became increasingly sophisticated in risk management techniques. In the last two decades, India has seen a wave of important DFIs convert to universal banks.

Today, India has 10 national DFIs that perform a combination of financing, regulatory and supervisory roles within their specific sectors, and 40 state-level DFIs that carry the same responsibilities but at a sub-national level. These DFIs still play an important role in the financing of long-term investments within specialised areas. While the number of DFIs has reduced, financial assistance from the remaining national DFIs has been increasing over the past 10 years.

Although there has been a significant increase in domestic infrastructural spending, India still has a large infrastructural deficit. According to its 12th Five-Year Plan (2012–17), the country requires investment of $1 trillion in order to fill this deficit.[*] India's DFIs, as well as regional and multilateral institutions, are crucial in bridging the gap.

The World Bank Group has initiated a country partnership strategy with India for 2013–17 and, in the next five years, will focus on three specific areas: integration, transformation and inclusion. The World Bank's new strategy proposes a lending programme of $3 billion to $5 billion each year over the next five years, with 60% of this funding going to government-backed projects. Inclusive economic growth and poverty reduction are priorities in the World Bank's strategy.

In 2014, the IFC, a private sector arm of the World Bank Group, committed to investing $4.7 billion in key Indian sectors such as infrastructure, telecoms, energy, education, water management and healthcare. For its part, the Asian Development Bank will fund a $7 billion to $9 billion loan for infrastructure development in the country and will provide additional funding of $30 million for technical assistance grants and developing institutions and capacity at both the state and local level. Despite this, multinational financial institutions often face multiple roadblocks to implementing infrastructure projects in India, including delays in approvals, land acquisition and environmental clearance issues, and lack of quality manpower.

INDIA'S INTERNATIONAL DEVELOPMENT CO-OPERATION

While India spends a considerable amount of development finance internally, it is also engaged in a substantial number of international development activities. In the past 20 years, it has progressed from being one of the world's largest recipients of donor aid to one of the largest emerging economy providers of development assistance. The increasing scope of India's international development assistance over the past few years mirrors the country's expanding political and economic influence within the global community.

The nature of India's development assistance has also changed in the years following its independence. In the 1950s and early 1960s, the country's development assistance consisted mostly of grants and loans offered by the Ministry of Economic Affairs (MEA). In the early 1990s, India sought an alternative means of extending development assistance. It established lines of credit (LoCs) that enabled the government to raise more resources through the private sector and subsidise the interest rate through the Ministry of Finance. LoCs remain one of the primary channels for India's development assistance and are a core component of its development co-operation in Africa, Asia and Latin America. They allow recipient countries to import goods and services and undertake projects for infrastructure development and capacity building. In the past 10 years, African countries have been the major beneficiaries of India's LoCs, accounting for $6.659 billion of the total $11 billion allocated to developing countries. The bulk of the remaining balance has gone to India's South Asian neighbours.

Due to the increasing amount of development assistance flowing out of India, the need for a centralised co-ordinating structure became acutely apparent. In a final effort to streamline the country's overseas investments, the Development Partnership Administration was established in 2012 under the MEA.

[*] Government of India, Planning Commission, Working Sub-Group on Infrastructure, 'Infrastructure funding requirements and its sources over the implementation period of the Twelfth Five Year Plan (2012–2017)', http://planningcommission.gov.in/aboutus/committee/wg_sub_infrastructure.pdf.

This development assistance is directed primarily at the country's neighbours in the South and South-East Asian region. Bhutan is currently the largest recipient of Indian financial assistance. India sees development co-operation as a means to share its developmental experiences with other countries along the same developmental path. This aid is said to strengthen its geopolitical influence and is driven primarily by strategic interests. India uses this type of development assistance, premised on the principle of mutual benefit, to differentiate itself from other emerging economies, particularly China. India cannot compete with China in terms of the amount of disbursements into the region; therefore it makes use of its comparative advantages in technology, industrial agriculture, education, and information and communication technologies.

REGIONAL IMPERATIVES

The power dynamics within the BRICS grouping require close attention. China's gross domestic product and foreign exchange reserves – which currently stand at $4 trillion – are greater than those of the other BRICS countries combined. Its economic dominance in BRICS has resulted in tensions, particularly between China and India, in discussions on issues such as the location of the NDB and the distribution of shares.

As the largest economy in South Asia, India has always had strategic importance. However, China's expanding influence in the region over the last decade has sparked a strained response from India. It has sought to keep China out of the South Asian Association of Regional Cooperation (SAARC) and the subcontinent, but due to strong support for China from neighbouring countries in the SAARC it has had to make concessions. As development financers, both independently and now within BRICS, India and China will increasingly have to engage in a co-operative framework within the larger context of geopolitical rivalry and competition.

China has initiated a number of development projects in South Asia, which has far-reaching strategic and security implications for India. China has been developing port facilities in Pakistan, Bangladesh and Myanmar, and is planning to build railroad lines in Nepal.[†] It is also investing $1 billion in the Hambantota port facility in Sri Lanka. China's growing role in South Asia through development projects has created serious strategic and security concerns for India. This is particularly relevant in the context of the newly created NDB, and it is important that the political leaders of BRICS ensure that the NDB does not engage in development activities in disputed areas.

CONCLUSION

India's approach to multilateral institutions is driven by two conflicting forces. While it has a strong commitment to providing developmental assistance to other low-income countries it still has a responsibility to its largely poor population, and significant infrastructural investments need to be made in an effort to attain inclusive growth. At times, India's leaders have neglected the importance of placing the country squarely within Asian multilateral forums to counterbalance China's regional influence. The NDB provides an opportunity for India to balance these two imperatives. It will allow the country to contribute to the region's development via financing disbursed through the NDB's structures, thereby pursing its own strategic objectives while counterbalancing China's growing presence in the region. India will also be able to use the NDB to finance its own infrastructure deficit.

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† Bajaj V, 'India worries as China builds ports in South Asia', *The New York Times*, 15 February 2010, http://www.nytimes.com/2010/02/16/business/global/16port.html?_r=0.

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