



## THE BRICS SUMMIT 2013: KEY ASKS AND PRIORITIES

*Pranay Sinha<sup>1</sup>*

### Background

Historically, international financial institutions developed as a result of the dominance of a few advanced economies, after the Second World War. Until quite recently, the status quo remained largely unchallenged. With the world becoming more interdependent, the dominance and unipolarity of the West is being challenged by the rise of the 'rest'. The three themes discussed in this paper, i.e. the BRICS Development Bank, the BRICS' Development Cooperation with Africa and Illicit Financial Flows reflect the interaction of emerging powers with the already established powers.

During the last decade, with the rise of emerging economies and their growing interest in Africa, the role of the BRICS countries has been widely debated and scrutinised. It is against this backdrop that there has been a real need for the BRICS countries to demonstrate a difference in its approach from the West. Consensus on the need to establish a BRICS Development Bank, efforts to strengthen development cooperation with Africa, both bilaterally and multilaterally, and the fight against illicit financial flows are but a few examples that refute criticism about the purported lack of unity and policy coherence among the BRICS countries.

### The BRICS Development Bank

The idea of establishing a dedicated BRICS Development Bank needs to be seen against the backdrop of continued demand exerted by its member nations to reform the international financial institutions and global financial architecture. The credibility and legitimacy of existing international financial institutions are continuously questioned by the BRICS countries when demands for governance reforms in the form of greater representation and change in voting shares are not met.

Furthermore, in the wake of the recent global financial crisis, the BRICS countries demonstrated their financial clout by pledging \$75 billion as its contribution to the IMF's bailout fund (2012). China contributed \$43 billion, whereas India, Russia and Brazil contributed \$10 billion each. South Africa brought an additional \$2 billion to the bailout table. With this increased financial clout running on surplus foreign exchange and sustained domestic growth, the idea of establishing the BRICS' own development bank gained currency as a counter to the governance deficit in the international financial system.

A few fundamental questions yet to be answered are the location of the secretariat (physical/virtual), the subscription amount (\$10

billion each/contribution on the basis of the size of the economy), control and ownership (opening up to other advanced economies/exclusive control by the BRICS countries), the geographical mandate of investments (within the BRICS confederation/beyond the BRICS confederation) and finally, the lending practices (divergence from/compliance with lending practices of other multilateral development banks such as the World Bank and regional development banks.<sup>1</sup> The modality of the proposed bank's lending instruments is currently being debated (non-concessional/concessional, syndicated lender to sovereign/non-sovereign projects)<sup>2</sup> In order to establish the BRICS Development Bank, it is reported that it could cost as low as \$50 billion and as high as \$250 billion, though the final figure is yet to be announced. The amount of \$50 billion is considered to be the starting capital, which is expected to rise in the months ahead. It is yet to be decided whether the bank will be raising funds from the market at a concessional rate alone, or bring in surplus foreign reserves as well.

### Emerging Issues

#### 1. Public Money and the BRICS Development Bank as a 'Public Development Finance Institution'

It is important to recognise that the resources pooled to create the BRICS Development Bank will be taxpayer money from the BRICS countries, whether this is in the form of surplus foreign reserve or funds raised from the market. When it comes to India's contribution to the bank, it is the decision of the Parliament to either raise these funds from the market or allocate them from existing budgetary resources. Questions naturally arise around the "public" nature of the institution. If funds are raised from the market, for instance, would that necessarily make the institution a commercial one?

To take the example of the Exim Bank, which is a Government of India owned institution, the fact that it raises its funds from the market does not necessarily make it a private finance institution. The EXIM bank, despite having the independence to raise capital on its own, is authorised by the Indian parliament to raise this capital within a stipulated limit. The issued capital is wholly subscribed by the Government of India and it is this subscription that makes the EXIM bank a 'public development finance institution'.

<sup>1</sup> Pranay Sinha is currently a PhD candidate at the University of Birmingham. He studied Development Diplomacy, Aid Management and Rural Development in Malta, the UK and India respectively. Until 2011 he was the principal investigator of a research initiative focused on South-South Cooperation Transparency. Over the last eleven years, his diverse work experience has included working in an academic institution in the United Kingdom, the United Nations and State government departments in India.. He has also undertaken research consultancy assignments independently (for Oxfam India) and with other organisations (for DFID, UK and OECD, Paris).

## 2. Ensuring Transparency and Accountability of the BRICS Development Bank's Projects

Claims of human rights abuses resulting from development projects supported by international financial institutions are not new. Issues are wide-ranging, including 'forced eviction', 'inappropriate use of public and private security force',<sup>3</sup> and land grabs.<sup>4</sup> Some large infrastructural projects have also adversely impacted the environment.<sup>5</sup> India has its own experience with the Narmada dam project where the rights of local people were violated. This prompted the World Bank to establish an independent Inspection Panel in 1993 to recognise the importance of creating an independent citizen-based accountability mechanism and to deal with its own possible policy violations in project lending. The Inspection Panel provides an independent complaints mechanism for grievance redressal. It would be the right way forward for the BRICS Development Bank to ensure that similar accountability mechanisms are in place.

## Recommendations

India should ensure that the following transparency and accountability mechanisms are in place before the BRICS Development Bank is fully operationalised.

### 1. Conducting an assessment of existing accountability mechanisms

The BRICS countries should ensure that an assessment of various multilateral development banks and individual banks is carried out. This would force development banks in the BRICS countries to adapt best practice and make this public development finance institution more responsive to a) BRICS citizens in their capacity as donors as well as recipients of funding from the proposed bank and b) other recipient citizens so that they can hold their respective governments and the BRICS Development Bank accountable for any grievances.

### 2. Ensuring that environmental and social safeguards are in place and are publicly disclosed before sanctioning infrastructure projects

India should ensure that the democratic principles of protecting the rights of the people and environmental safeguards are maintained by the BRICS Development Bank. Emphasis should be placed on ensuring that thorough and timely environmental impact assessments take place. Emphasis should be placed on addressing issues around loss of livelihoods and involuntary resettlement.

### 3. Ensuring public disclosure of approved projects

India should ensure that information on approved projects is publicly disclosed as per international aid transparency standards, and as agreed by other multilateral development banks.<sup>6</sup>

## The BRICS' Development Cooperation with Africa

In recent years, the BRICS' development cooperation with Africa has been on the rise. India pledged \$5.4 billion and \$5 billion during the first and second India – Africa summits in 2008 and 2011 respectively, bringing the total to approximately \$10 billion. China pledged \$20 billion in 2012. Compared to India and China, aid from South Africa and Brazil is much smaller. In the case of South Africa, annual disbursement to African countries is around \$100 million,<sup>7</sup> whereas Brazil spends about 55 per cent of approximately \$1 billion foreign aid budget in Africa.<sup>8</sup> In 2012, Russia wrote off \$20 billion debt and contributed \$50 million to Africa through the World Bank.<sup>9</sup>

However, not all economic cooperation or development cooperation from the BRICS countries can be termed as aid, as classified by the Organisation for Economic Cooperation and Development (OECD) – Development Assistance Committee (DAC). In the case of Chinese official finance to Africa, grants, zero-interest loans, debt relief, and concessional loans would qualify as ODA, whereas preferential export credits, market-rate export buyers' credits, and commercial loans from Chinese banks, would not qualify as ODA.<sup>10</sup> Furthermore, the DAC segregation of ODA from Other Official Finance (OOF) on the basis of concessionality (25 per cent grant element) and the pure purpose (development) conditionality of financial flows are not followed by the BRICS countries.

## Emerging Issues

### 1. Transparency of Development Aid

Transparency of the BRICS' development aid is low compared to its western counterparts. The lack of transparency could be attributed to limited availability of information due to definitional challenges, lack of institutional capacity, non compliance with western donors' systems of reporting, the absence of an alternative South-South cooperation reporting system and minimal disclosure of project level aid information.

With significant development aid already signed and at different stages of project implementation, it is imperative for both donors and recipient countries to remain accountable to their citizens. Aid transparency helps citizens in recipient countries to hold their respective governments accountable regarding aid utilisation and effectiveness, and further enables them to provide feedback about the quality of aid. This is expected to improve the accountability of the government, as well as other implementers in the aid delivery chain.

### 2. Role of the Public and Private Sector in Land-related Investments

Land acquisition in African countries has triggered widespread international debate and has often been termed as 'land grabs'. On one side of the debate, organisations such as the Oakland Institute<sup>11</sup> are making an ethical case for the prevention of land-grabs (i.e. from the perspective of human rights violations). On the other hand, organisations such as the Munden Project/Rights and Resources Initiative<sup>12</sup> are approaching the issue from a business perspective, highlighting the significant investor risks involved if there is a failure to inform or fairly compensate communities. Issues around land grabbing are now on the agenda for the forthcoming G8 Summit. These deliberations could potentially provide an opportunity to develop some international standards around the prevention of land grabs.<sup>13</sup>

African governments are attracting foreign direct investment. They have signed land deals not only with companies from the BRICS countries, but also from the Middle East (UAE, Kuwait, Qatar and Saudi Arabia), Europe (UK, German and Sweden), the United States of America, and South Korea.<sup>14</sup> Foreign direct investment deals have been signed within African countries as well, for instance, Djibouti companies leasing land in Malawi, Egyptian companies' securing land in Sudan, and Libyan firms holding land in Mali. It is in this context that agro-businesses and the private sector from the BRICS countries operating overseas find themselves in the midst of global controversies around land grabs.

Growing social agitation over the issue of land acquisition, displacement and environmental degradation within the BRICS confederation demonstrate the extent of conflict around the processes underlying infrastructure development.

For instance, in Brazil, 458 people have reportedly died in land disputes from 2000 to 2012;<sup>15</sup> in China, land disputes accounts for 65 per cent of all social unrest cases,<sup>16</sup> and it is estimated that around 60 million persons are displaced and are project-affected in India.<sup>17</sup> Recent agitation against Vedanta's Niyamgiri mining project and Posco's steel plant points to the wider issue of development-induced displacement and environment degradation. Due to problems like environmental damage, displacement of local populations without adequate compensation, loss of livelihood and violent conflict<sup>18</sup>, natural resource mining is increasingly becoming controversial in India. This has resulted in Indian businesses relocating overseas - for instance to Australia for coal and to Africa for metals.

## Recommendations

### 1. India should ensure safeguards compliance for the public and private sector operating abroad

It is important to emphasise that 'infrastructure development is where current conflicts around natural resources are currently playing out'.<sup>19</sup> As land is a complex issue and subjected to a country's sovereign legal jurisdiction, governments of the BRICS countries should regulate their private players, which are investing in land in African countries to ensure that the human rights of project affected communities are not violated. Access to information, fair consultation and compensation of affected locals should be in built and adhered to in the investment cycle of public and private sector actors operating overseas.

### 2. India should make its development aid transparent

Indian development assistance has grown both in its size and scope since 2003. Its loan and grant portfolio in the neighbouring countries is growing at a fast pace especially in Afghanistan where India is the fifth largest donor with an overall commitment touching \$ 2 billion in 2011. The effectiveness of Indian development assistance cannot be determined due to the lack of project level data, which restricts the wider public to track aid through the aid delivery chain. Transparency would not only enable a better understanding of India's development cooperation but also demonstrate how it is allocated and spent. India should proactively disclose the details of its development cooperation projects. India should also help establish a reporting mechanism for South-South Cooperation providers by taking a lead to bring consensus on a common definition and measurement of South-South Cooperation development assistance.

## Illicit Financial Flows

Illicit financial flows (IFFs) are described as the cross-border movement of money that is earned, transferred or utilised illegally such as corruption, transactions involving contraband goods, criminal activities and efforts to shelter wealth from a country's tax authorities'.<sup>20</sup> Tax avoidance in the form of finding loopholes in the domestic constituency, adjusting a company's accounting and shifting profits out of the country through transfer pricing are some of the different mechanisms deployed by multinational companies (MNCs) to avoid the tax liability. These resources usually end up in tax havens and offshore financial centres specialised in non-residential financial transactions.<sup>21</sup>

It is interesting to note that during 2001-10, four of the BRICS countries i.e. China, Russia, India and South Africa were amongst the top 11 exporters of illicit financial flows (IFFs) and in total, the IFFs from the BRICS countries stood at \$3051 billion, of which \$2741 billion was from China.<sup>22</sup>

IFFs ending up in tax havens and offshore financial centres could be harmful by a) preventing developing countries from receiving the full value of their assets and economic production; b) depriving developing countries of government revenues which could be used to fund essential services; c) distorting the allocation of spending and provision of services; and d) reducing the stock of national savings.<sup>23</sup>

## Emerging Issues

### 1. Combating IFFs to Generate Government Revenue to Fund Social Sector Spending

Over the past sixty years (1948-2008), India has lost a total of \$213 billion in IFFs, whose present value is \$462 billion.<sup>24</sup>

Amongst BRICS countries, India spends far less on health and education as a percentage of its GDP and has fewer resources available due to low levels of tax revenue. Brazil and South Africa spend around 9 per cent of their GDP in health which is more than the double of India's expenditure (4 per cent of GDP).<sup>25</sup> Unlike the other BRICS countries<sup>26</sup>, India's spending on education as a percentage of GDP in 2010 (3 per cent) has marked a sharp decrease from its 2000 level (4 per cent).<sup>27</sup>

One of the ways forward is to raise domestic tax revenues by preventing tax avoidance and tax evasion and thus combating IFFs.

India's tax-GDP ratio (17 per cent of GDP in the Budget Estimate of 2011-12<sup>28</sup>) compares poorly against the other BRICS countries, such as Brazil (34 per cent) and Russia (32 per cent).<sup>29</sup>

### 2. Are Indian government efforts sufficient to break the secrecy of tax havens?

The Indian government reports having taken domestic and global initiatives to curb the menace of IFFs, by creating appropriate legislative frameworks and joining the global campaign against black money.<sup>30</sup> Strengthening Direct Taxes provisions including those related to International Taxation and Transfer Pricing through the introduction of Section 94A in the Income Tax Act aims to 'discourage transactions between residents and persons located in jurisdictions that do not effectively exchange information with India (non-cooperative jurisdictions)'.<sup>31</sup>

It is difficult to determine whether information exchange to trace tax avoiders and determine the tax liability in non-cooperative jurisdictions, or the 'confidentiality' clause imposed by the participating governments to disclose 'beneficial ownership' and books of accounts in cooperative jurisdictions are producing the desired results.

Beneficial ownership refers to the ultimate beneficial ownership or interest by a natural person<sup>32</sup>. However, 'in some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner, who is a natural person, is found'. Due to varying interpretations by courts and tax administrations, the concept of 'beneficial ownership' is itself currently being revisited. For the last two years, public consultations have been taking place to clarify the meaning of 'beneficial ownership'. At present, the OECD's Working Party 1 of the Committee on Fiscal Affairs is examining public comments received on its draft discussion paper on this issue.

As the tax information exchange takes place between governments, and they are bound by their respective domestic and international tax laws, it is important to explore alternative ways to determine what is happening within the MNCs, so that tax authorities can determine the tax liability of such MNCs in their respective jurisdictions

## Recommendations

In an era of economic globalisation, domestic efforts to tackle the issue of illicit finance are not sufficient but need to be supplemented by simultaneous global efforts to check this menace. As the other BRICS countries also face tax evasion through illicit financial flows, they are well placed to take this challenge forward. The following recommendations could potentially check the accumulation of illicit financial flows, especially by MNCs that fail to pay their dues to the local public exchequer.

### 1. Country-wise reporting

The Indian Government should consider commissioning a study to explore how MNCs report their sales, profits, and taxes paid in all jurisdictions, in their audited annual reports and tax returns. The study can be jointly supported by the BRICS countries and a common consensus could be reached

on the issue of country-by-country reporting by the MNCs, which could in turn be recommended to the International Accounting Standards Board to execute recommendations.

### 2. Beneficial ownership

The Indian Government along with other BRICS countries should take the issue of beneficial ownership forward in G20 forums and other international platforms like the Financial Action Task Force. The effort should be to bring consensus that tax haven jurisdictions should maintain this information and incorporate this information in bilateral treaties.

These recommendations are along the same lines as those recommended by international civil society groups like Global Financial Integrity, Tax Justice Network and Publish What You Pay, as well as those put forward by the Indian government in international platforms.<sup>33</sup>

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