GEGAFRICA
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BRICS INSIGHTS PAPER 3

THE RISE OF DEVELOPMENT FINANCE INSTITUTIONS: SOUTH AFRICA, BRICS AND REGIONAL STRATEGY

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Introduction

In contrast to the normative edge to South Africa's foreign policy under former president Nelson Mandela and the focus on Africanism under former president Thabo Mbeki, foreign policy has taken a hard-edged posture under President Jacob Zuma's administration. This is demonstrated by South Africa's growing integration with the other, and increasingly influential, BRICS countries. The rise of the BRICS countries and other non-Western emerging powers has played an important role in shaping South Africa's foreign policy under the Zuma administration.

The emergence of BRICS

The leaders of Brazil, Russia, India, China and South Africa have used the BRICS designation as a basis for constructing a shared platform for co-operation. These countries have moved quickly to establish themselves as a social institution and an alternative to the G7 group of countries, which was formed in the mid-1970s and has been dominated by the West. The BRICS grouping has coalesced in order to reinforce its diplomatic weight on the global stage, as well as to develop initiatives that run parallel to those that are dominated by developed countries, namely the World Bank and the International Monetary Fund (IMF).

Despite criticism that the BRICS countries do not have much in common, they do pursue clear political objectives. They are dissatisfied with and critical of Western dominance of multilateral institutions and the perceived refusal of the West to share power. This is one salient negative driver of emerging co-operation in BRICS. The positively stated dimensions have to do with increasing voice and representation in international financial institutions, growing economic and trade co-operation, and collaborating on accelerating the provision of infrastructure in the developing world.

The manner of the BRICS grouping's evolution broadly conforms to key 'constructivist' tenets: that shared ideas, as opposed to material forces, primarily determine the structures of human association; and that the identity of purposive actors are a function of shared ideas rather than decreed by nature. It is possible to see in BRICS the potential for policy innovation both in existing multilateral structures and in those that it creates in parallel to the existing ones.

An analytic excursion on the shifts in the global order

China has emerged as a potential challenger to the US' dominance of the global system, using its financial muscle to create parallel institutions. Riding on the mantra of 'peaceful rise', China has steadily been drawing its battle lines for global influence. There is little suggestion that China, or any of the BRICS countries, plan to overhaul the existing Western governance regime and replace it with normatively different arrangements. Instead, there is a commitment to making existing institutions receptive to different voices and influence. The major economies within BRICS have consciously engaged with the process of globalisation, using market reforms to facilitate the openness of their economies and, to varying degrees, actively participating in international trade. Under the auspices of the BRICS grouping, they may have little in common other than their dissatisfaction with Western dominance of international institutions, but their non-hegemonic narrative and pragmatic co-operation on financial and economic matters seem to be powerful cohesive forces.

BRICS as a regime type

In a substantive sense, the BRICS grouping can be seen as reflecting a multiplicity of power centres – a feature of the global system in the 21st century, where no one single power can claim unquestioned authority on global issues. To the extent that it establishes a co-operative arrangement that reinforces multipolarity, BRICS can be regarded as a form of international regime, albeit an exclusive one.

Regimes such as BRICS are institutional mechanisms – formal or informal – that are socially constructed for a specific purpose, and evolve over time. Just as the G7 today differs in substance and form, agenda-wise, from the one formed in the mid-1970s, BRICS may yet evolve in varying structures and shapes.

Regimes are driven by the urge to create a stable framework within which mutual expectations can be negotiated and fulfilled. In the case of BRICS, a set of issues triggered the formation of this alternative regime bloc. At the core of these issues was the BRICS countries' concern about the deficit of representation in key international institutions, the skewed distribution of power in favour of the West, and the developmental challenges that still mark much of the developing world.

BRICS as a non-hegemonic institution

Infrastructure is a salient manifestation of these developmental challenges, and lends a powerful rationale for BRICS to direct its financial resources towards infrastructure supply in the developing world. This is not to suggest that the form of international regime exemplified by BRICS could become a substitute for the faltering pillars of the post-1945 hegemonic order. However, that power is becoming more diffused and there are thus multiple instruments with which specific challenges can be tackled, including through the recently established BRICS New Development Bank (NDB).

China is not ready yet to assume the global superpower role long held by the US. Despite its claims to a 'peaceful rise', China is a subtle power maximiser; it has refrained from thrusting itself in the limelight, preferring to bide its time.

The other BRICS countries have no distinct interest in overhauling the pillars of Western dominance, but they do have an interest in amplifying their voice and participation in global governance and in being recognised as equal partners. Like China, the rest of the BRICS countries want to shape an evolving global architecture that is no longer based on hegemonic incorporation.

Furthermore, the BRICS countries perceive economic gains in integrating with the Chinese economy via trade and investment flows. As such, the desire to maximise their power and boost economic gains are core motivating factors behind the BRICS countries' co-operation outside the traditional global governance arrangements, without necessarily jettisoning outright the formal institutional processes that still reflect Western dominance.

These countries are not seeking simply to maintain their position in the international system but to improve their diplomatic and economic fortunes, away from the periphery towards the centre. Provided there is an intervening order in the form of deeper co-operation between the two major powers, the US and China, this growing multipolarity could signal potential instability in the global system by triggering intense competition. Currently, however, the relationship between the US and China seems to be characterised more by competition than deeper co-operation, as efforts at financing infrastructure development show.

The rise of the NDB

If there were any doubts about the seriousness of BRICS to realise substantive agreements, as well as its commitment to emerge as an equal interlocutor with the West, the creation of the NDB should dispel these. These countries have proven that they are not just inward looking in the sense that they are only interested in cutting commercial deals among themselves, but that they are also outward looking, making powerful assertions about key challenges in the global system. These challenges range from faltering global trade negotiations and security threats to environmental and climate change and the deficiencies of existing multilateral institutions.

BRICS may be constituted of countries with uneven economic weight, but its pointed focus on making interventions in infrastructure development across the developing world is a demonstration of its potential economic power and determination to make an impression in the developing world. The decision to establish the NDB shows the BRICS countries' commitment to push ahead with building an institutional mechanism that will stake out infrastructure as one of their comparative advantages, given China's financial clout and the massive demand in the developing world for infrastructure projects.

For South Africa, the NDB could play a pivotal role in financing infrastructure projects on the continent, with a view to inducing structural transformation in resource-dependent economies in Africa and stimulating regional integration. South Africa's active championing of BRICS's involvement in infrastructure development on the continent was also in indirect support of the Programme for Infrastructure Development in Africa (PIDA), which is driven by the AU, the African Development Bank and the New Economic Partnership for Africa's Development.

The Africa Regional Centre, which has been assigned to South Africa, could drive BRICS projects in support of PIDA. In utilising this instrument, South Africa could leverage the existing development finance institutions (DFIs) under its ownership that have a continental reach – the Industrial Development Corporation (IDC) and the Development Bank of Southern Africa (DBSA). The DBSA has a mandate to spearhead infrastructure investment. It is likely that South Africa will be looking at positioning the DBSA to benefit from the NDB's activities in Africa, especially in PIDA-related projects.

At the 5th BRICS Summit in Fortaleza, Brazil in 2014, decisions around the NDB and the establishment of the Contingency Reserve Arrangement were made, but without seeing much progress on the institutional shape of the NDB. There is still a long way to go in fleshing out its operational structure and norms. However, what became clear is that there is no intention to position the bank as a substitute for existing multilateral institutions. BRICS leaders are aware of their limited capacities and careful not to appear to be antagonising the Western countries that still have a firm grip on international financial institutions.

Multi-layered framework of infrastructure support

Australia's G20 presidency has elevated infrastructure to the top of the global economic governance agenda. The G20 Summit in Brisbane expressed a commitment to create a global infrastructure hub with a four-year mandate that will contribute to developing a knowledge-sharing platform and networking among governments, the private sector, development banks and other international organisations.

Globally co-ordinated efforts to stimulate investment in infrastructure have an important role to play in sustaining recovery and supporting job creation in a global economy that remains anaemic. However, the various efforts confront a number of challenges. The first has to do with the fact that the G20 is institutionally weak and has limited legitimacy. It lacks the capacity to enforce commitments. Second, a large number of countries that are affected by infrastructure constraints, especially in Africa, are under-represented in the G20. They have no voice in the deliberations that could affect them. Third, too many competing infrastructure initiatives are being touted around the world at the same time. This could lead to the duplication of efforts.

The fact that Western countries continue to use their economic muscle to block candidates from emerging markets and developing countries from taking over the reins of the international financial institutions undermines the legitimacy of these institutions and induces a counter-response from countries such as China as well as the rest of the BRICS grouping. Infrastructure development will witness a surge of competition between Western and non-Western suppliers such as China, as well as the institutions that depend on their financial resources. This could, in some ways, benefit the African continent, as there will be a glut of resources and no shortage of suitors. However, it may also place DFIs such as those from South Africa in a difficult competitive landscape. They could find themselves crowded out by the more financially muscular China and the NDB.

South Africa's development finance institutions and their regional role

South Africa has a diverse range of DFIs with different organisational structures and operational mandates. They also differ in the weight of their financial resources and the nature and scale of the projects they finance. There is, however, a common thread that defines them: they have all assumed some centrality in South Africa's 'developmental state' objectives, particularly since 1994.

South Africa's post-apartheid regional strategy, of which its DFIs are pivotal instruments, takes its cue from the government's 'developmental' priorities, but with an awareness of the need to play a positive role in developing the broader Southern African Development Community (SADC) region and the continent. This thinking is also crystallised in the country's foreign policy strategic plans. South Africa's commitments in SADC, at least rhetorically, have been evident quite early at the cusp of the democratic transition in 1994.

South Africa's regional strategy post-1990 shifted the tone substantially and placed emphasis on 'stabilising' the domestic economy and facilitating regional economic development as a stepping stone to deeper and more beneficial global integration. Beyond fulfilling its historical obligations and projecting itself as a benign development partner, South Africa sees the region in a mercantilist sense as a market that could 'suck in' its export products. It also sees it as an avenue for South African corporations to expand their footprint.

At the domestic level, the South African government views its DFIs as instruments aimed at achieving a range of objectives intended to improve its citizens' quality of life; enhance public service delivery; increase economic growth; improve infrastructure; and create jobs.

The DBSA in Southern Africa

According to the National Treasury, the role of the DBSA is to promote 'socio-economic development and growth within South Africa and in the Southern African region'. Its primary purpose is to contribute to sustainable economic development and growth, human resource development and institutional capacity building by tapping into public and private sector resources locally and abroad.

Considering Southern Africa's vulnerability to exogenous shocks and the lack of organisational capacities in the SADC region, the DBSA's role in supporting investment shortfalls and project bankability has been vital. As of August 2013, the DBSA's regional project portfolio as managed by its International Finance Unit covered all 15 SADC member states.

The Industrial Development Corporation

At its establishment, the IDC's main purpose was to industrialise South Africa, and it has helped to pioneer the development of synthetic fuels and chemicals industries in the country. An important change came with the expansion of the IDC's mandate by the Industrial Development Act of 1997, which widened its ambit. The new mandate was to enable the IDC to extend to the rest of Southern Africa, allowing it to finance cross-border industrial development initiatives and promote the regional expansion of South African firms. This was done mainly to encourage regional economic integration and support the growth of new markets for South African products.

The IDC's mandate was further expanded by another amendment in 2001, which extended the geographical area that it could invest in to include the rest of the continent. In short, the IDC is a key industrial development actor in the country and has the dual role of being both a financing institution and a development agency. The IDC's support role is varied and includes both finance and non-finance mechanisms. Among its main activities is providing development finance in the form of general debt, quasi-equity, equity and export–import finance.

The IDC has supported 41 projects across 17 African countries, approving around $2 billion in funding between 2001 and 2010. Most economic activities take place in the IDC's traditional areas of mining and tourism, although it has started to expand into industrial infrastructure, green industries and agro-processing sectors.

There is enormous pressure from the South African government, in particular the economic development ministry, for the IDC to justify its financing on the continent on the basis of the contribution this makes to job creation in South Africa, and its impact on growth.

The job creation link of the DBSA and the IDC is a core issue for the government. Both DFIs have no objective criteria against which developmental outcomes can be measured in a robust manner. This makes it difficult to undertake an accurate evaluation that directly links jobs or certain developmental outcomes to their initiatives. In this respect, the government seems to be at odds with itself, especially since it has also set out an objective of increasing investment in infrastructure and building up supply-side capacities on the continent as a defining factor for integration and development. The DBSA struggles with this issue to a more limited extent than the IDC.

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