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The BRICS Contingent Reserve Arrangement and its Position in the Emerging Global Financial Architecture

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EXECUTIVE SUMMARY

In its present shape and size the BRICS Contingent Reserve Arrangement (CRA) should be regarded as symbolic and exploratory rather than as a substantive challenger to the International Monetary Fund (IMF). However, the momentum of the BRICS process and the experience of the similar Association of Southeast Asian Nations plus Three (ASEAN+3) process suggest that the CRA has the potential to develop in two directions. Firstly, it should aim to become an adequate safety net and provide high-quality macroeconomic monitoring, and hence ensure participating countries' independence from the IMF. Secondly, it should aim to draw in other emerging economies. However, the CRA in itself does not represent a significant break from prevailing orthodoxy. Its limited scope may condemn it to playing a bit part in the global financial system.

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INTRODUCTION

The 5th and 6th BRICS summits in 2013–2014 marked a watershed in the evolution of the BRICS group with the establishment of the first BRICS institutions. These included the BRICS New Development Bank, the CRA, the BRICS Business Council and the Think Tanks Council. Although this has weakened the 'political talk shop' perception of the group, critics have questioned whether these institutions will have a substantive effect. In particular, doubts have been cast upon the effectiveness of the CRA. Eichengreen[1] expresses a fairly common view when he describes it as mere 'empty symbolism'. This is partly a criticism of the specific modalities of the CRA, but it also reflects a deeper concern about whether the BRICS process itself is evolving in a way that is likely to foster genuinely inclusive and sustainable development. This policy insight focuses on the CRA. Firstly, it considers the global governance environment and how this has influenced the way BRICS has developed. Secondly, it explores the nature of the CRA itself. Thirdly, it considers debates about the role of the CRA in the emerging global financial architecture. Finally, it provides policy recommendations for the grouping.

BACKGROUND

Discontent with the main multilateral institutions (the IMF, World Bank, World Trade Organization [WTO] and aspects of the UN) has stalled the process of formal multilateral rule making, leading to concerns that the international community will not provide much-needed governance for stability and development. The growing influence of emerging markets and their increasing challenge to Western-dominated institutions have contributed to this. This has caused what Cooper and Farooq call the 'privileging of new informal forums at the hub of global governance [which] has allowed some significant degree of reform within the global system without huge disruption', resulting in a 'growing multilayered "thick" international architecture of global governance'.[2]

BRICS itself can be regarded as one of the foremost manifestations of this tendency in global governance. BRICS brings together a group of countries that critics have described as 'fundamentally incompatible' for a number of reasons, not least that certain of its members are in 'strategic competition' with one another.[3] The growing momentum of the BRICS process in the face of this (and its emerging identity as *the* representative of the developing world) attests to the level of discontent with the existing 'formal' architecture of global governance. However, it also underlines the difficulty of finding common positions on many issues.

A large part of the success of BRICS is due to the fact that, unlike the WTO, it makes no attempt to force consensus. It seems to manage tension by deliberately downplaying issues where consensus is unlikely and emphasising areas of common interest. For example, in their individual capacities India, South Africa and Brazil are vocal on the question of UN Security Council reform. However,

it is almost a non-issue at BRICS summits.[4] By contrast, a powerful sense of grievance unites the parties on global economic and financial governance. The global financial architecture is a case in point. The joint declaration following the 2012 New Delhi Summit was particularly critical of the monetary policy approach adopted by developed countries in response to the global crisis and its impact on currency volatility and capital flows in emerging markets. The stalling of the IMF reform process was also highlighted. Although BRICS countries constitute 20% of the global economy, failure to reform the IMF means that they still only control 11% of voting shares.[5] In the light of this, it is no surprise that institutionalisation has begun in this sphere.

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STRUCTURE AND FUNCTIONING OF THE CRA

The preamble to the Treaty for the Establishment of a BRICS Contingent Reserve Arrangement (CRA Treaty) states that the BRICS countries 'agree to establish a self-managed contingent reserve arrangement to forestall short-term balance of payments pressures, provide mutual support and further strengthen financial stability … [T]he Parties agree that this contingent reserve arrangement shall contribute to strengthening the global financial safety net and complement existing international monetary and financial arrangements.' Article 1 of the treaty sets out the CRA's objective: to offer 'a framework for the provision of support through liquidity and precautionary instruments in response to actual or potential short-term balance of payments pressures'.[6]

The CRA is modest in size in comparison to the IMF and other similar arrangements such as the Chiang Mai Initiative Multilateralization (CMIM). At this stage the BRICS countries have committed $100 billion to the CRA, with China committing $41 billion, Russia, Brazil and India $18 billion each and South Africa $5 billion. The CMIM reportedly has a reserve pool of $240 billion and the IMF resources of $780 billion. It has been noted that with BRICS's foreign reserves standing at about $5 trillion, a commitment of 16% would take the CRA pool to $800 billion.[7]

Article 2 of the CRA Treaty indicates that participating countries retain possession of committed resources until a request for assistance by one party is granted and a currency swap takes place. Article 5 of the treaty sets out the maximum access limits and relevant multipliers for each country. China, with a multiplier of 0.5, is entitled to request up to half of its commitment of $41 billion; Brazil, Russia and India have a multiplier of 1 and can therefore request up to $18 billion, while South Africa, with a multiplier of 2, can request up to twice its commitment of $5 billion.

A key feature of the CRA, explained in Article 5, is that just 30% of the maximum amount a party is entitled to request will be made available subject to the approval of the other participants only. This is referred to as the 'de-linked' portion of the amount available. Where financing in excess of this 30% limit is required, an 'IMF-linked portion' will be made available. This will allow the

country access to the remaining 70%, provided that a conditionality-based agreement with the IMF is concluded.

The CRA's instruments are defined in Article 4 of the treaty. They comprise 'a liquidity instrument to provide support in response to short-term balance of payments pressures' and 'a precautionary instrument … to provide support in light of *potential* short-term balance of payments pressures'.[8] The provisions of Article 5 regarding de-linked and IMF-linked portions apply to both instruments. Article 6 provides for the establishment of an inter-bank agreement between the BRICS countries' central banks to operationalise the currency swaps that will take place when support is requested.

The currency swap involves the exchange of the requesting country's currency for US dollars, to be re-paid at a later date (Article 8). According to Article 10 of the treaty, the exchange rate for both the transaction and later repurchase is the spot market rate two days prior to the date on which the respective central banks' accounts are credited. Article 12 indicates that the maturity date on which the requesting country's currency must be repurchased is six months after the original transaction for a de-linked drawing and one year for an IMF-linked drawing. Interest is paid on the dollars obtained by the requesting party but not on the requesting party's currency by the providing party. Drawings under the liquidity instrument may be renewed up to three times for a de-linked drawing and twice for an IMF-linked drawing. Drawings under the precautionary instrument may not be renewed.

A requesting party must comply with a set of conditions and safeguards set out in Article 14 of the CRA Treaty. These include the proscription of arrears with other parties or multilateral and regional financial institutions, as well as 'compliance with surveillance and provision of information obligations to the IMF' as outlined in the relevant IMF Articles of Agreement.[9]

GOVERNANCE OF THE CRA

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Governance of the CRA will occur at two levels: via the Governing Council, which is responsible for the CRA's strategic direction, and the Standing Committee, which is responsible for its operational functioning. The Governing Council includes representatives from each party at the level of finance minister or central bank governor. Article 3 of the CRA Treaty provides that decisions at the level of the Governing Council will take place by consensus. Among its responsibilities, the Governing Council has the authority to review and alter the size of the pool and its components, and approve changes to access limits, multipliers, interest rates, maturity periods, preconditions and sanctions.

Importantly, Article 3 provides that the Governing Council may allow the entry of new partners, adjust the proportion of access de-linked from the IMF and establish a secretariat or concrete surveillance unit for the CRA. At present the CRA is not a legal entity as such and has no office or macroeconomic

research facility. However, the provisions of Article 3 signal that institutional and surveillance arrangements may evolve, along with the scale of the pool and the nature of the CRA's linkages with the IMF.

At the second level of governance of the CRA, the Standing Committee comprises representatives from each party, ordinarily central bank officials, and is primarily tasked with approving and facilitating requests for assistance from participating parties. There is a weighted voting system at the level of the Standing Committee for decisions related to requests for support. Other decisions are to be taken by consensus. The weighting system is explained in Article 3(e): while 5% of voting power is equally spread among participants, the distribution of the remaining 95% depends on the value of each participant's commitment to the CRA. Article 3 emphasises, however, that '[a]s a matter of principle, the Standing Committee shall strive for consensus on all matters'.[10]

ASSESSMENT

The CRA has been criticised at two levels. The first, which is the focus of the present briefing, relates to the way it has been set up. This criticism accepts the liberal ideals embedded in the mainstream multilateral process (free trade, financial development and financial globalisation), but argues firstly that the process of multilateralisation has been hijacked by the established powers and secondly that the CRA in its current form is unlikely to redress this dominance. This is an important point: developing countries have long memories of having to accept 'help' on the IMF's terms. However, the second level of criticism is also important. Even if the CRA is set up in a way that allows it to achieve its stated purpose, the issue remains whether the BRICS institutions will result in genuinely transformative change. The danger here, as the Left has argued, is that *seeming* to do something can legitimise the status quo.[11]

Returning to the first level of criticism, concerns that the CRA will simply be ineffective stem largely from perceptions about a similar process that took place under the auspices of the ASEAN+3 grouping. The Chiang Mai Initiative (CMI, 2000–2010) was very similar to the CRA in its current form and seems to have been ineffective in the 2008 crisis. However, the CMI process also has positive lessons.

Size and IMF linking (along with the lack of a rapid response facility) seem to have been major problems with the CMI. For example, in 2008 South Korea, along with Singapore and Indonesia, experienced severe balance of payments difficulties. However, none of these countries used the CMI. South Korea, whose non-IMF linked portion in the CMI was only $3.7 billion, relied on a currency swap of $30 billion with the US. It would have been 'politically suicidal' for any Korean government to access the IMF-linked share ($14.8 billion), which would in any case have proven insufficient. It is also not ideal for countries to

rely on other sources for relief. Indonesia was unable to come to terms with the US and ended up in a swap agreement with China.[12]

The other two issues that create doubt about the effectiveness of the CRA are its size and the IMF linking. For example, South Africa's drawing rights of $10 billion (of which only $3 billion is not IMF linked) may be insufficient to meet any major balance of payments eventuality. (By comparison, Thailand required $17.2 billion from the IMF in 1997 at a time when its gross domestic product was only 40% of what South Africa's is today.) As many authors have argued, the IMF linking seems hard to reconcile with the intention to provide a counterweight to the IMF. Although countries are unlikely to face conditionalities as stringent as those in the 1990s, it would probably be politically difficult for them to accept IMF conditionality, both because of lingering resentment at past experiences and because of the ongoing dispute about voting shares.

Against these criticisms, the most important positive lesson to draw from the ASEAN+3 process is that it *is* a process. The CMI, which itself evolved from a more limited ASEAN arrangement, has evolved into the CMIM. In the CMI case, the motive for IMF linking was that the grouping did not have the capacity to distinguish between liquidity and solvency problems. Although the CMIM continues to attract criticism,[13] it now has a permanent secretariat, a Macroeconomic Research Office, which should eventually make the IMF linkage redundant, and a much larger swap arrangement. This evolution has happened despite bitter rivalry among its main protagonists (the +3 are China, Japan and South Korea). There is also the view that the very existence of such arrangements has an important effect on the behaviour of the IMF, even if they are not used.

CONCLUSION

> The primary present focus of the CRA should be finding ways to work toward providing an adequate safety net and eliminating the IMF-linked portion, particularly if IMF reform is not forthcoming

It is not possible to sum up the CRA and the form it has taken in a simple way. It is symbolic (which is critically important in itself) and exploratory; its limitations probably mean that its evolution, like that of the CMIM, will be slow; and it undoubtedly reflects prevailing class forces. These points can be made about the BRICS processes more generally. As Cooper and Farooq put it: 'It is difficult to see the BRICS taking on a more comprehensive role as system transformer; however, the attributes embedded in the informal club style that the BRICS possess to an impressive extent will allow them considerable staying power in a world otherwise in flux.'[14] The primary present focus of the CRA should be finding ways to work toward providing an adequate safety net and eliminating the IMF-linked portion, particularly if IMF reform is not forthcoming. To this end the CRA should develop a dedicated macroeconomic surveillance and research facility; increase the size of participants' commitments and develop modalities for a rapid crisis response facility; and reduce the IMF-linked proportion of the drawing amount available to a drawing party. In the

longer term, BRICS should consider the possibility of expanding the number of countries involved in the CRA and reviewing its scope.

ENDNOTES

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