# Amid the Global Financial Crisis: Impact on the BRICs and "BRIC" Response

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This paper examines the impact of the global financial crisis on the BRIC countries, and their response(s), as individual nations and an emerging collective grouping – "the BRIC". There have been variations both in the impact of the crisis, country by country, as well as in their responses. At the same time, despite the variance in experience across issues and countries, the "BRIC" concept has been turned into a formalized institution with the first BRIC Leaders' Summit held in central Russia in mid June 2009. The concept of these four countries as a collective group has its origins as an investment idea from leading forces of financial globalization.[1] What is most interesting is how, in response to global crisis, the objects of attention have turned themselves into active subjects – into a geopolitical reality – in order to redefine their place in the world and reshape the global order that is emerging out of the current crisis. While the BRIC are, in many senses, a creation of the globalization of the past two decades, they are now attempting to reorder the global economy – the main dynamics and balance of forces in the global economy, and the organizational structures and rules governing global economic integration.

The perspective of the BRICs on the global economic crisis is especially interesting because they have come to occupy the space where the economic flows of the North and the South intersect, where the concerns of the traditional Northern powers meet and contest the interests of Southern countries. The BRIC are attempting to turn themselves into an institutional focal point for interest aggregation among the BRIC countries themselves, and between the BRIC and the poorer developing countries more broadly. Along with the interest aggregation, we see their self-identification with developing

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[1] Jim O'Neill, lead economist of Goldman Sachs is credited with inventing the term "BRICs".

world concerns, despite the fact that these emerging market economies occupy a different position within the global hierarchy than the “poorest of the poor”. For example, the four have become active as international donors. Cynics would refer to the BRICs as the self-stylized representatives of the “global South”. While BRIC governments have drawn contrasts between themselves and the G7, making passing reference to the G7’s “exclusiveness”.

Economists tend to question the longevity of the BRIC project. Political scientists and students of international relations are finding the BRIC interesting in terms of its political and diplomatic potential, and what it may tell us about the emerging world order. Whereas much of the discussion on the BRICs and the global crisis has, to date, been dominated by the economists, this paper offers some preliminary thoughts on the significance of the BRICs drawing on concepts in international and comparative political economy, and the literature on global governance and international organization.

## 1. Impact Assessment

The impact of the global financial crisis on the BRIC countries has varied. There has also been variance in the responses of the individual states to the crisis. Both impact and response have been shaped by path dependent variables. The impact has been most dramatic and direct in the case of Russia, and more indirect for Brazil, India and China, though nonetheless significant. The current crisis is turning out to be a critical juncture for each of the BRIC countries, in defining or altering the trajectory of their evolution. To generalize, the direct and indirect impacts of the crisis on the BRIC countries can be seen in the following channels: 1) exports and imports; 2) availability of credit, global and domestic; 3) foreign investment, including portfolio investment and FDI; 4) exchange rate; 5) interest rates; 5) industrial output; 6) remittances; 7) employment; 8) social welfare provision. An area of uncertain impact is in foreign aid provision, both from the G7/8 and the so-called “emerging donors”.

In all four BRIC country cases, the state has intervened heavily through interest rate adjustments, monetary policy, exchange rate policy, industrial policy, and employment policy. Unlike the less developed Southern countries, the BRIC have some degree of public financial cushion for weathering the storm. Unlike many of the traditional G7 powers, the BRIC went into the crisis with stronger macrofundamentals (the Russian case may be the exception due to strong reliance on energy exports). All four states are now at the stage in the policy cycle of analyzing the feedback and effects of their initial policy interventions, and gauging next steps in the policy cycle. The details of the four

BRIC country-cases are examined below, focusing first on immediate impacts and then on mid- to longer-range scenarios.

***Russia***

The immediate or short-impact of the global financial crisis on Russia has reportedly been quite dramatic. In the past 6 months, incoming FDI, which reached a record $28 billion in 2007, has dried up to a few billion. Foreign trade volume plunged 45.3%. Russia's two stock markets have seen massive falls, and Russia's banks have seen panic withdrawing from fear of a financial collapse. In May, Russia's Federal Statistics Service reported that Russian industrial output was down 14.9% year on year between January and April.[2] Moreover, the downturn accelerated in April. The data indicates the depth magnitude of Russia's economic woes, as global commodity prices began to rebound in the first-four months of the year. The drop has been driven by falls in manufacturing output, which was down 25.1% year on year in April as those sectors exposed to the crisis have borne the brunt of the downturn: steel production, cement and construction materials have recorded over 30% falls year on year; automotive production is down more than 60%. Mitigating the losses, to a limited extent, have been gains in food production, with cereal production up more than 23%, meat up 12.7%, and dairy up 4%.

In April, Unicredit's Head of Strategy and Research, Vladimir Osakovsky predicted that the Russian economy is still some distance from recovery, and further declines in output could be expected, and tentative steps to recovery emerging much later this year. In May, Russia's industrial production fell a further 17%, suggesting that the economy was still far from stabilizing, let alone recovery. The GDP contracted nearly 10% in the first quarter, and is expected to decline by 6 to 8% this year. The global financial crisis has dampened demand for oil and other commodities, greatly affecting the world's largest energy supplier. The drop in oil prices, the drying up credit markets, and the drop in the ruble have produced the worst national economic crisis for Russia in a decade. Elena Sharipova, senior economist for Renaissance Capital notes that the government's policy interventions heretofore (ruble devaluation, capital injections into the banking sector) have proven inefficient, and failed to stimulate domestic demand, but she believes that Russia's central bank will be able to keep the ruble stable, keeping the national currency rate at 32-35 rubles per dollar till the end of 2009. However, close to half of Russia's FOREX reserve has been spent on defending the ruble.

[2] "Industrial Output Down 14.9% January to April", *Russia Today* (Business) (online), May 19, 2009.

Amid this worrying economic scenario, the Russian government adopted a new anti-crisis program on June 19, 2009, in which it has pledged responsible macroeconomic policy aimed at maintaining economic stability, and creating incentives for the growth of the public's savings.[3] The plan also calls for increased investment in the economy, and the formation of an entirely new model of economic growth that stresses innovation, and departing from heavy dependence on energy exports and overseas borrowing. The program aims to modernize the Russian economy, optimize the economic structure, by helping the commodity economy evolve into an innovative economy, with five priority fields of development: energy saving; nuclear technology; space technology; health care; and information technology. Russian President Dmitriy Medvedev emphasized in his speech announcing the plan that it is necessary for Russia to being the process of modernization without delay.

In terms of economic stimulus, the government has already spent 1.4 trillion rubles ($46.7 billion) from its oil funds to carry out the anti-crisis spending measures, and the new federal budget of April 2009, identified spending in education, health care, and pensions as priority, and 17.5% of the stimulus spending for the real economy. 300 billion rubles ($9.66 billion) will also be spent on the high-tech sectors of space and nuclear industries. The stimulus package may have taken some effect as the unemployment rate declined to 9.9% in May from 10.2% in April, the first fall since September 2008. Inflation for the year through June also fell to 7.1 percent. The FOREX market and stock markets also show signs of stabilizing. The Economic Development Ministry is banking on a rebound from appropriate allocation of government assistance and if oil prices continue to rise. It appears that Moscow is still hoping that rising energy prices will play a significant role in allowing Russia to export its way out of the current scenario. It will be a challenge for the country to move off its heavy dependence on energy exports, and to greatly increase the share that innovative industries contribute to national growth, as it will require Russia to raise its productivity much higher than its current rate which is one-fourth the level in the US.

### *India*

Based on reports to date, the impact on India and Brazil has been somewhat less dramatic than with Russia, but nonetheless noticeable. India, over the past decade has become much more increased integration into the global economy, and as such, has also felt the impact of the global financial meltdown. Exports have decreased and growth has

[3] Yu Maofeng and Zhao Jialin, "Russia's Anti-Crisis Measures Take Effect", *Xinhua* (online), June 21, 2009.

slowed in India, which has the potential to impact hundreds of millions living on less than a dollar a day. The reduction in Indian exports affects not only export-oriented value-added industries but rather industries across the entire value chain.[4] According to the Reserve Bank of India, the impact has been spread in three dimensions: financial; real economy; confidence.[5] India's financial markets – equity markets, money markets, forex markets, and credit markets – have all come under pressure due to the global liquidity squeeze, as overseas financing has dried up. This shifts the pressure of credit demand from Indian companies onto the domestic banking sector, and has put pressure onto domestic money markets and credit markets. The FOREX market has come under pressure because of the reversal of capital flows due to the global deleveraging process. Corporations were simultaneously converting locally raised funds into foreign currency to meet their external obligations. This combination has put downward pressure on the rupee. The Reserve Bank's intervention into the FOREX market to mange the volatility of the rupee added further liquidity tightening.

In the real economy channel, the transmission of the global downturn has been quite direct – as a slump in demand for Indian exports. The US, EU and Middle East, which account for three-quarters of India's goods and services trade are in synchronized downturn. The contractions of overseas migrant employment opportunities have caused a slowdown in remittances as the Middle East has had to adjust to lower crude prices, and as advanced economies have gone into recession. These dynamics have resulted in a crisis of confidence. Although Indian financial markets have continued to function in an orderly manner, despite the seizure in global financial markets, the tightening of global liquidity that has followed the Lehman failure of September 2008 has caused risk aversion in the Indian financial system and made Indian banks cautious about lending. This crisis of confidence in the banking sector despite the fact that Indian banks have strong balance sheets, are well-capitalized, and well regulated. The capital adequacy ratio of (every) Indian banks is well above Basil norms and those stipulated by the RBI. No Indian banks have had to be rescued in the aftermath of the crisis. The Indian government has thus emphasized that, although India has not been part of the global financial sector problem, it has nonetheless been affected by the crisis through the "pernicious feedback loops" between external shocks and domestic vulnerabilities, through these three channels.

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[4] Haruhiko Kuroda, "South Asia Forum on Impact of Global Economic and Financial Crisis", (welcoming remarks by the ADB President, Manila, March 9, 2009).

[5] Duvvuri Subbarao (Governor of the Indian Reserve Bank), "Impact of the Global Financial Crisis on India: Collatoral Damage and Response", Tokyo, February 18, 2009.

The Indian government has taken steps to maintain the stability of the rupee, to augment FOREX liquidity, and keep credit delivery on track so as to avoid moderation in growth. Similar to China, this marked a reversal of the Indian Reserve Bank's policy stance from monetary tightening in response to heightened inflationary pressures of the previous period to monetary easing to ease inflationary pressures and growth slowdown. AQmong the non-conventional measures taken, the Reserve Bank established a rupee-dollar SWAP facility for Indian banks to give them comfort in managing their short-term foreign funding requirements. In response to the depth of the current crisis, the Indian government invoked emergency provisions of the FRBM Act to seek relaxation from the fiscal targets and launched two stimulus packages in December 2008 and January 2009. These fiscal stimulus packages together amounted to about 3 percent of GDP, and included additional public spending (capital expenditure), spending on infrastructure, cuts in indirect taxes, expanded guaranteed cover for credit to small and micro enterprises, and additional support to exporters. These stimulus measures came on top of already announced expanded spending for social safety-net for the rural poor, a farm loan waiver package, and salary increases for government staff, which should also stimulate demand. Indian political analyst Ajay Singh has noted that, despite the lingering world economic recession, the economic sectors of the four BRIC countries, especially India and China, are showing optimism on growth, income and employment.[6] He added that India confidently expects GDP growth of above 7% this year, after achieving 6.7% last year. Moreover, the reelection of Congress Party is seen as positive for maintaining stability and growth.

### *Brazil*

Brazil has fallen into technical recession after registering two consecutive quarters of declining GDP.[7] Brazil's unemployment rate reached a two-year high of 9%. To manage the crisis, the Brazilian government has introduced a series of macro-control measures and stimulus plans, and has additionally sought expanded international cooperation with other countries, such as China. Brazil has moved swiftly to adjust the country's economic policies and ease the impact of the global slump. The central bank has cut its basic annual interest rate (Selic) by 1 percentage point to 9.25%. The rate had been 13.75% in January. To stabilize the value of the real, which has lost more than 30% against the US dollar since the start of the crisis, the central bank has sold millions of

[6] Deng Shasha, "Indian Officials, Scholars Express High Expectations of BRIC Cooperation", *Xinhua* (online), June 13, 2009.
[7] "Brazil Acts Swiftly against Financial Crisis", *People's Daily* (online), June 14, 2009.

dollars in repurchase agreements or dollar swaps and increased the amount of money for lending. President Lula signed a law creating a 14.2 billion reals ($6.4 billion) sovereign wealth fund, and he granted tax breaks to banks, automakers, construction firms, and airlines late in 2008. The tax cuts on industrial products triggered record auto sales of 271, 494 new vehicles in March, up 17% from the same period in 2008, and the Brazilian auto industry saw a rebound in production in the first-quarter of 2009.[8] To help farmers and the agricultural sector, the government has encouraged banks to provide more loans to farmers and agricultural companies. According to the finance ministry, the agricultural sector will have received loans totally at least 15.8 billion reals ($6.79 billion) by the end of 2009.

Brazil's reforms over the past decade are said to have helped position the country to weather the global economic crisis, to continue to provide investors with opportunities – and there allow Brazil to access capital markets at a relative advantageous rate.[9] The benefits of the Real Plan of the 1990s, the commodity boom, and the growing buying power of the expanding Brazilian middle class are all contributing to providing the country with a financial cushion. The Real Plan has strengthened Brazil's external account position, and kept inflation under control. The steady demand for commodities – especially from China and India – has helped Brazil build a large cushion of FOREX reserves. And the growth of the manufacturing and service sectors have facilitated economic diversification.

It is clear that a prolonged downturn will create significant difficulty for Russia, and it would likely become serious for Brazil and India as well, in terms of sustaining the overall upward trajectory. However, both appear less vulnerable than Russia. For now, a number of institutional investors continue to suggest that the macro-fundamentals of Brazil and India are strong.

***China***

The Chinese case is not straight forward. China's leaders and citizens are concerned about the ripple effect of the global financial crisis. Worldwide demand for Chinese exports has decreased, leading to slowdowns in industrial production. Factory closures and layoffs in southern China have led to some growing frustration, and the potential for rising unemployment is cause for concern. Contraction in the growth rate,

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[8] Overall car sales for the first-quarter of 2009 also reached record-high levels as well, with 668,314 registered sales.

[9] The Bank of New York Mellon Corporation, "Brazil Well Positioned to Weather Global Financial Crisis and Provides Opportunities: Reforms, Demand for Commodities help Build Financial Cushion", *Reuters* (online), April 6, 2009.

consecutive drops in housing prices, and losses in industrial sectors ranging from electricity production, textiles, non-ferrous metals and information technology have further raised concerns. However, not all of the slowdown and factory closures have been the result of global financial meltdown, and some of it has been due to adjustment measures the government had initiated prior to the onset of the global meltdown. At the same time, China has been less directly affected by the financial crisis than other countries, due to its more closed financial system, and because of the banking reforms that China has undertaken in the decade since the 1997-98 Asian financial crisis, including fixing weaknesses such as its many non-performing loans. China also has a low level of foreign debt relative to its huge store of foreign currency reserves. Its new-found strengths, combined with Washington being mired in its own problems, led other nations to urge China to provide a greater financial hand in this crisis, such as by increasing its imports, and providing international financing to countries in need, including through increased contributions to the Bretton Woods institutions.[10]

On November 10, 2008, the Chinese government announced a historic $586 billion stimulus package aimed at encouraging growth and domestic consumption in ten areas, with new investment for housing, rural infrastructure, transportation, health and education, environmental protection, industry, to post-disaster reconstruction, incomes, taxes and finance. These measures aim to loosen credit supply for major projects that help rural areas; reduce taxes to help small businesses and offer rebates to exporters; and start massive infrastructure spending that would aid cement, iron and steel producers. Chinese authorities also preceded these changes by reducing interest rates. By curtailing imports, China has maintained a favour balance of payments, and its huge FOREX reserves have been protected. Chinese authorities have maintained the value of the RMB throughout the crisis period, and some nations have argued that it needs to devalue further.

In mid June 2009, the World Bank revised its forecast of China's economic growth rate to 7.2% in 2009, from its earlier forecast of 6.5%, as the government's expansionary fiscal and monetary policies seem to have kept the economy growing at a respectable pace.[11] The Bank further projects GDP growth to reach 7.7% for 2010. The Bank's lead economist for China, Ardo Hansson did add that "it is too early to say a robust recovery is on the way". The positive signs have been the result of the half-trillion dollar fiscal stimulus plan, while the monetary stimulus has led to a surge in new bank lending.

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[10] Gregory Chin, "China and the End of the G8?", *Far Eastern Economic Review*, December 2008.
[11] Zhang Xiang, "World Bank Raises China's 2009 Growth Forecast to 7.2%", *Xinhua* (online), June 18, 2009.

Positive signs have emerged in the real estate sector, and consumption has held up well, however, weak exports have continued to be the main drag on growth, while imports have recovered as raw material imports have rebounded. Meanwhile, the Chair of China's banking regulatory agency, Liu Mingkang forecasted on June 12 (2009) that economic growth would be around 8% for the year, and that China's domestic demand has been recovering steadily and credit growth remains high. At the same time, he added that China still faces some severe challenges including sluggish overseas demand, rising unemployment, and an unstable international economic and financial situation.

Some argue that China's seeming recovery does not represent a sustainable upturn because it is driven mainly by state stimulus. That the high level of banking lending that has taken place since the start of the this year is fuelling a new round of non-performing loans in China's state banks, and putting them back into a position of longer-term fragility. Albert Edwards, strategist of Societe Generale is predicting that the "bubble of belief" in China is about to burst.[12] Others note that the level of new state spending for social welfare and building the social safety net for the rural poor in China is not sufficient, and that serious constraints on increased domestic consumption remain, and that Beijing's moves will not be successfully in helping the country to reduce its export dependency. However others note that China is well placed to weather the global economic downturn with its high level of reserves, room for policy easing, strong savings rate, and low leverage.[13] China also appears to possess reserve or latent trade capacity which it has yet to fully tap, as a crisis mitigation strategy, by shifting downward on the technology ladder in order to unleash such trade potential with neighbouring Asian countries. For now, strict regulations from Beijing continue to be maintained in order to try to encourage the shift up the technology ladder, and industrial upgrading that central authorities are aiming for. This gives China a certain amount of economic cushion to withstand the external risks of plunging equity and currency markets, for a certain period.

China is still on a priority list to receive asset allocation or portfolio in worldwide markets, once they become available. Other analysts also point out that the state activism even prior to the crisis, and especially henceforth, is adding momentum to China's trade with emerging economies, if not bypassing the West – a la "decoupling" – then supplementing trade with the West. That from 2003 to 2007, China's trade with the

[12] David Wilson, "Bubble of Belief' in China Economy Seen Bursting: Chart of Day", *Bloomberg,* June 17, 2009.
[13] Xie Peng and Qiao Jihong, "China Well Place to Withstand Global Financial Crisis", *Xinhua* (online), January 4, 2009.

three BRIC partners alone grew twice as fast as its trade with the US, as China soaked up iron ore from Brazil, oil from Russia, and exported consumer good to India. While trade flows within the emerging markets bloc may not replace trade with the West, these new trade flows, as well likely increased trade and investment between China and its East Asian neighbours may allow the country to ride out the tide of the current global downturn, and emerge from the crisis more quickly, and in a stronger position.

***Debating Medium and Long-Term Implications***

From the perspective of the shifting global order, the more interesting, but even less precise predictions are for the medium-term and longer-term impact of the current crisis on the BRICs. Here there is no consensus among the pundits. The Allianz Group is hedging its predictions, or less generously, offering a rather confusing picture. One part of Allianz Group says that the BRICs are going down. Karine Berger, Director of Economics and Sectoral Studies, a subsidiary of the Group says that, "The most likely scenario is that the emerging economies will exit the crisis weak and impoverished."[14] Accordingly, this is because the emerging economies have not created enough wealth, have not sufficiently developed their domestic markets, over the past decade of globalization, to allow them to recover from the crisis on their own. However, in another part of Allianz, Michael Konstantinov says that the emerging powers are coming out of the crisis sooner. Konstantinov is betting on the resiliency and fundamentals of the BRIC economies, and sees 'the recession as primarily a developed world phenomenon'.[15] He notes that the BRICs are still growing, and driven increasingly by higher domestic demand and lower export reliance. Kostantinov has noted the surge in trade among the BRIC, and their international currency moves. Which is it?

Jim O'Neil, the Goldman Sachs's chief economist who coined the term "BRIC", has reevaluated the situation yet remains steadfast. He predicts that the BRIC countries will come out earlier and stronger than the G7. The global crisis, according to O'Neill, means China and the other emerging economies will overtake developed economies even more quickly.[16] Defying the nay sayers, his estimate is that China's economy will now likely overtake the United States in less than 20 years, and that the four BRICs could dwarf the G7 by then. Challenging those who are predicting that the "BRICs dream" has been

[14] "Domestic Demand in the Emerging Economies Remains Weak" (translation by Michael Erdman, CIGI Project Officer), *Le Monde* (France), June 4, 2009.
[15] Grace Ng, "BRIC Building Its Own Way Out of Recession: Brazil, Russia, India, and China are Trading More and Relying Less on the West", *The Straits Times* (online), June 15, 2009.
[16] Guy Faulconbridge and Michael Stott, "Crisis Speeds BRIC Rise to Power: Goldman's O'Neill", *Reuters* (online), June 9, 2009.

shattered by the crisis, O'Neill now conceives of China challenging the US for the number one position in the world economy by 2027, and the combined BRIC countries bigger than the G7 within 20 years – that's 10 years ahead of his earlier predictions about the BRICs. Whereas Goldmans predicts that the world economy will contract by 1.1 percent this year, the BRICs will average 4.8 percent growth, allowing them to 'dominate the world growth picture even more than when the world economy was booming, and this includes Russia forecasted as weak for 2009. The view here is that the BRICs are dominating world growth even more than when the global economy was booming, and this despite the fact that Russia has been hit quite hard this year by the crisis. O'Neill, contrary to the nay sayers, argues that China has had a "good crisis", in the sense that the crisis has forced China to adjust its role in the world, and to realize that their next stage of growth cannot be export-driven. Goldman's forecast for Chinese growth is 8.3 % for 2009, and10.9% for 2010 – while it sees the world economy only growing by 3.3% in 2010. These numbers are somewhat higher than the World Bank's recently revised estimates. Goldman estimates that India will grow at an average rate of 6.3% from 2011 to 2050, China at 5.2 %, Brazil at 4.3%, and Russia at 2.8% because of its forecasted population declines.

Part of the challenge in making sense of the mid- to long-range impact of the current crisis on the BRICs is that most analysts stick to a relatively short time frame, and more importantly, because there is no logical theory for longer-term prediction of historical contingencies. For China, most analysts stick to asking whether, when, and how China will come out of the current global downturn, whether it will come out stronger or weaker, on the other side of the current downturn, and in what position in world ranking. An interesting "other" emerging economy perspective on the impact on China comes from El Economista of Mexico, which reports that China's is en route to becoming the world's second largest economy, likely superseding Japan before the end of the year".[17] It is arguably such longer-term changes in relative international ranking that actually matter the most in gauging whether we are really witnessing a fundamental shift in the global order. It is not so much whether or not China will suffer a period of downturn with the rest of the world economy, as it surely is now, or whether or not China suffers from serious domestic social and economic vulnerabilities, as surely its does, but rather whether it will be on a relative upward growth trajectory – over the next few decades – even if there are periodic downturns. In other words, despite the tensions inside Chinese society, and the possibility of more episodes of reduced growth over the

[17] "China En Route to Becoming the World's Second Largest Economy" (translation by Michael Erdman, CIGI Research Officer), *El Economista* (Mexico), June 10, 2009.

next few decades, whether, overall, China is on a upward trend, especially relative to every other national economy? If we recall, the United States also suffered some serious downturns at various stages of its rise from the early to mid twentieth century, with the Great Depression and during the inter-war period. As the world's manufacturing center, America suffered from rising trade protectionism and slow downs in demand for its manufactured goods in these periods. However, relative to every other country, including Britain, the US was powerful and still on the rise. Perhaps it is awareness of the significance of the relative shifts in international power rankings that led President Lula to emphasize that one of the most important effects of the global financial crisis is that it has made countries "more equal". In the first visit of a Brazilian President to Kazakhstan, in central Asia, Lula said: "…before the crisis, there were many countries that had greater significance than others, and some countries which had no significance at all. After the crisis, everyone has become similar."[18]

The most important questions then, for the BRICs are whether they will come out of the current downturn earlier, especially in relation to the G7; and whether, over the next three decades we can expect the emerging economies, the BRICs, to be on an overall upward trend, especially relative to the current OECD countries? While predictions on the medium and longer-term impacts of the crisis on the BRIC are largely speculative, and imprecise, what we do know is that the BRIC nations are responding, both as individual nations, and collectively, as a group. Although these responses are nascent at this point, and have a protean quality, they reveal political dynamics that, cumulatively, add up to more than the sum of the economic statistics. The emerging trends may be foreshadowing significant qualitative shifts in the global order.

## 2. The Economic Diplomacy of the "BRIC"

What is most interesting for political economists and international relations scholars is the "BRIC" response – in other words, the emergence of a collective response. Rather than splintering as with previous movements of developing country alliances, such as Bandung in the late 1950s, or the call for a New International Economic Order in the early 1970s, what is most interesting about the current grouping is that it has drawn closer together amid the global economic crisis.[19] It has become clear to the individual BRIC governments that it makes sense for them to act together to press the developed

[18] "Global Financial Crisis Makes Countries More Equal: Brazilian President", *Xinhua* (online), June 18, 2009.
[19] Gregory Chin, "The Emerging Powers: Global Financial Crisis Gives Rise to New International Order", *The Waterloo Record*, April 30, 2009.

world to make the global organizational structure more reflective of the shifting balance of economic power. Statements by every single BRIC leader indicated that the BRIC members are conscious they can gain leverage in the G8 and G20 negotiations by acting as a group.[20] The global financial crisis, cum economic crisis, has exposed fundamental flaws in global governance. It has thrown a spotlight on the fact that the major multilateral institutions that were created after the Second World War are increasingly divorced from the international economic and geopolitical realities of the twenty-first century. Their preexisting crises of efficiency and legitimacy became further accentuated by the calls of the BRIC nations and the newly self-identified "G5" for greater clout in the IMF, World Bank, and in the UN system.[21] In such a scenario, the G7/8 club of rich nations looks increasingly anachronistic – even if the G7/8 has actually made some adjustments to evolve such as the creating the G20 finance track in the late 1990s.[22]

For the G7, such group identity formation on the part of the BRIC is not necessarily a negative development. After all, it has been one of the objectives of the G8+5 HDP to encourage the "O5" to meet, discuss, build trust, and develop a common sense of shared interests, as part of a structured dialogue with the G7/8.[23] Such emerging BRIC group formation allows for more clear-cut negotiating positions to emerge, which is useful if the G7 is serious about a reform agenda. The first Summit of the BRIC leaders was primarily dedicated for finding this collective voice. Lula, who came all the way from Brazil to meet his counterparts in central Russia, has championed developing countries and the emerging powers playing a greater role in global institutions. He was the most explicit in saying that he would urge his counterparts at the first-ever BRICs Summit to forge a common position on reforming the international governance system, including the IMF and the United Nations Security Council.[24] The Joint Communique issued by the BRIC at the end of their Summit supported Lula's wish.

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[20] Chris Buckley, "Much-Trumpeted BRIC Summit End Quietly", *Reuters* (online), June 17, 2009.

[21] On the pre-existing dual crises of the G8 see: Anthony Payne, "The G8 in a Changing Global Economic Order", *International Affairs*, 84(3), May 2008, pp.519-534; Thomas Fues, "Global Governance Beyond the G8: Reform Prospects for the Summit Architecture", *Internationale Politik and Gesellschaft*, 2, 2007, pp.11, 13; Andrew F. Cooper and Kelly Jackson, "Regaining Legitmacy; The G8 and the Heiligendamm Process", *International Insights* (Canadian Institute of International Affairs), 4:10, 2007, pp.1-4.

[22] On the G8's adjustment efforts see: John Kirton, "From G8 2003 to G13 2010?: The Heiligendamm Process' s Past, Present and Future", in A.F. Cooper and A. Antkiewicz (eds.), *Emerging Powers in Global Governance: Lessons from the Heiligendamm Process* (Waterloo: Wilfred Laurier University Press, 2008), pp.45-82.

[23] Andrew F. Cooper, "The Heiligendamm Process: Structural Reordering and Diplomatic Agency", in A.F. Cooper and A. Antkiewicz (eds.), *Emerging Powers in Global Governance: Lessons from the Heiligendamm Process* (Waterloo: Wilfred Laurier University Press, 2008), pp.1-18.

[24] Todd Benson and Raymond Colitt, "Brazil Lend IMF $10 Bion, Urges BRIC Strategy", *Reuters* (online), June 10, 2009.

The new collective vision – and identity – starts with the BRIC interpretation of the causes of the global financial crisis and what the crises has meant for the world. Their interpretation has potential impact because BRIC countries hold combined reserves of nearly US$3 trillion, and are among the biggest holders of U.S. Treasuries (the others include Japan, Taiwan, South Korea and the ASEAN countries). The Chinese (and Indians) are said to be more in the follower's role, while the Russians and the Brazilians are said to be forefront in pushing the BRIC agenda.[25] Even within the Chinese side, some bureaucratic actors seem to be more cautious in discussing reforms to the international monetary and financial systems, while others have been more interested in exploring alternative options. The PBOC has led the innovation process, while the MFA has been more status-quo oriented, as seen in the cautious statements by China's G20 sherpa and Vice Minister He Yafei, downplaying the interest of China (in the BRIC grouping) in pursuing international monetary reforms. Nonetheless, the view coming out of Beijing in China's official newspaper is revealing and has a direct effect over currency markets. To quote the senior staff editor of the People's Daily the day before the BRIC Summit:

> As is known to all, the current financial crisis has originated in the United States and spread elsewhere on the globe rapidly due to the vital role of the American economy in the world economy and the U.S. dollar's status as the global economy's sole reserve currency. **The worsening financial crisis shows the imbalanced growth of the present world economy and implies the failure of the existing economic order and financial setup [read: the G7 countries] to comply with global economic order and financial structure**.
>
> …**Since the outbreak of the financial crisis, the confidence and role of the U.S. dollar have been further impaired, and it has been widely questioned if the dollar will go serving as the global reserve currency**. Meanwhile the BRIC countries have begun to increase their hold of International Monetary Fund (IMF) bonds, so as to seek a stronger voice in global financial institutions while prompting the U.S. to take a more responsible approach.
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> As a matter of fact, **the "de dollar" process has already begun** in many regional bilateral and multilateral trading arrangements **among developing countries**. In fact, changes in

[25] Siddharth Varadarajan, "BRIC Should Create Conditions for Fairer World Order", *The Hindu* (online), June 17, 2009, accessed June 17, 2009.

> the evolution of the role and functions of the dollar will undergo a **relatively lengthy process**.[26]

Beijing's words are backed up by significant monetary and financial heft – its growing global financial power[27] – and it picks its words carefully. Moscow has come to appreciate how its words can also move the currency markets. The dollar fell 0.9 percent against a basket of currencies on world markets after President Medvedev's comments, the day before the BRIC Summit, after the Russian President remarked that the existing reserve currencies, including the dollar, have not performed their function, and that "we are likely to witness the creation of a supranational currency… which will be used for international settlements".[28] The largest holders of US Treasuries are increasingly nervous about the fiscal stability of the US going forward, despite Timothy Geithner's efforts to ease such concerns during his recent May visit to Beijing, his first as Treasury Secretary. At the same time, Beijing, in particular, realizes how tenuous this form of power is, and that it must be exercised with extreme caution, when one is sitting on more than a trillion of foreign currency reserves, in order to avoid a run on the dollar.

However, what is most significant is that despite their collective need to prevent a collapse of the dollar, the BRIC countries are moving ahead with their incremental diversification strategies. Brazil and China have agreed to conduct more trade in their own currencies. Moscow and Beijing just signed a similar agreement. If not de-coupling, we are seeing the beginning of what Beijing is coining "de-dollarization". In early June 2009, it was announced that Russia and Brazil was joining China in plans to diversify their debt holdings by becoming the first countries to buy a new bond to be issued by the IMF. Russia said that some reserves may be moved out of US dollars to fund the IMF purchase. Brazil announced on June 10, 2009 that Brazil had decided to contribute $10 billion to the IMF, which will be made through the purchase of bonds linked to the so-called Special Drawing Rights, is part of the push to reform the multilateral lender. In so doing, it joins Russia which has also pledged $10 billion to the Fund, and China, which earlier pledged $40 billion to help capitalize the IMF. President Lula da Silva explained that, the $10 billion pledge "gives us moral authority to keep pushing for the changes

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[26] Huang Qing, "Dollar and Future of BRIC May Dominate Summit", *People's Daily* (online), June 16, 2009, accessed on June 16, 2009. (emphasis added)

[27] Gregory Chin and Eric Helleiner, "China as a Creditor: Rising Financial Power?", *Journal of International Affairs*, Fall 2008, pp.87-102.

[28] Guy Faulconbridge, "Emerging Powers Try to Wean Themselves Off U.S. Dollars", *Reuters*, June 17, 2009; Naomi Tajitsu, "FOREX-Dollar Falls on Russia Comments, BRICs Awaited", *Reuters*, June 16, 2009 (online), accessed June 16, 2009; Wanfeng Zhou, "Dollar Slides after Russia Comments, BRIC Summit", *Reuters*, June 16, 2009.

that are needed at the IMF." One June 16, 2009, China lowered its holdings of US Treasury Bonds for the first time in more than one year, a move that experts told Xinhua News Agency was triggered by a weakening of the value of the dollar, and that reflected concern over the safety of US dollar-linked assets.[29] US Treasury data showed that China pared its stake in Treasury bonds by US$4.4 billion, to US$763.5 billion, as of the end of April, compared with March. China is not the country that trimmed its US dollar holdings in April. Japan, Russia and Brazil did likewise, all reducing their reliance on the dollar, by a measure. Zhang Bin, of CASS, said that it would take months to see if China is really looking to lower its stake in US dollar holdings, and even then, any reduction would be incremental, in order to avoid "shaking" international financial markets. What does such gradual "de dollarization" mean for the G7, for the US, for the EU, and its Euro project? As well as the gradual internationalization of the Chinese RMB, a move that would help reduce China's demand for US dollar?

It has been reported that it is primarily Russia, and also Brazil, that is most interested in the BRIC get-togethers and meetings. The BRIC discussions over alternative international monetary and trade arrangements would be of particular interest to Moscow considering that Russia has lost over half of its FOREX reserve in trying to defend the value of the ruble against the dollar. These Summits would be one way in which Moscow could clearly register its displeasure with not only the current international monetary order, but also with the fact that it has been left out of the G7 finance grouping, despite having joined the G7 in 1998, and turning the it into the G8. This situation is reflective of the lingering inhibitions which "the likeminded 7" hold toward Russia, and their anxieties over the inevitable links between economic security and political security concerns. For Moscow, the BRIC Summits could become a surrogate "G4 finance and central bankers grouping". China, arguably because it is the biggest of the four in terms of current economic size and potential, and its high level of dependence on, integration within the current international monetary and financial order, appear most cautious in approaching the BRIC Summits. And yet China and Russia, together, were the initiators of the RIC foreign minister's trilateral meetings that preceded this first BRIC Leader's Summit for four years. Together, Moscow and Beijing reached-out to Delhi.

Whether the BRIC initiative appears more, at this point, as a political statement than a full-blown attempt to diversify away from their large holdings of US debt, much in the future of the BRIC depends on how the West responds. The G7, the US response will

[29] "China Lowers Holdings of US Treasury Bonds 'Response to Weaker Dollar'", *Xinhua* (online), June 16, 2009.

elicit a counter-reaction from the BRIC. For now, financial analysts in ING Moscow, for example, predict that no more than a few percentage of reserves can be reinvested into BRIC bonds. That what we're seeing is still at the stage of discussions, to find an alternative to the dollar system, but nobody is going to make fundamental alterations yet". The "yet" is key.

Beijing and Moscow followed up the BRIC Summit with a landmark bilateral on 17 June 2009 in which the two sides signed three MOUs that included economic agreements worth US$100 billion. These agreements include major energy supply deals, for what will soon be the world's longest natural gas pipeline, for Russian energy supplies to East Asia. What are the implications of this new eastward pipeline? This pipeline has the potential to be a "game changer" in the geopolitical great game, if one considers how Russia sits relative to EU energy security, and the potential heavy demand for Russian energy supplies in East Asia, namely China, Japan and South Korea.[30] And even if only a portion of the $100 billion worth of deals are concluded, they will have a major impact on the world economy in terms of global supply and demand dynamics. Beijing also beefed up its international financial lending, and further underlined its growing economic clout, by offering Central Asian states a US$10 billion line of credit at the SCO meeting that backed onto the BRIC Summit, to help them mitigate the effects of the current global economic slump, although Chinese President Hu was careful not to link this official loan to proposals for diluting the dominance of the dollar.[31]

As Andrew Cooper has explained, although there is a self serving component in any specific BRIC reform idea, it does not reduce the importance of the effort for its catalytic effect.[32] Moreover, the BRIC have usually also made sure to coordinate their messaging with the interests of the poorer countries. The BRIC meetings "show a very strong desire of developing countries to play a bigger role in world finance, especially given the growing insecurity related to the current crisis", according to Marsha Lipman, a political analyst of the Carnegie Center in Moscow.[33]

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[30] I thank Sergei Plekhanov for highlighting this point.

[31] In February 2009, Russia announced it would contribute $7.5 billion to a regional fund of the Eurasian Economic Community, which also includes Belarus, Kazajstan, Krygyzstan, and Tajikistan. Source: "BRIC Countries May Shun Dollar", *Bloomberg News* (online), June 16, 2009.

[32] Andrew F. Cooper, "The G20: A Work in Progress for Global Governance?", keynote address at the 8th FES-SWP North-South Dialogue, Berlin, June 17, 2009.

[33] Source: "BRIC Countries May Shun Dollar", *Bloomberg News* (online), June 16, 2009.

## Concluding Observations: Systemic Significance

In summary, what are we to make of the BRIC group, and their Summit meetings in mid June? O'Neil makes a poignant observation in stating that "the BRIC, as an institution, is a very useful threat and inter-temporal political grouping to force more realistic change of global institutions".[34] The BRIC serves an important medium-term function as a catalyst for forcing reforms of the international power structure; reforms that are otherwise being resisted by the traditional powers when left to their own to decide. One can hear echoes of such purpose in Chinese President Hu Jintao's call on the BRIC to recognize the unique historical conjuncture that they find themselves in, and how a convergence of factors is creating a diplomatic opening for the emerging powers that they should not miss: "We should seize the historic opportunity, strengthen unit and cooperation, and jointly safeguard the overall interests of developing countries." As such, there is some base to the view that the BRIC is mainly a diplomatic and political club for converting their growing economic power into greater geopolitical clout.

There are many questions about how such different countries will work together over the longer-term. Much here will depend on interests, both individual state and collective, but there will also be a significant role for contingency. China's Hu Jintao has offered a set of norms and principles, and areas for focus, for the BRIC: 1) "strengthen mutual trust" and be an "example of mutual respect and equal coordination in the international community"; 2) to deepen economic cooperation in resources, markets, labour force, and technology, and beyond trade and investment, should create partnerships in S&T to deal with climate change, new energy, and create new growth engines; 3) promote cultural cooperation, and promote mutual understanding to "lay a solid social groundwork for all-round cooperation"; and 4) to "encourage learning and drawing on useful experiences from each other".[35] Hu further called on he four nations to "enhance dialogue, exchange and cooperation with each other on the principles of openness and transparency". When one also notes that China's official media also referred to the meeting of the G8 Foreign Ministers as an "exclusive club", one can see the distinction that is being drawn with the norms proposed by Hu for the BRIC, i.e. mutual respect and equal coordination relations, openness and transparency. Hu also added a four-point proposal for dealing with the ongoing global financial crisis,

[34] Guy Faulconbridge and Michael Stott, "Crisis Speeds BRIC Rise to Power: Goldman's O'Neill", *Reuters* (online), June 9, 2009, accessed June 16, 2009.
[35] "Chinese President Calls for Closer Cooperation, Joint Efforts to Tackle Financial Crisis at BRIC Summit", *Xinhua* (online), June 17, 2009.

knowing that this contingency will have a direct impact on the individual and collective interests of the four BRIC countries.

While there are good reasons to question the future of the BRIC as an institution, as scholars in some BRIC countries, namely China, are also doing, we should also avoid jumping too quickly to O'Neil long-term conclusion that 'although the BRIC serves a temporary purpose – to prompt reform – "it is unlikely to become a powerful institution on the world stage". His belief is that the BRIC is likely a temporary marriage of convenience that will last as long as the bloc is an effective pressure group for greater representation, and a counter weight to US unilateralism or dominance over global governance. Once this changes, then the purpose for the BRIC, as a largely oppositional lobby will have withered away. While economic logic may lead one to see the rational organizational adjustments that are needed to address the gap between the economic reality and the current international political system, there is a lot of politics standing in the way between here and the outcome of an organizational situation that is more appropriate for the emerging balance of power.

To conclude, I would suggest that the focus should be shifted back onto the G7. The reasoning is that whether the BRIC becomes a longer-term institutional force will depend not only on the national interests and intentions of the BRIC, but also, in large measure, on how the West plus Japan, or the G7 respond to the rise of the BRICs. The West will actually have strong role in determining the contingencies that will shape the interests of the BRICs as they move forward, both individually, and as a potential alliance. This leaves us with two questions: first, whether the West, as a collective group, can exhibit the clear-minded and far-sighted vision to know when and how to share the global leadership and global institutional power? And to share both to a degree, such that what emerges is a more inclusive set of global institutions, an institutional mix that more accurately the emerging distribution of global economic capability? Second, and equally important, whether the BRIC will fully step up and take on global responsibility, if and when the West makes the move? We can only hope that the current crisis will give cause to all the key players, traditional and emerging, to focus on reforming the global governance system.