

EXTREME POVERTY AND THE NEW DEVELOPMENT BANK OF BRICS

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ABSTRACT

Eradication of poverty and extreme poverty has received attention from economists, sociologists and policy planners for a long time. The past two decades have witnessed significant progress in reducing the incidence of global poverty largely due to the efforts of the United Nations and the World Bank Group. The International Development Association (IDA), an affiliate of the World Bank Group focuses exclusively on the reduction and ultimately elimination of extreme poverty. However, the newly founded BRICS Bank, which also calls itself New Development Bank (NDB) appears to deviate from the focus of poverty reduction, and considers stabilization of global financial markets as its primary goal. Extreme poverty exists in four of the five founding countries of the NDB. This paper examines the events leading up to the formation of the NDB and evaluates its charter, its resources and its initial lending decisions. Such evaluations lead to the conclusion that the NDB does not have a goal of alleviating poverty nor does it address the issues of social and economic inequalities, denial of basic freedom and human dignity which are considered as consequences of extreme poverty. While the NDB is still in its formative stage, its shift of emphasis as a development bank from elimination of extreme poverty to global financial stability is likely to have a negative impact in fulfilling the Millennium Development Goals adopted by the United Nations.

Key Words: BRIC, Development Bank, Extreme Poverty, Millennium Development Goals

INTRODUCTION

Arguably, the two most important issues of the developing world are alleviation of poverty and reduction of inequality. In 1979, Ahluwalia, Carter and Chenery (1979) analyzed growth and distribution of Gross National Product (GNP) of 36 developing countries. They ranked the 36 countries into four groups based on the GNP per capita and came to the conclusion that both the GNP per capita and the income per capita of the poorer countries grew at a slower rate than that of the richer countries. Using “poverty maps”, Elbers et al (2007) concluded that targeting poor segments of population in developing countries and channeling resources to alleviate their economics status improved the poverty situation in a number of countries. Maria (2008) analyzed the incidence of poverty from the cultural point of view including class, race and gender. These studies generally suggest the need for resources to alleviate poverty and thereby improve distribution of income of target groups of population in the developing world. Since the founding of the International Development Association (IDA) in 1960, an awareness has been created to deal with the multifarious issues associated with poverty and income distribution (United States Department of the Treasury, 2005). Until the founding of the NDB, the concept of a development bank has been principally associated with concessional loans to the world’s poorest countries with the main goals of alleviating poverty and improving income distribution.

However, the shift of attention of the NDB away from poverty issues has created a new awareness of a development bank. The purpose of this paper is to trace the origin of the NDB, analyze its charter and examine if the development community and the United Nations would continue to benefit from some of the founding members of the NDB, notably, India and China where extreme poverty exists at a large scale.

The idea of the BRICS Bank or the New Development Bank (NDB) was initially conceived by four countries namely Brazil, Russia, India and China (BRIC) after the publication of a paper in 2001 (O'Neil, 2001). Notwithstanding other significant implications of macroeconomic performance, particularly the existence of extreme poverty in three of the four BRIC countries and analyzing country-level data, the paper demonstrated that in 2001 and 2002, the combined GDP growth of the four emerging countries named above would exceed that of the Group of 7 or G7 countries (Canada, France, Germany, Italy, Japan, United Kingdom and United States). As Figure 1 shows, using simple trend analysis, the paper resorted to extrapolation of the 10 largest economies of the world in 2050 (Wikimedia Commons, 2011).

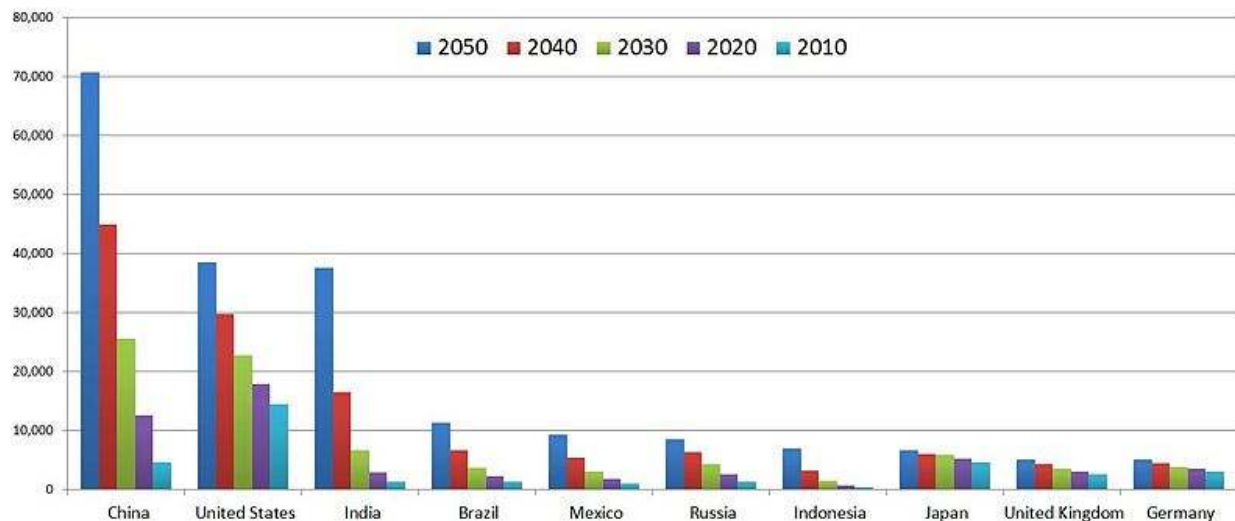


Figure 1: The ten largest economies in the world in 2050, measured in GDP (billions of 2006 USD). Source: Wikimedia Commons, 2011

O'Neil's work received significant attention from the academic and policy making communities leading to the formation of a Development Bank. In addition to the four BRIC countries, South Africa was added to the initiative in setting up this Development Bank. Consequently, the grouping acronym was changed from BRIC to BRICS. The Development Bank thus established was named BRICS Bank. In July 2014, the heads of government of the five BRICS countries, after meeting in several Summits, renamed the BRICS Bank to The New Development Bank (NDB). NDB is dubbed as a multilateral development bank. It has been promoted as an alternative to the World Bank and the International Monetary Fund (Pop, 2014). However, an evaluation of the NDB's charter, notably its mission and its modus operandi does not lead to the conclusion that the Bank has much similarities with the World Bank Group, particularly its affiliate, the IDA. Conspicuously absent from the NDB's declaration and mission is any

reference to poverty alleviation, arguably the most significant aspect of an International Development Bank.

BRICS GOALS AND FORMATION OF NEW DEVELOPMENT BANK (NDB)

Several years after the publication of O'Neil's paper, in June 2009, the four BRIC countries held the first formal Summit in Yekaterinburg, Russia. The focus of this Summit, attended by all four heads of government was to devise ways and means for improving global economic situation. The Summit failed to specify action plans for achieving the goal but decided to focus on ways and means for improving global economic situation. Later in that year, the BRIC nations agreed on the need for a new "global currency" ostensibly to offset the dominance of the dollar. Apprehending that any global forum must have representations of the African continent, South Africa started a campaign to join the group. Consequently, in 2010, South Africa was invited to join the group, and BRIC was renamed BRICS. (Smith, 2011). Using International Monetary Fund (IMF) data, it is found that five BRICS countries represent almost 3 billion people or 40% of the world population with a combined nominal world GDP of 40% in 2014. These five countries hold U.S. \$4 Trillion dollars of combined foreign reserves (International Monetary Fund, 2013).

The formation of a development bank or an international financial institution similar to the World Bank or the IMF emerged gradually from deliberations of the BRICS countries, and it appears that the concept crystalized after South Africa joined the group. In June 2012, the BRICS nations pledged \$75 billion to boost the lending power of the IMF subject to the condition that IMF reform the voting system. A year later, at the fifth BRICS Summit held in St. Petersburg, Russia in September 2013, the five nations agreed to form a "currency pool" of U.S. \$100 Billion. The total pool consisted of China contributing \$41 Billion, Brazil, India and Russia each contributing \$18 Billion and South Africa contributing \$5 Billion. On July 15, 2014, at the start of the sixth BRICS Summit held in Fortaleza, Brazil, the BRICS countries signed an agreement creating the \$100 Billion BRICS Development Bank, and a reserve currency pool worth another \$100 billion. (Marull, 2014) The agreement signed by five members of BRICS renames the BRICS Development Bank to New Development Bank. Interestingly, a number of medium- to low-income countries ranging from Turkey to Bangladesh are campaigning to join the BRICS. At this time, it is unclear if the BRICS would add other members requiring the change of its grouping acronym.

NDB: A SEQUEL TO VOTING RIGHTS OF BRETTON WOODS INSTITUTIONS?

The emergence of the NDB has been and continues to be the subject of intense debate and scrutiny by the world financial and political forums. At the heart of the debate is the voting rights of member countries of the World Bank and the IMF. Notwithstanding the complicated voting rights formula, many member nations of the two paramount global development institutions have felt for some time that the weights assigned to some member countries undermined their contributions to the overall development of the global financial markets. For example, even though BRICS comprise over 20 percent of the global economy, together they can only exercise about 11 percent of the votes at the IMF. But all attempts of reform of the governance of Bretton-Woods institutions has not been successful. It is perhaps because of this disillusionment

that in the late 1960s, “Andean nations created the *Corporación Andina de Fomento* (CAF), also known as the “Development Bank of Latin America,” as a way of bypassing the stringent rules imposed by the World Bank on infrastructure loans. In the early 2000s, partly as a reaction to a widely perceived failure of the IMF to stop currency speculation during the Asian Crisis, 10 ASEAN nations plus China, South Korea and Japan established a network of bilateral currency swap agreements that would become the Chiang Mai Initiative.” (Desai and Vreeland, 2014).

The focus of the BRICS on global currency alone was not perceived as the only important issue by many analysts. Cooper (2014) saw the emergence of the BRICS as a show of power by “middle powers and small states”. Larionova, et al (2014) examined the charter of BRICS in relation to the health issues of the poor and concluded that the groups needed to re-evaluate the importance of such issues.

The New Development Bank was formed by several countries, some of which has posted impressive economic growth statistics. The headquarters of the NDB will be in Shanghai. The first President of the Bank will be an Indian with a six-year term. The Chair of the Board of Governors will be a Russian, and the Chair of the Board of Directors will be a Brazilian. The following operational details of the NDB has been adapted from Desai and Vreeland (The Washington Post; July 17, 2014):

“The NDB has been given \$50 billion in initial capital. As with similar initiatives in other regions, the BRICS bank appears to work on an equal-share voting basis, with each of the five signatories contributing \$10 billion. The capital base is to be used to finance infrastructure and “sustainable development” projects in the BRICS countries initially, but other low- and middle-income countries will be able to buy in and apply for funding. BRICS countries have also created a \$100 billion Contingency Reserve Arrangement (CRA), meant to provide additional liquidity protection to member countries during balance of payments problems. The CRA—unlike the pool of contributed capital to the BRICS Bank, which is equally shared—is being funded 41 percent by China, 18 percent from Brazil, India, and Russia, and 5 percent from South Africa.” China being the leading member of the group has the largest foreign exchange reserves. The charter of the NDB or at least what is known so far from the proceedings of the summits does not indicate that this institution is designed as a Development Bank with a goal to channeling its resources for serving the poorer countries. In the following section, we trace the origin of the World Bank, until recently known as the only Development Bank, which is owned and managed by 188 countries of the world.

DEALING WITH INEQUALITY AND POVERTY – PRIMARY GOAL OF A DEVELOPMENT BANK

In this section, we briefly describe the formation of the World Bank with its five constituent bodies (World Bank Group) with particular emphasis on the International Development Association (IDA) with a goal to describing IDA’s role in alleviating global poverty and creating more equitable societies across continents. The concept of a global development bank was developed by John Maynard Keynes along with Harry Dexter White. The World Bank emerged from the forerunner institution known as the International Bank for Reconstruction and Development (IBRD), proposed in 1944 at the Bretton Woods Conference as part of the United

Nations. At its inception, the goal of the IBRD was to “to help Europe recover from World War II” (World Bank, 2015). With the passage of time, the IBRD has become a development bank for almost all countries of the world. IBRD is one of the five constituent bodies of the World Bank Group. The five members of the World Bank Group as they emerged are listed below:

1. 1945. The International Bank for Reconstruction and Development (IBRD). Main goal: providing debt financing on the basis of sovereign guarantees.
2. 1956. The International Finance Corporation (IFC). Main goal: various forms of financing primarily to the private sector without sovereign guarantees.
3. 1960. The International Development Association (IDA). Main goal: concessional financing (interest-free loans or grants), usually with sovereign guarantees. The terms of these loans may extend up to 40 years.
4. 1965. The International Center for Settlement of Investment Disputes (ICSID). Main goal: working with governments to reduce investment risk.
5. 1988. The Multilateral Investment Guarantee Agency (MIGA). Main goal: providing insurance against certain types of risk, including political risk, primarily to the private sector.

Today, the World Bank Group is structured like a cooperative of 188 member countries. The combined efforts of member countries who own and operate IBRD enhance knowledge and technical services of the group and provide strategic advice for achieving desired results in socio-economic spheres. The Group's resources are pooled in the World Bank Treasury where all clients have access to capital on favorable terms and in larger volumes than are available in the global financial markets. By virtue of cooperative-like structure, these loans are disbursed in a more sustainable manner which the financial markets could not provide.

Three of the five constituent bodies of the World Bank Group, namely IFC, ICSID and MIGA are specialized bodies dealing primarily in the private sector, and as such, the World Bank Group's efforts in global development are known through its work of other two bodies, namely IBRD and IDA.

Even though the charter of the IBRD called for recovery of Europe, from its inception, it also helped creditworthy medium income countries in other parts of the world. Some of the unique characteristics of IBRD loans include long-term human and social development needs; preservation of a borrower's financial strength; institutional reforms through mutual agreement; and deliberately catering to the needs of the poorer segment of the population. However, recognizing the need for enhanced efforts for alleviation of poverty of the poorest countries, and reduction of inequality, the World Bank Group created the IDA in 1960. In a sense, the World Bank Group's efforts in dealing with global development issues are shared by the IBRD and the IDA on the basis of economic standing of the countries.

IBRD funds are raised on the world's financial markets and geared towards to the middle-income countries while IDA loans and grants are geared towards the low-income countries. Since issuing its first bond in 1947, IBRD has become one of the most established international borrowers. The income generated by the IBRD over the years is used to fund development activities and to ensure its financial strength. This has enabled it to borrow at low costs and offer its clients

borrowing terms that cannot be offered by other creditors. Today, IDA operates in 77 poorest countries of the world. It is considered as the “lender of the last resort” in these countries where the majority of the population lives on less than \$2 a day. IDA grants and credits provide basic social services in these countries comprising almost 3 billion people. IDA thus complements the IBRD, the World Bank’s original lending arm. The following excerpt summarizes IDA’s role in alleviating poverty and bringing about a positive change to the poorest countries of the world:

“IDA lends money on concessional terms. This means that IDA credits have a zero or very low interest charge and repayments are stretched over 25 to 38 years, including a 5- to 10-year grace period. IDA also provides grants to fragile and conflict-affected states, and other countries at risk of debt distress. In addition to concessional loans and grants, IDA provides significant levels of debt relief through the Heavily Indebted Poor Countries (HIPC) initiative, and the Multilateral Debt Relief Initiative (MDRI). Since its inception, IDA has supported activities in 112 countries. Annual commitments have averaged about \$18 billion over the last three years, with about 50 percent of that going to Africa. For the fiscal year ending on June 30, 2014, IDA commitments reached \$22.2 billion spread over 242 new operations. 12 percent of the total was committed on grant terms.” (World Bank, 2014)

BRICS COUNTRIES AND POVERTY

During its 69 years of operation, the World Bank Group, notably the IBRD and the IDA have achieved a large measure of success in addressing these twin issues. In doing so, the Group has distinguished itself as the world’s largest reservoir of data on socio-economic development. In this section, we provide relevant statistics of the BRICS countries based on the annual publication of the World Bank. Table 1 shows the economic status of the five BRICS countries.

Table 1: Economic Status of BRICS in 2013

Country	Income Group	Economic Status
Brazil	4,126-12,745	Upper Middle Income
Russia	12,746 or more	High Income
India	1,016 – 4,125	Lower Middle Income
China	4,126-12,745	Upper Middle Income
South Africa	4,126-12,745	Upper Middle Income

Source: World Bank (2013, 2014)

Based on the per capita Gross National Income (GNI), the World Bank classifies countries in various categories ranging from low income to high income countries. Using this criterion, Table 1 shows the five BRICS countries are diverse and fall in three economic categories.

Using the Purchasing Power Parity (PPP) index, the World Bank defines extreme poverty as the proportion of a country’s population living on \$1.25 a day or less. The Bank defines PPP as “the number of units of a country’s currency required to buy the same amount of goods and services in the domestic market as a U.S. dollar would buy in the United States. The ratio of PPP conversion factor to market exchange rate is the result obtained by dividing the PPP conversion

factor by the market exchange rate. The ratio, also referred to as the national price level, makes it possible to compare the cost of the bundle of goods that make up gross domestic product (GDP) across countries.” (World Bank, 2015). By this measure, Sub-Saharan Africa continues to be the most poverty-stricken region of the world where 46.8% of the population lives on extreme poverty followed by the South Asian region where 24.5% of the population lives on extreme poverty. As Table 2 demonstrates, except for the Russian Federation, extreme poverty exists in four of the five BRICS countries.

Table 2: Per Capita Gross national Income, GDP Growth Rate and Extreme Poverty

Country	GDI per capita, current Atlas method, 2013	GDP growth rate, 2013	Per cent of population in extreme poverty	Survey year for poverty
Brazil	11,690	2.5	3.8	2012
Russia	13,860	1.3	-	-
India	1,570	5.0	24.7	2011
China	6,560	7.7	6.3	2011
South Africa	7,190	1.9	9.4	2011

Source: World Bank (2014, 2015)

As Tables 1 and 2 demonstrate, the five BRICS countries are diverse in their economic status. India, being the poorest of the group has a significantly high rate of extreme poverty. Even though India posted a growth rate of its GDP at or above 5 per cent for a number of years, its poverty rate has remained high with over 309 million people living in extreme poverty. South Africa has the second highest rate of poverty rate among the group of five countries with almost 5 million of its 53 million living in extreme poverty. Despite posting the highest rate of economic growth for a sustained period, 85.5 million people of China remain in extreme poverty. Brazil is at the higher plateau among the upper middle income countries. The country is endowed with 200.4 million people with 7.6 million living in extreme poverty.

GLOBAL EFFORTS FOR ERADICATION OF EXTREME POVERTY

Discussions about inequality and poverty have remained central to the efforts of all development agencies. Concentration of wealth in a very small segment of the population and lack of opportunities for supportable income to feed the hungry across globe were the driving considerations for the global community to devise ways and means of tackling the twin issues. With that in mind, in September 2000, the United Nations (U.N.) held its largest Summit as of that date in its headquarters in New York. The Summit was attended by heads of state or heads of government of all 189 member states of the U.N. The Summit resulted in the Millennium Declarations which was followed by eight Millennium Development Goals (MDG) to be achieved within a period of 15 years. While it is not the purpose of this paper to address the MDGs, the eight goals listed below are relevant to the founding of a Development Bank such as the BRICS Bank now known as the New Development Bank.

Millennium Development Goals

1. To eradicate extreme poverty and hunger
2. To achieve universal primary education
3. To promote gender equality and empower women
4. To reduce child mortality
5. To improve maternal health
6. To combat HIV/AIDS, malaria and other diseases
7. To ensure environmental sustainability
8. To develop global partnership for development

A closer evaluation of all 8 MDGs reveals that the goals were crafted to simultaneously deal with the issues of poverty alleviation and inequality. Other goals listed in order of importance are complementary to the twin issues of inequality and poverty. In July 2014, The United Nations reported that between 1990 and 2010, the global extreme poverty rate has been halved; however, 1.2 billion people of the world still live on less than \$1.25 a day (United Nations, 2014). As Table 3 demonstrates, extreme poverty declined from 36 per cent of the world population in 1990 to 18 per cent of the world population in 2010. However, the progress in this regard has not been satisfactory for several regions of the world, notably Sub-Saharan Africa and Southern Asia including India.

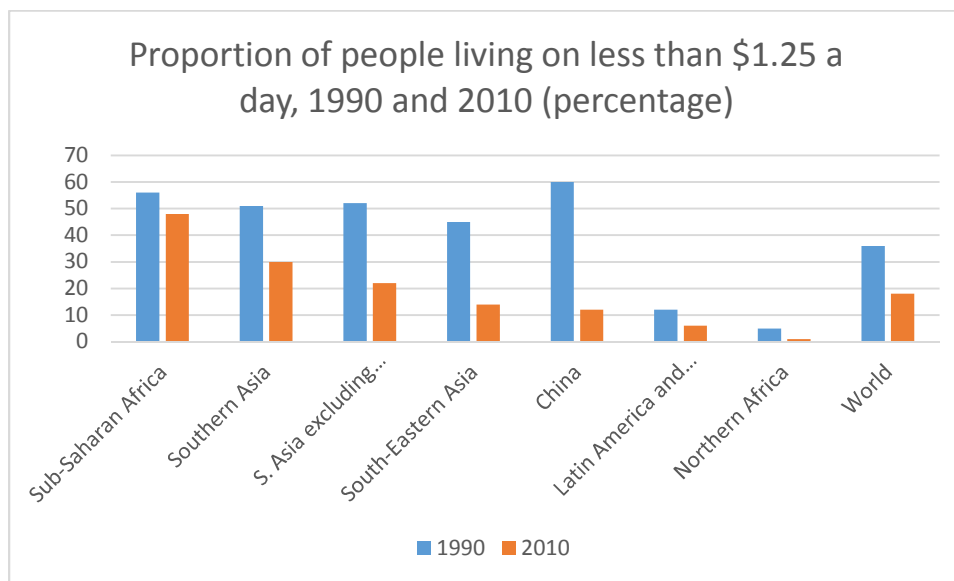


Table 3: Extreme Poverty in World Regions and the World
Table constructed using data from United Nations, 2014.

The MDGs were timed for full achievement by 2015. The World Bank acknowledges many difficulties in measuring progress of the 8 goals across countries. Important among these difficulties were “three challenges: selecting appropriate targets and indicators, constructing an international database for global monitoring, and significantly improving the quality, frequency, and availability of the relevant statistics.” (World Bank, 2013). When the goals were adopted, the target year was considered an ideal time-span in which to engage the development partners for

total achievement of all 8 goals. As Figure 2 shows, with less than a year left, the results suggest that the incidence of extreme poverty were the highest in India with 30 per cent of its population living under \$1.25 a day. However, during 2008-2011, more people were lifted out of extreme poverty from India than from any other country. For the same period, China was the second highest contributor to reduction of extreme poverty (World Bank, 2015).

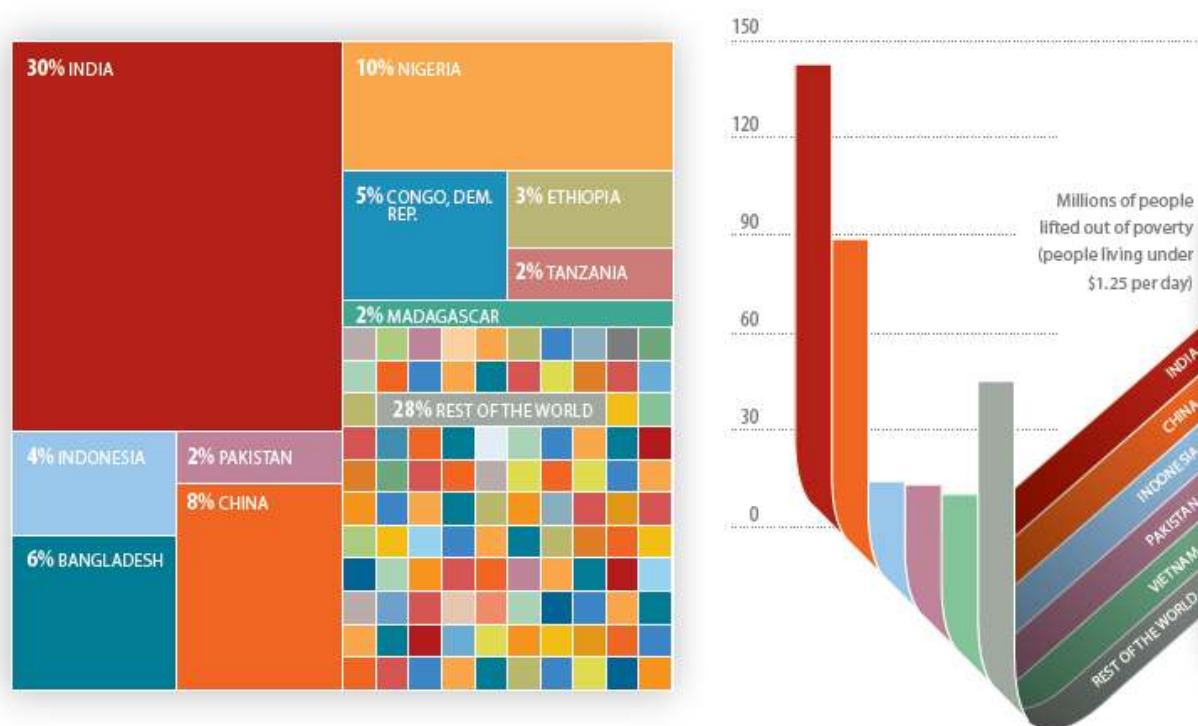


Figure 2: Left Panel: Per cent of people living in extreme poverty, 2011
Right Panel: Leading contributors to poverty reduction, 2008 to 2011
Source: World Bank. 2015.

This above analysis suggests that extreme poverty and hunger, the most significant of the 8 MDGs exists in four of the five BRICS countries; however, the concerted efforts of two founding countries of the NDB, namely India and China resulted in significant progress of reduction of extreme poverty of its people. The BRICS as a group and its members as individual countries are expected to be active in the world forum in combating inequality and poverty; however, it remains to be seen if the NDB takes away resources of these countries in fulfilling their commitment of achieving the MDGs.

SUMMARY AND CONCLUSION

The grouping acronym BRIC came into economics literature in 2001 through a seminal paper published by O'Neil. Analyzing broad macroeconomic data, O'Neil demonstrated that in 2001 and 2002, the combined GDP growth of four emerging countries namely, Brazil, Russia, India and China would exceed that of G7 countries. O'Neil's paper was in large part a comparison of the GDP growth rates of G7 countries and the BRIC. Notwithstanding other significant

implications of macroeconomic performance of three of the four BRIC (Brazil, India and China), the acronym received significant attention from the development community. However, the incidence of poverty remain high in the BRIC and the incidence of economic and social inequality remain high in three of the four countries named above. Apparently, O'Neil's paper had a significant influence in uniting the four countries through a series of Summits, the first one being held in 2009. The BRIC Summits resulted in the addition of South Africa to the group, ostensibly to include the African continent with the ultimate goal of creating a Development Bank called the BRICS Bank, later renamed as the New Development Bank.

BRIC was a diverse group of countries to begin with, and the addition of South Africa has made BRICS even more diverse. If there is one common denominator in four of the five BRICS, it is the incidence of extreme poverty. India being the second largest country of the group and containing approximately one-sixth of world population was classified as a Low Income country at the time of formation of the BRIC. Later India "graduated" to the status of a Lower Middle Income country. Even though it posted the GDP growth rate at or above 5 per cent for a number of years, India's poverty rate has remained high with over 309 million people living in extreme poverty in 2011. South Africa has the second highest rate of poverty rate among the group of five countries with almost 5 million of its 53 million people living in extreme poverty. Despite posting the highest rate of GDP growth for a sustained period, 85.5 million people of China remain in extreme poverty. Brazil is at the higher plateau among the upper middle income countries. The country is endowed with 200.4 million people with 7.6 million living in extreme poverty. Russia is in the category of High Income country posting GDP growth rate of 1.3 per cent, the lowest among the group but with no incidence of extreme poverty.

Since the creation of the World Bank, a number of its affiliates have been engaged in combating the twin issues of poverty and inequality. The efforts of the Bank were re-enforced in 2000 when heads of State or heads of Government of all 189 members of the United Nation met in a Summit and formulated eight goals known as the Millennium Development Goals (MDGs). It was agreed that the most important goal was eradication of extreme poverty and hunger. The set of eight goals were complementary to the first goal in order of priority in that the eradication of extreme poverty would empower the large segments of population in many countries and would make it easier to achieve the other goals. With the target year of achieving the MDGs being less than a year away, evaluation of the success of eight goals is mixed. Therefore, it is likely the development community would meet again and re-formulate strategies for dealing with the twin problems of poverty and inequality. The absence of clear strategies on the part of BRICS to engage in this continuing effort leads to the conclusion that the focus of the New Development Bank has shifted from the global efforts of reducing poverty and eliminating extreme poverty.

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