BRICS Then and Now

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BRICS – Why are they interesting and controversial?

- **Brazil, Russia, India, China, and South Africa are:**
  - **Very important to the global economy**
    - 43% of world population
    - Nearly one-fourth of world GDP
    - Account for about one-half of the growth of world GDP in the past 20 years (catching up)
  - **Underrepresented in current global governance**
    - 13% of World Bank votes and 15% of IMF quota shares
  - **Reshaping global institutions and relations**
    - Impacting existing international institutions
    - Creating their own international institutions
    - Building trade and investment networks in “non-traditional” regions and ways
- **Are BRICS a “real” grouping with important commonalities or just a marketing slogan?**

Some “definitions” of BRICS

- Countries that are large, that are growing in economic importance and that are seeking a more important role in global institutions and governance.
- “Economists believe these … nations will become **dominant suppliers** of manufactured goods, services and raw material by 2050.”
- “…the BRICS agenda gives priority to coordination within the G20, including the IMF reform …(and)… advocates the reform of the United Nations and its Security Council, with a view to enhancing its representativeness, and favors the **democratization of international governance**.”
- “The BRICS…(have) rapidly expanded (their) diplomatic activities, advocated a larger voice in global economic and security forums for its members, and created brand new financial institutions. The member countries share a **desire for the world to accord them a larger role**…. These five countries have rapidly used the BRICS format to signal to the world that the **old twentieth-century institutions have to change.”**

Outline of the Talk

- We are interested in BRICS for two reasons – economic and political.
- Economic side:
  - Rapid Growth vs. Middle-Income Trap
- Political side:
  - Role of politics in middle-income trap
  - Role in governance of global economy and global institutions
- For the economic aspects I will use the framework of Alexander Gerschenkron.
- Look at similar groups of economies which could have been considered the BRICS of their time for some lessons from history about possible outcomes for today's BRICS.

Why Gershenkron?

- Systematic theory (based on European experience in mid-late 1800s)
- Speed – development occurs with a growth spurt
- Relative backwardness provides (1)“tension” and (2) ability to adopt newest technologies (so each growth experience is unique but the same)
- Changing “prerequisites” - new institutions to facilitate industrialization so each industrialization experience is unique due to differences in backwardness – yet the same
- Structure and organization of economy and firms depend on relative backwardness
- The growth spurt may fail – the middle income trap

Who were the first BRICS?: 19th Century

- **France, Germany, Italy, Imperial Russia, Japan.**
- **Large and important to world economy. Some unifying political forces.**
- **Felt the tension from economic backwardness.**
- **Economic tension**
  - **Industrialization and new technologies could lead to vast changes in living standards and "national power".**
  - **Social changes – Urbanization and Revolutions of 1848, Meiji Restoration.**
- **Were dissatisfied with existing world order and their role in it.**
- **Political tension**
  - **Colonialism.**
  - **Nationalism.**

Political Outcomes

- Upsurge in nationalism in France, Germany, Japan. Less so in Italy and Russia.
- All countries tried colonialism/imperialism, faced 2 problems:
  - Most good colonies already taken.
  - Had to compete/fight for colonies.
- As a result:
  - Colonies were of little net economic value.
  - The economic case for colonies was fading.
- In many ways, "old BRICS" supported the old international political order in theory, though they destabilized it in practice.

Old BRICS Differed in Relative Backwardness vs Great Britain and Themselves

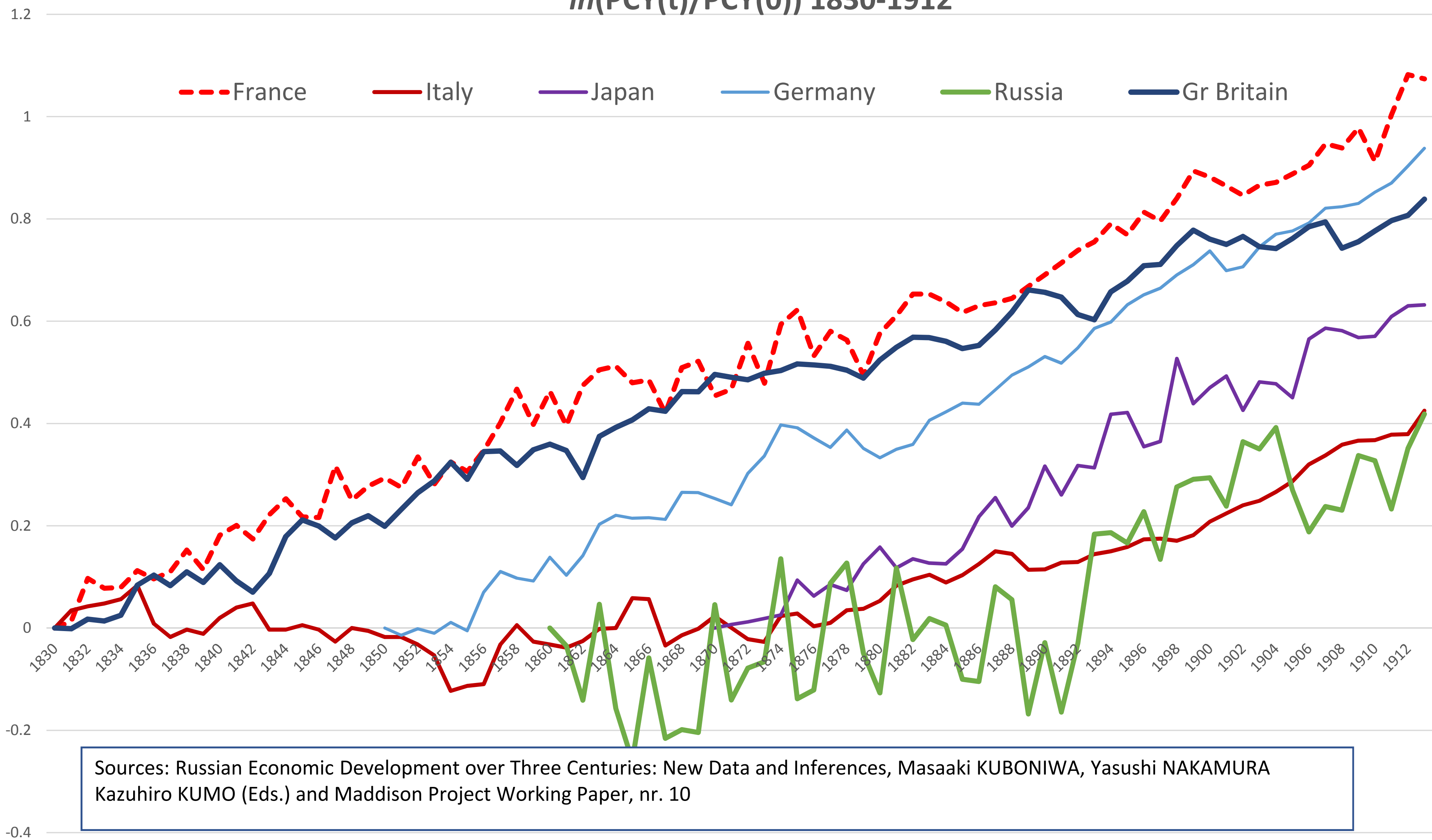
- **1860 and 1912 per capita GDP in 2011 US$ and population in Millions**

	1860	1912	1860 Population
Great Britain	$3355	$6161	29 million
Germany	$1592	$5487	36 million
France	$2404	$5274	37 million
Italy	$1422	$2632	26 million
Japan	$ 985*	$1848	33 million
Russia			74 million

*1870

- Sources: Maddison Project Database, version 2018. Bolt, Jutta, Robert Inklaar, Herman de Jong and Jan Luiten van Zanden (2018), Rebasing 'Maddison': new income comparisons and the shape of long-run economic development" Maddison Project Working Paper, nr. 10, available for download at www.ggdc.net/maddison . N. F. R. CRAFTS, Gross National Product in Europe 1870-I 910: Some New Estimates EXPLORATIONS IN ECONOMIC HISTORY 20, 387-401 (1983) and https://www.tacitus.nu/historical-atlas/population/russia.htm

Chart 1: GROWTH OF PCY IN FIRST "BRICS“ AND GREAT BRITAIN
***ln*(PCY(t)/PCY(0)) 1830-1912**



Sources: Russian Economic Development over Three Centuries: New Data and Inferences, Masaaki KUBONIWA, Yasushi NAKAMURA Kazuhiro KUMO (Eds.) and Maddison Project Working Paper, nr. 10

What Does Chart 1 Show?

- Catch up for France, Germany, Japan.
- Italy and Russia grow but do not catch up – the first middle-income trap?
- The more “backward” a country, the faster its growth spurt.

What Does History Teach Us?

- Countries did adopt “latest” technology, so they did not imitate the structural features of their predecessors.
- New institutions for growth emerged, and firms tended to be larger:
  - Great Britain – early industrialization financed by private wealth.
  - France – Credit Mobilier – a new type of bank.
  - Germany and Japan – banks that had strong ties to firms.
  - Russia – reliance on the state.
- Expanded role of government as backwardness is greater.

Why did Italy and Russia fall into middle – income trap?

- Russia
  - Commercial dishonesty precluded bank financing.
  - Late abolition of serfdom, post-serfdom ties to the land.
  - Only the state could provide adequate credit to sustain growth in 1890s. This led to political instability due to high taxation on peasants.
- Italy
  - North - South divide.
  - Weak government policies & bad tariff policies.
  - Emigration of 14 million people from 1876-1914.
  - Small firms. Limited FDI and lack of banks.
- We should neither underestimate or overestimate role of exogenous factors.
- Failure to develop substitutes for prerequisites => **lack of resources**. Link to settler economies.

Second Group of BRICS: Settler Economies

- (European) settlers replace or marginalize the indigenous people.
- Settlers free themselves from the home country - to different degrees.
- They have an abundance of land and natural resources, shortage of labor and capital.
- Export staples (food, minerals, raw materials). Reduced costs of ocean shipping, development of refrigeration, increased demand for food and raw materials due to industrial revolution
- Extreme dependence on global economy, commodity prices.
- Conflict between landed class and emerging proletariat & capitalists.

Settler Countries

- Argentina, Australia, Canada, South Africa, United States.
- Surprised by Argentina?
- "… most economists writing during the first three decades of the (20th) century would have placed Argentina among the most advanced countries - with Western Europe, the United States, Canada, and Australia. To have called Argentina "underdeveloped" in the sense that word has today would have been considered laughable. **Not only was per capita income high, but its growth was one of the highest in the world.**" Carlos Diaz-Alejandro

Settler Economies

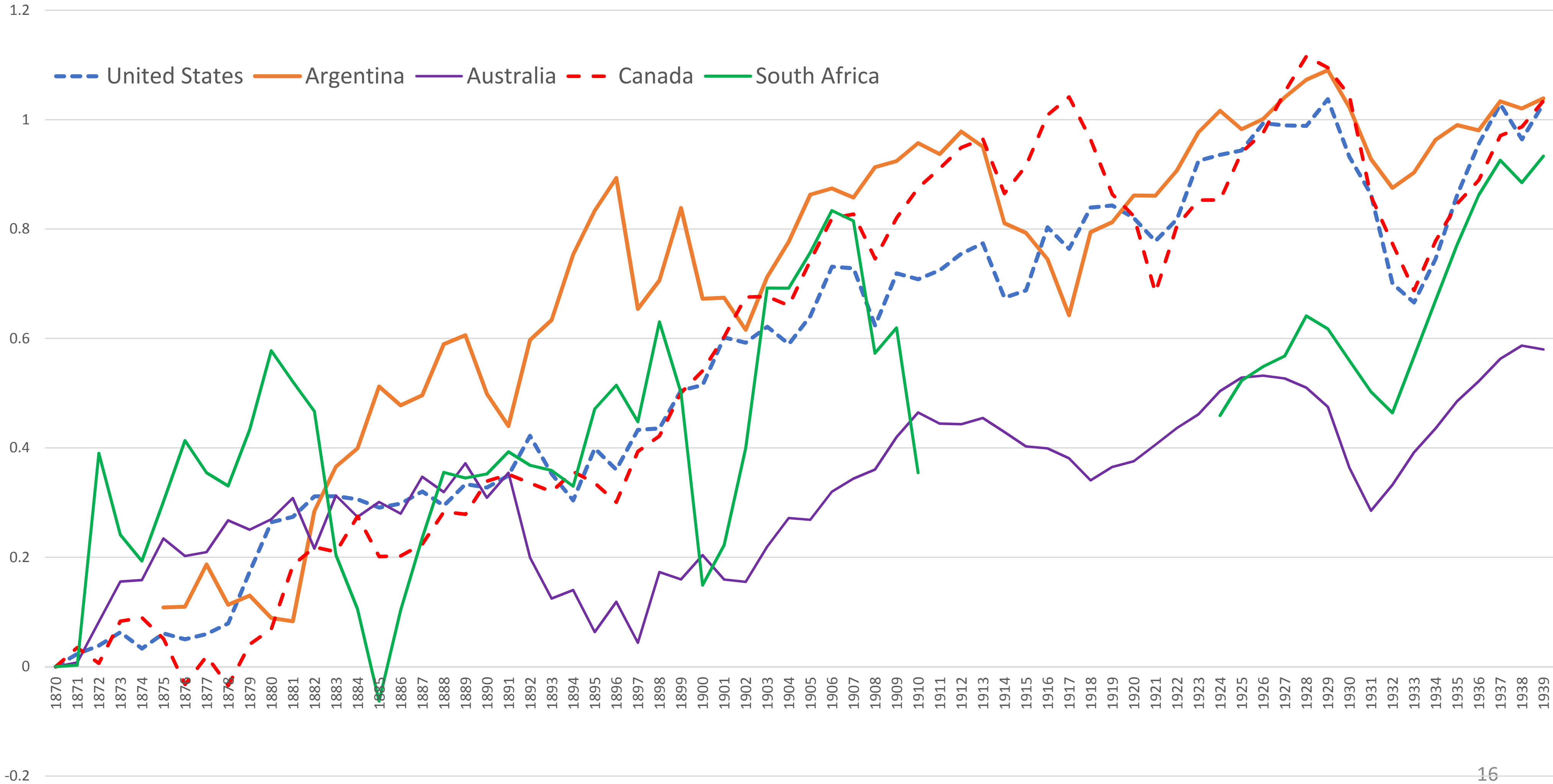
per capita GDP 2011 US$

	1870	1913	1920	1939	1990
Argentina	2514	6505	5949	7105	11878
Australia	4292	8380	8491	11159	27767
Canada	2894	7026	6386	8110	30226
South Africa	1681	2397*	2421**	4275	7866
United States	3736	8101	8485	10459	36982

* 1919 **1918

Source: Maddison Project Database, version 2018.

Chart 2: GROWTH OF PCY IN SETTLER ECONOMIES
ln(PCY(t)/PCY(0)) from 1870 to 1939



Sources of Growth in Settler Countries

- Rapid expansion of population and capital stock.
- In Argentina between 1890 and 1913, immigration accounted for nearly one-half of the population growth.
- At similar point in time, about one-half of the Argentine capital stock was foreign owned. FDI>Domestic saving.
- Similar experience in Australia, Canada, United States, South Africa though resource inflows less important in relative terms.

Avoiding the Middle-Income Trap.....

- Post-WWI Immigration slows. Great Britain is bankrupt, capital flows stop. Open land in settler countries starts to disappear.
- Commodity boom in 1920s followed by Great Recession.
- What did settler economies need to do to avoid the trap?
  - New model of growth. Intensive not extensive growth. Rely on domestic savings.
  - Move on to new forms of economic activity that yields higher TFP growth.
- Australia, Canada & US succeeded. What does that mean…?
- South Africa and Argentina did not.

…or Falling into It

- Argentina – abandons globalization, pursues import-substitution. (Policy or bad luck?)
- South Africa – some important differences from other settler economies:
  - Indigenous population too large.
    - Savings.
    - Inability to mobilize large indigenous labor force and "wrong immigrants".
    - Continued reliance on mineral exports.
    - Import substitution for a small market.

Lessons from the “old” BRICS

- Strategies for growth differ according to degree of backwardness.
  - **Backward countries** used extensive growth. Mobilized or imported capital and labor (if needed). Created institutional innovations to become “middle-income” countries.
  - First BRICS (like France and Germany) were able to move to “middle (or even high) income” level quickly.
  - Russia, Italy and Japan needed a longer period of capital accumulation. More vulnerable to exogenous shocks and policy reversals.
  - **Settler countries** also needed a longer period of extensive growth of capital and inflows of immigrants.
  - WW1, Great Depression as examples of shocks.
  - Not much evidence of “pause” at some intermediate-income stage.

Middle-Income Countries

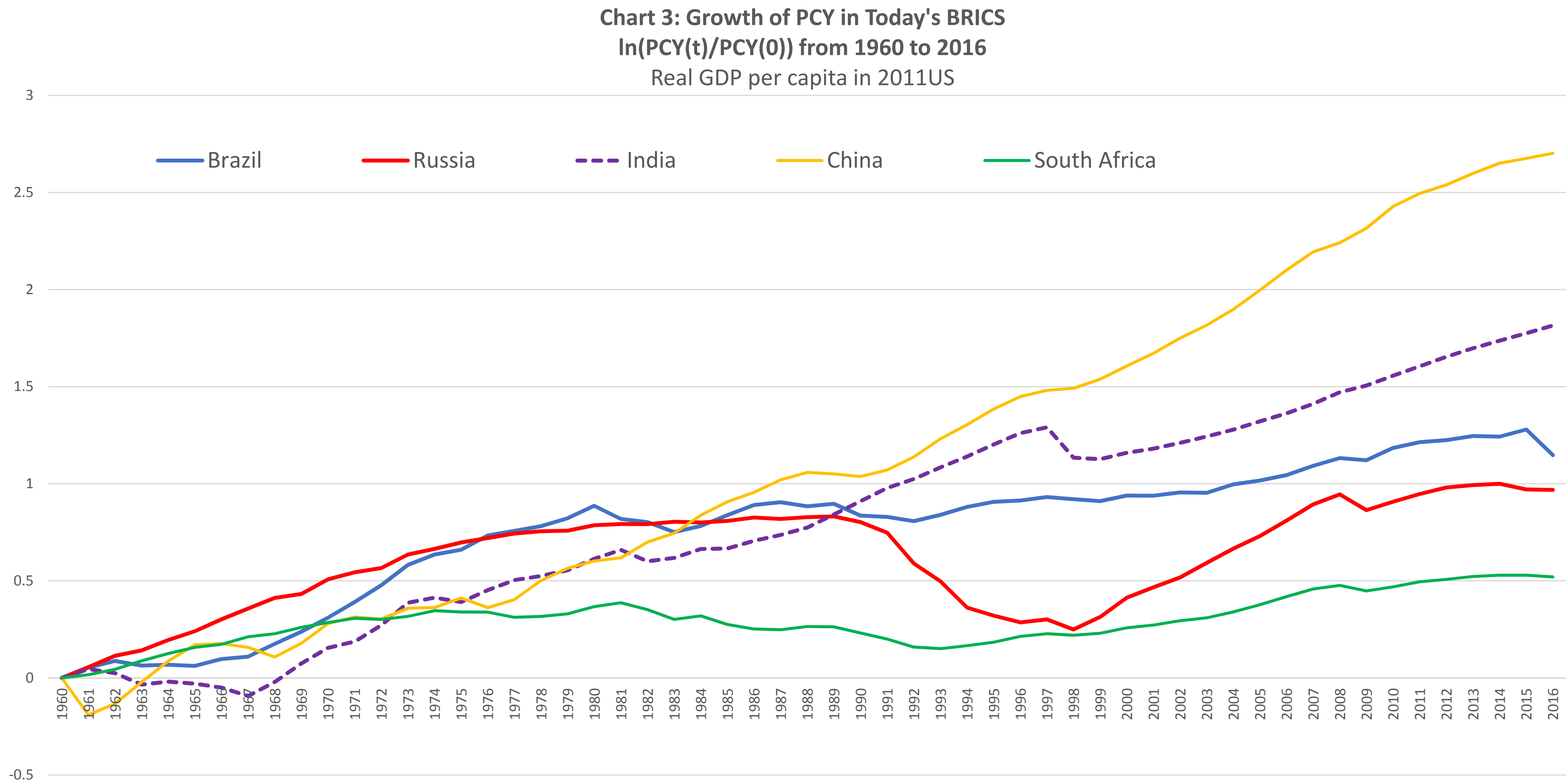
- At some point, successful countries changed from extensive growth to intensive growth in order to become wealthy.
- Less reliance on factor accumulation, more on gains in total factor productivity (TFP). Domestic saving becomes the main source of capital formation.
- Fast structural change from agriculture to industry.
- Openness to trade.
- Greater income equality => more saving, more human capital investment.
- Shift in political power.

Current BRICS

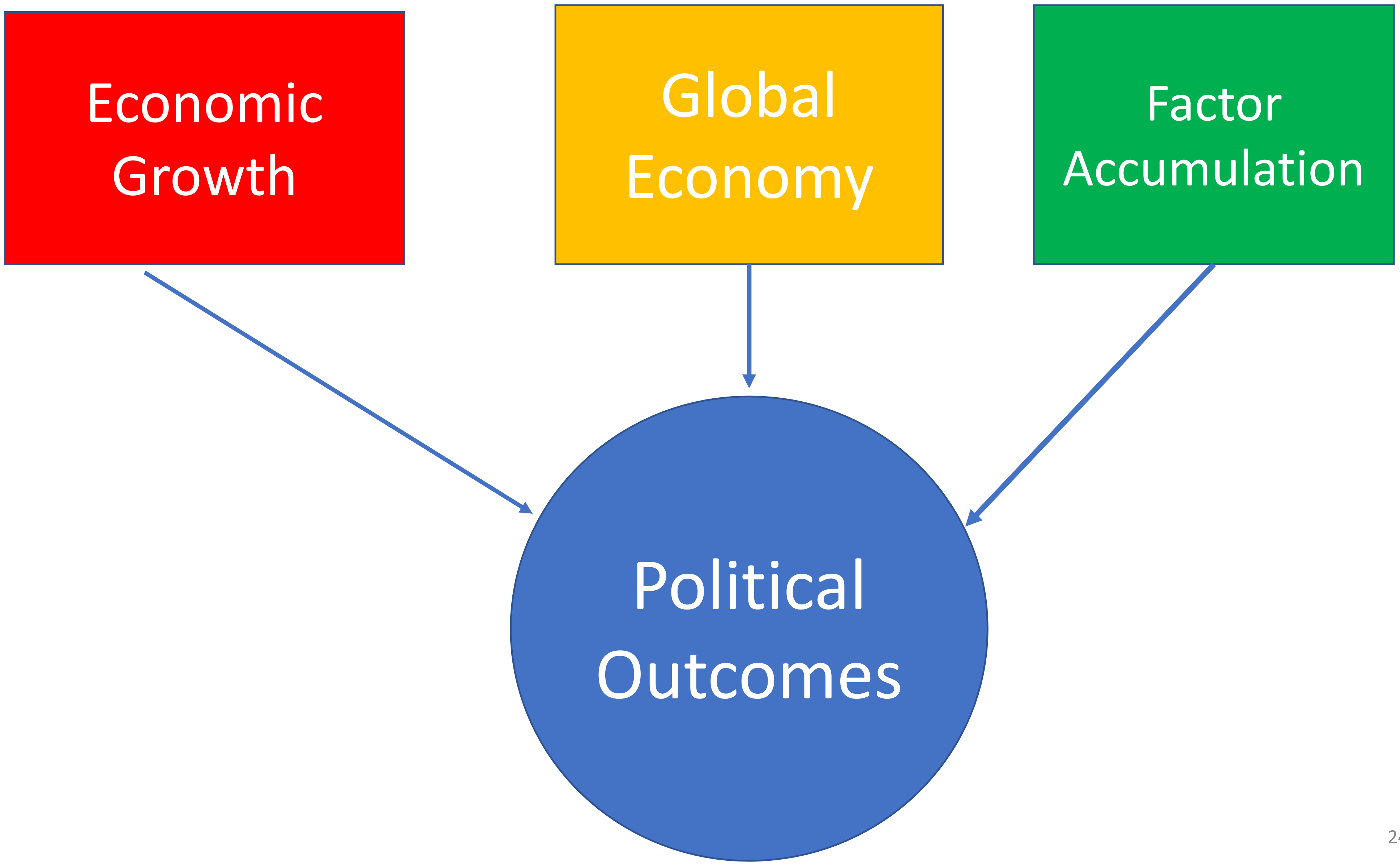
per capita GDP current US$ and population (1000)

	Pcy US$ 2016	Population 2016
Brazil	8860	208249
Russian Fed.	9710	143833
India	1680	1268155
China	8250	1372860
South Africa	5490	54263

Source: https://www.worldbank.org/en/country/mic/overview and Maddison Project Database, version 2018



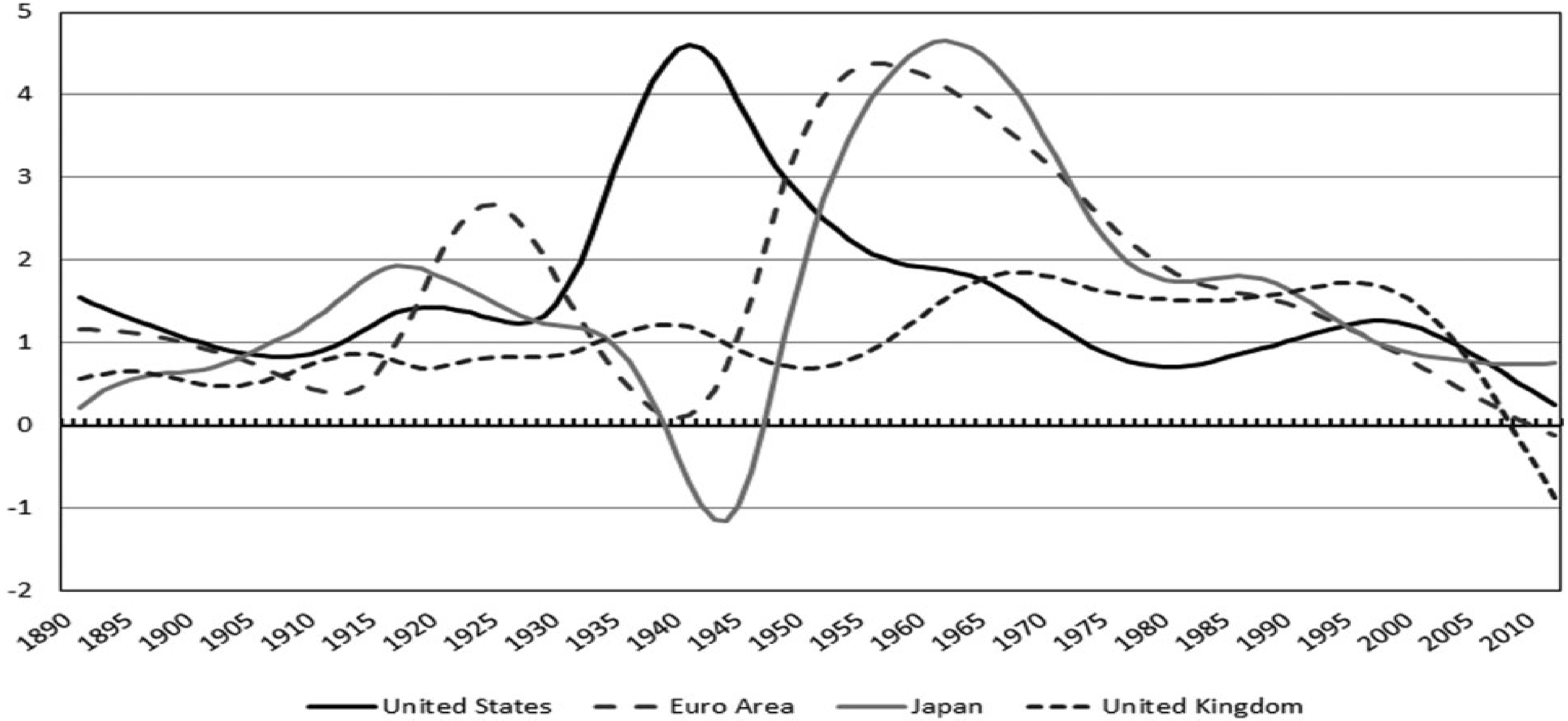
Source: Maddison Project Database, version 2018


Economic Growth
Global Economy
Factor Accumulation
Political Outcomes

Exogenous Events and Policy Changes: How Will They Influence BRICS?

- Growth and technological progress.
- Possibilities for international trade and factor movements.
  - Growth process deeply influenced by global economic forces (e.g. tariffs).
  - Includes technologies relating to openness of economies (transportation costs as example).
- Development as a process of factor accumulation also has deep political implications that influence policy.

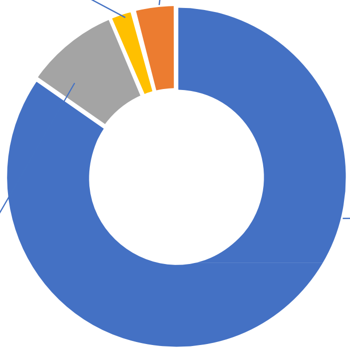
Technological Progress

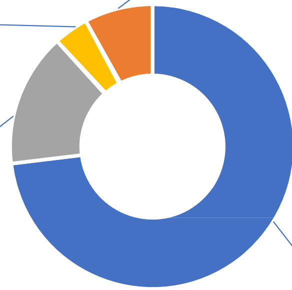


Smoothed (through Hodrick–Prescott Filtering) Annual Growth of Total Factor Productivity (*TFP*) in the United States, the Euro Area, Japan, and the United Kingdom, 1891 to 2012 (percent) Source: Bergeaud et al. (2016)

Factor Movements

Global Capital Inflows





BRICS are getting a bigger share of global capital flows but not larger inflows of funds.

Source: MILKEN INSTITUTE GLOBAL OPPORTUNITY INDEX 2018

Demography

- Populations ageing, birth rates dropping, some countries are already experiencing negative population growth.
- In addition to people, need educated/skilled workers.
  - China
  - India
  - Others

Costs of Trade are Rising Volume of Trade is Falling

- Transportation Costs
  - Price of oil is increasing.
  - Capacity constrains on transportation services. Size of (container) ships has increased, but capacity for loading, unloading and inland transportation and storage are limited.
- Trade barriers are rising.
  - Doha Round.
  - US-inspired tariff measures.
  - TPP.

Changes in Factor Endowments and Trade

- Development leads to/is caused by changes in factor endowments. This leads to changes in political power and economic policy. Accumulation of capital and (industrial/urban) labor (K & L). As K & L increase, they gain political power and seek policies favorable to themselves.
- Examples:
  - Germany and US in 1800s:
    - US had abundant land, scarce capital and labor.
    - Germany had abundant labor, scarce capital and land.
    - In US, politics pits capitalists and workers vs landowners (urban-rural) influence tariff policy.
    - In Germany politics pitted owners of land and capital vs workers (class warfare) radicalizes labor, makes K + Land owners more conservative.

Source: R. Rogowski, *Commerce and Coalitions.*

Implications for the Near Future

- Tariff increases and rising costs of trade and factor movements will tend to raise power of scarce factors in the BRICS. This means either land or capital or both, which may lead to radicalization and protectionism.
- Since different BRICS have different factor scarcities, this means that their responses to global developments will differ and become more difficult to reconcile.

In the Long Run

- China will become a developed high-income country.
- Capital accumulation in Brazil and Russia will cause / is already causing major shifts in political power.
- Indian policies already shifting in the decline of the Congress Party and Modi’s reelection.

Factor Endowments of BRICS

- Scarce K, Scarce Land, Abundant Labor
- **India and China**
  - Export Labor-Intensive Goods & Services
- Development to "advanced" status means **Abundant K**, Scarce Land, **Abundant Labor**
- Long-term: Urban vs Rural Conflict
- Short-term: Headwinds reduce power of K, Land, workers opt for populist solutions.

- Scarce K, Abundant Land, Scarce Labor
- **Brazil, Russia, South Africa**
  - Export Agriculture and Raw Materials
- Development to "advanced" status means **Abundant K**, Abundant Land, Scarce Labor
- Long-term: Class Conflict
- Short-term: Headwinds reduce power of Land, K + Labor opt for protectionism.

What Do BRICS Want from the World Order? From Each Other?

- Same things as the "old" BRICS did:
  - Outward FDI, free movement of capital, global value chains, trade liberalization …. All key elements of the "old" order.
  - Regional or global political and economic power.
  - Respect.
- Conflicts among BRICS
  - China is "different" and has global ambitions…and the resources to pursue them.
  - Are the BRICS similar enough?
    - China is an exporter of manufactures, India of services and others of raw materials.
    - Regional frictions – e.g. India vs China.
  - Can institution building overcome these differences?

Can the BRICS Create a New World Order?

“Old” World Order no long exists. Not destroyed by BRICS but by its creator.

BRICS have chosen a “champion country” in South America, Africa, South Asia, NE Asia and Europe. These “champions” have some weaknesses: Political problems, disliked/distrusted by neighbors.

What would a new world order look like? And who would pay for it?

Thank You.