Building a Currency from BRICS

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What does the legitimacy of a currency rest upon? To answer this fundamental question, it is useful to return to economic fundamentals and maintain a historical scope. As elucidated by the FED in its *The Economic Lowdown* series, money serves three interconnected functions: Money acts as 1) a store of value, 2) a unit of account, and 3) a medium of exchange. Should one of these functions falter, the other functions unravel as well; If, say, the economic infrastructure in an economy no longer facilitates the transmission of a certain currency, its value as a store of exchange diminishes as it loses the ability to be redeemed.

In this endeavour, the eminent economies of the 1880s all agreed to denominate their currencies in quantities of gold in order to smoothly reap gains of trade. As the economist Barry Eichengreen explains, however, gold as the common denominator of these currencies was arbitrary. What effectively matters is the authority behind the functionality of the currency. In this historical case, it was the preeminent hegemon of the period: Britain, who presided over the aptly named *Pax Britannica*. The Bank of England's exclusive commitment to Pound-to-gold convertibility was rather a consequence of historical coincidence – as Isaac Newton calculated a sloppy exchange rate for silver in 1717, which effectively caused silver to be phased out as legal tender. Given Britain's pioneering industrial production and global military prowess, adapting to the British system became pragmatic. This financial order endured until 1914 due to the Bank of England's unwavering dedication to gold convertibility, even at significant fiscal and political costs.

The 20th century witnessed the baton passing to the next anglophone hegemon, who would preside over the respectively named *Pax Americana*. The Bretton Woods monetary system would see most of the developed world ratify convertibility to the Dollar, with the United States ensuring Dollar-to-gold convertibility. Bretton Woods would also see the establishment of the IMF to monitor exchange rates and lend reserve currency to countries with balance of payment issues. This post-war period is often regarded as an economic miracle, but it is naive to dismiss the immense political backing behind it. As Keynes put it: "To suppose that there exists some smoothly functioning automatic mechanism of adjustment which preserves equilibrium if we only trust to methods of laissez-faire is a doctrinaire delusion which disregards the lessons of historical experience without having behind it the support of sound theory." In similar prescience, Keynes would also remark that "the gold standard is already a barbarous relic." While the United States could not muster the political capital anymore in 1971 to protect gold convertibility, she also didn't have to. An adherence to the world's oldest constitution, the unmatched force of her armed forces, as well as the governance over the world's largest economy meant that the US government had the legitimacy to simply declare the Dollar currency as legal tender. Global trade in other currencies is simply denominated in USD; the Dollar's reserve status is unmatched [Figure 1].

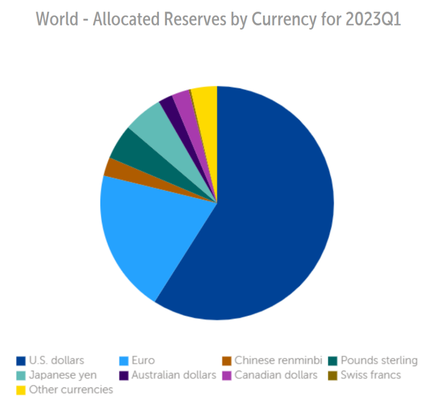

Figure 1: Allocated reserves worldwide by currency

Today, many countries foster harmonious ties with the United States wherein their economic interests align. A tacit agreement has emerged between most of the western world and the United States where the US may issue the fiat reserve currency, but she must also bear the defence burden. Nevertheless, the Pax Americana faces challenges as a coalition of 'developing' economies called BRICS (Brazil, Russia, India, China, South Africa) rises to contest the Dollar's dominance. According to the IMF, these countries collectively account for 26.7% of the world's land surface, 41.5% of the global population, and 26.6% of the nominal global GDP. As such, BRICS outweighs the US economy — which has led to speculation of a BRICS currency toppling the Dollar hegemony. Could BRICS establish a legitimate currency, and then rival the Dollar?

To address this question, extensive journalism, literature, and economic data are consulted. Additionally, guiding commentary by Bundesbank market analyst

Jasper Heineking is given. It is important to note that Heineking's views do not represent the German Bundesbank. This exploration begins by presenting the initial motivations behind the creation of BRICS and then delves into an assessment of the tools at BRICS' disposal. Subsequently, the process of establishing a novel currency for BRICS countries is examined. Finally, a summary forward-looking perspective is provided. In order to not rest on speculation and also satiate impatient readers, it has already been disclosed regarding the immediate future by Anil Sooklal, South Africa's Ambassador, to Reuters in July that "There's never been talk of a BRICS currency, it's not on the agenda."

Motivations for BRICS

The origin of the term "BRICs" can be traced back to a 2001 Goldman Sachs research paper by Jim O'Neill. It is crucial to grasp the context that existed before the 2000s, particularly following the dissolution of the Soviet Union, where global finance was heavily dominated by the G7 countries: The United States, Japan, Germany, United Kingdom, France, Italy, Canada, and later the head of the EU commission. Over time, the G7 formalized discussions on key financial matters, gaining collective influence over global finance after the Bretton Woods system ended with the collapse of the gold standard.

In 2001, Jim O'Neill observed that the BRIC – without South Africa – are "each set to grow again by more than the G7" [Figure 2], so consequently "their share of world GDP is set to rise", which he deemed "not only [...] 'interesting' but obviously highly relevant for financial market prices.". In that same year, China's GDP in USD outstripped Italy's, and O'Neill accurately predicted that China's increasing economic weight would be a driving force. What followed was a surge of investments in the BRICs seeking to capitalise on the growth of the emerging markets, which a liberalising China provided and the commodity-rich Brazil and Russia symbiotically fueled.

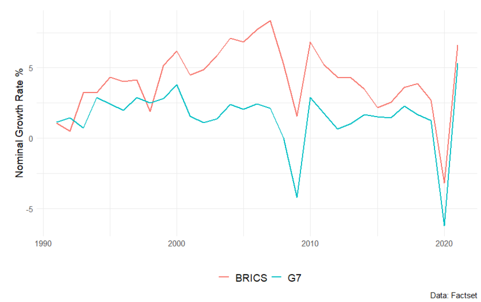

Figure 2: Nominal GDP in USD growth rates over time equally weighted for the G7 and BRICS members

The exact impetus behind the founding of the BRIC intergovernmental organisation is more complex to trace. Heineking stipulates: "Ultimately, it came down to economic interests [of] rising developing countries with a similar trajectory which sought to counterbalance the developed economies [...] which were relatively homogenous at the time". As Richard Weitz explains, the origins of an organised counterbalance against the western economies can be traced back to the Shanghai Cooperation Organisation (SCO). In 1997 the Russian president Yeltsin and the Chinese president Jiang Zemin signed a declaration on a "multipolar world" and opposing "intervention in other countries' internal affairs".

The SCO was established in 2001 by Russia, China, and post-communist countries like Kazakhstan, Kyrgyzstan, and Tajikistan to improve political and economic cooperation. In 2004, the leftist Indian National Congress came back to power in India with prime minister Manmohan Singh, and in the following year India sent representatives to the SCO; What US observers feared as a "strategic triangle" in Eurasia was shaping, or aptly called the "RIC". During the same time, the leftist president Lula da Silva came to power with the anti-neoliberal "pink tide" in South America. These developments culminated at the margins of a 2006 UN Assembly, where the leaders of the BRIC met to discuss closer cooperation. In 2009, the BRIC leaders of Brazil, Russia, India, and China officially ratified the establishment of BRIC in Yekaterinburg, Russia.

Following the summit, Dmitry Medvedev told Reuters: "We are likely to witness the creation of a supranational reserve currency [...] which will be used for international settlements [...] The existing currency system is not ideal.". This statement prompted widespread speculation and a minor decline of -1.4% in the value of the Dollar against a basket of currencies, as seen on the US Dollar Index. "I do believe that the United States immensely profits from the Dollar's role as the global reserve currency, " Heineking explains. "However, from the BRIC's point of view it is understandable [...] to think about alternatives because the US dominance makes you dependent on the US infrastructure [...] being well-disposed towards you." Essentially, access to global trade is at the whim of the United States.

One instance where the US effectively wielded this influence was against apartheid South Africa, pressuring the most developed African nation to overhaul its domestic policies. This is perhaps one reason why South Africa accepted the invitation to join BRIC, in addition to gaining geopolitical clout. Renu Modi explains that South Africa's invitation was also influenced by its development status and natural resources. China's push for South Africa's accession was aimed at bolstering BRIC's influence on the African continent. Thus, South Africa officially joined the BRICS organization in 2010. Now complete, the group still enjoyed synergies despite the waning commodity boom from China's industrial base powered by Russian oil, Brazilian soy, and South African minerals. Throughout the 2010s, the BRICS worked on developing instruments and nurturing their positive relationships.

Institutions of BRICS

Throughout the 2010s, BRICS made notable progress in establishing concrete instruments, as evidenced by the official outcome documents of their annual summits. However, the task of launching a currency would necessitate a multitude of prior agreements and intergovernmental institutions to establish the necessary operational and supervisory framework. The first notable institution arose from the group's 5th summit in 2013, which brought a specific focus to BRICS' influence in Africa. Here, BRICS agreed to establish the New Development Bank (NDB). The following March 2014, Russia would annex Crimea, which resulted in Western sanctions and backlash. This motivated Russia to push for new, western-independent financial institutions. That same year, in July, the NDB was formally established with an initial capital of USD 100 Billion. Notably, the use of USD for the initial capital underscores the prevailing eminence of the Dollar even within BRICS nations. The Dollar dominance is also visible in the currencies lent by the NDB [Figure 3]. Each member was granted one vote in the NDB; convenient therefore, that they recently added a 5th member to the BRICS. The NDB's mission included funding global infrastructure projects like China's Belt and Road initiative, resembling a counterpart to the World Bank established under Bretton Woods.

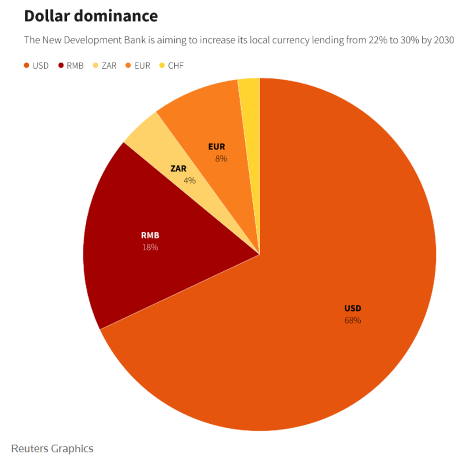

Figure 3: NDP lending volume by currency

At the same 2014 BRICS conference, the Contingent Reserve Arrangement (CRA) was introduced. This reserve, also valued at USD 100 billion, aimed to alleviate short-term liquidity pressures of its members by offering loans, akin to the IMF's function. However, as China contributed USD 41 Billion to the reserve, it also earned proportional voting rights. According to the founding treaty, the providing parties of a loan may also attach additional obligations for the drawing party, which could include policy changes. Beyond the NDB and CRA, BRICS initiated multiple platforms and initiatives to enhance collaboration in technology and payment services. Despite these strides, Heineking observes: “In my perception, these institutions are not that present, if you think globally. Here, the institutions of western countries still dominate [...]. I presume however that the picture in the BRICS countries is quite different.”

BRICS seem to be crafting a compelling alternative network of government finance that operates parallel to the Bretton Woods institutions. However, little headway has been made in actually establishing a common currency. There is far more talk of “de-dollarization” than actual progress and proposals towards a common currency. Reflecting on the development of the euro, the next step would be to establish a common unit of account akin to the European currency unit, as Heineking notes. This unit of account would require a fixed exchange rate with the national currencies of BRICS members. Subsequently, monetary union would need to be created, in which the members would follow macroeconomic convergence criteria to adjust their economies to remain within stable bands of the common currency unit. Throughout this potentially decades-long process, strict adherence to commitments among all members and substantial political capital investment would be essential. Do the BRICS members have the macroeconomic conditions and political resolve for this process? As previously mentioned, any of these required steps are conspicuously absent from the agenda of the upcoming BRICS summit.

Establishing a currency

To be remotely feasible, the BRICS currency would not replace national currencies. As Heineking states: “This would most likely not go hand in hand with abolishing national currencies, but instead [it] would be a supranational currency.” The closest historical comparison is the creation of the Euro, which as Heineking remarks, many economists initially did not presume to be feasible as well. The process began with the introduction of the European Currency Unit in 1979, and it took two decades of gruelling crises, political compromise, and strict fiscal and monetary adjustment to finally introduce the Euro in 1999 for those members of the European Union which meet the convergence criteria. The entire process also suffered many speculative attacks, like during the 1992 exchange rate mechanism crisis in which speculators targeted the exchange rate bands set between national currencies. These issues persisted despite real economic gains to be reaped from larger capital markets, allowing more debt and equity to be raised. Competitiveness within the monetary union increased dramatically, and gains of trade would face barely any friction in an economic area which is already extremely intertwined. And then even after the introduction of the Euro, the currency almost collapsed less than a decade later in the financial crisis. The economic interdependence, a shared history of liberal democracy, the commitment to lasting peace and a common geopolitical positioning within geographic proximity allowed the leaders of the time to uniquely conjure the political capital for the Euro. In comparison, the BRICS do not remotely share these preconditions.

Heineking states briefly that BRICS is simply too "heterogeneous" now. This becomes evident when examining the powerful members within BRICS, each of whom have distinct economic and political objectives.

Brazil

As Heineking remarks, "Brazil is a wildcard because they are very politically driven". It is no coincidence that the BRICS was created under Lula – Who does not hide his criticism of an American order. However, under the Bolsonaro regime, Brazil again pursued closer ties with the United States. Now returning to Lula again, The political shifts in Brazil contribute to its unpredictable stance within BRICS.

Russia

To see where the idea of a BRICS currency comes from, one only needs to look to Russia. Since BRICS' inception, then-president Medvedev has toyed with the idea of a new currency. More recently, nationalist lawmaker Babakov at the Russia-India Business Forum raised the idea of creating a BRICS currency, possibly pegged to commodities like gold. This perspective is contrary to official BRICS communication, revealing Russia's strong inclination toward a common currency, as also Heineking agrees. Not even considering geopolitics, the Russian petrostate has always been at the mercy of currency fluctuations. To nullify any frictions with the biggest trading partner – China – would be an incredible boon. Additionally, of all BRICS members, Russia has witnessed the full weaponization of Dollar-led order and will therefore understandably undertake any measures which will weaken the Dollar.

India

From the start, India's modern history has been one of global non-alignment. India has also fostered relations with the Soviet Union during the Cold War, and still refuses to sanction Russia. However, relations with China have deteriorated more than at any point since the 1962 Sino-Indian war. As prime minister Modi pursues a bold nationalist stance, the policy of India comes into conflict with the equally even more bold policy of China. India is even a member of the QUAD security forum along with the United States, Australia, and Japan. The group is clearly a stance against China. Finally, India is also on a policy of promoting its own currency which already spans an economic region of 1.4 Billion people.

China

"Ironically, the BRICS currency would most probably fail because of China, as China is actively trying to establish the Renminbi." As O'Neill predicted correctly, China would clearly be the heavy weight in the BRICS. China's weight within BRICS is substantial, contributing 69% of the group's GDP according to the IMF's 2022 data. China is also the member of the group pushing to expand the membership, as it did first with South Africa; More members will make a common currency infinitely more difficult. China's strategy appears to be positioning the Renminbi as a competitor to the Dollar while maintaining BRICS as an alternative global financial order to rival the Bretton Woods Institutions. In more and more bilateral trade, China is insisting on Renminbi transfers. Saudi oil sales to China are now conducted in Renminbi. As Heineking puts it: "Year on Year, the Renminbi tends to gains a bit more importance, both in the settlement of payments and also in currency reserves." Slowly, the Renminbi tries to etch at the Dollar behemoth

[Figure 4] .

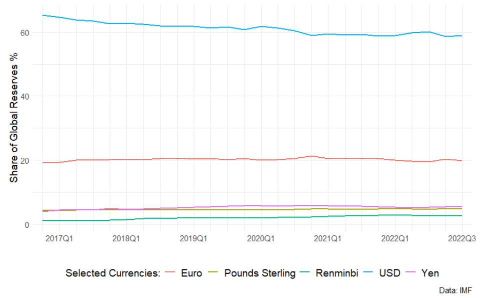

Figure 4: Global currency reserves over time

Future Outlook

As the upcoming BRICS summit on the 22nd August approaches, what can be expected, and what lies ahead for the future? It is evident that a common currency within the BRICS framework is not on the horizon, and if current trends persist, it becomes even less likely. The groundwork for a shared unit of account is yet to be laid, the necessary exchange infrastructure is absent, and the political determination required to painstakingly establish a valued currency is lacking. The alignment of geopolitical and economic interests among BRICS members is insufficient, and no member seems willing to invest the substantial political capital needed for such an endeavour.

It is essential to return to what BRICS fundamentally is: An interest group of significant emerging economies dissatisfied with the current international order. In every BRICS summit outcome document, the diminished standing of BRICS members on the global stage is reiterated. While the economies exhibited great synergies during the founding and commodity boom, the economic diversification of India and especially China is offsetting these effects. China's efforts to expand its influence, partly through BRICS, coincide with India's aspirations to assert its own prominence.

"The most interesting developments will come from the dynamic between India and China, " highlights Heineking. This relationship could be the factor that either makes or breaks the entire BRICS project. Russia's pursuit of international support could deepen its subordinate position to China. Given the vast array of differing political and economic interests within BRICS, the likelihood of a common currency emerging seems dimmer than the possibility of Russia simply aligning more closely with the Renminbi. It remains to be seen whether China can expand the BRICS sphere in the coming summit. What BRICS will surely stay is a stage for those powers that seek to put the current order in question. Given the reserve entrenchment of the Dollar, only another Bretton Woods could dislocate the greenback hegemony. The form of this future order, whether it be denominated in Renminbi, Rupee, or Dollar, remains uncertain.

The contrast between the optimism of the 2000s and today's tensions is almost disheartening. When O'Neill first introduced the BRICs, it was with the idea to integrate the BRIC into the global monetary order, even envisioning an expansion to a G9. This vision aimed to foster global cooperation and unity. While there is still opportunity to collaborate on the collective challenges of the 21st century, it seems that BRICS have more so built walls than bridges with the West.

References

Figures

- Figure 1: IMF: Currency Composition of Official Foreign Exchange Reserves. Available at https://data.imf.org/?sk=e6a5f467-c14b-4aa8-9f6d-5a09ec4e62a4
- Figure 2: FACTSET
- Figure 3: Reuters: 'BRICS bank' looks to local currencies as Russia sanctions bite
- Figure 4: IMF: Currency Composition of Official Foreign Exchange Reserves. Available at https://data.imf.org/?sk=e6a5f467-c14b-4aa8-9f6d-5a09ec4e62a4

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