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A Decade after the Birth of BRICs
：Developments in Russia and Other Three Countries

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＜Summary＞

1. More than ten years have passed since the four countries of China, Brazil, Russia and India began to be called BRICs as a group. During this period, each of them generally showed a successful economic development with much growing GDP and higher per capital income as was originally expected or even better than that.
2. Looking into the details, however, several problems have emerged in their economic structure and financial system, with some countries sometimes pushing on authoritarian politics in the domestic affairs as well as in the foreign diplomacy which may be the reflection of their fragility and vulnerability on both domestic and external fronts. Such economic development pattern with multiple problems, like the coexistence of high growth and uncertainties, is a common characteristic not only to the BRICs but to other emerging developing countries.
3. In this article, I would review the development path of the BRICs countries in the past

decade centering on Russia while comparing it with the other three, and give some suggestions learned from their experiences.

4. Taking into account the experience of China, Russia’s accession to the WTO in August 2012 will likely benefit Russian economy both in reality and in expectation for the improvement of its business environment through enhanced market opening.
5. The experience of India suggests that the gradual transformation of the industrial structure while protecting one’s advantages is the surest way to a solid sophistication of the economy, even if it looks like a long way round. It will be important for Russia to continue to foster and encourage manufacturing companies that produce chemical and petrochemical products and mineral and related products, while riding on the strength as a resourceful country in such energy and minerals as petroleum, natural gas and iron ore.

＜Full Text＞

Introduction

More than ten years have passed since an American investment bank coined a name of BRICs for the four countries of China, Brazil, Russia and India. The name has now lost its freshness in the naming, to be used so often in common use. The report of “Dreaming with BRICs: The Path to 2050”, published by the bank in October 2003, envisioned a bright future for the four countries that would enjoy high growth for a prolonged time up to 2050. Their economies have generally shown just as expected or more than expected performance including in their GDP growth and rise in per capita income.

Yet, while each country has achieved more encouraging results in its economic scale and income level, various problems have also developed in the contents of the economy and financial market, as are represented by a biased economic development that relies on specific sectors, income inequality, underdeveloped financial sector and market, etc. In addition, in some of them, authoritarian politics were sometimes taken on both domestic and external fronts which may reflect their fragility. An economic development pattern with various problems including coexistence of high economic growth and uncertainties is a common characteristic to all of the BRICs countries.

In this article, I will try to review the development until now of the BRICs centering on Russia in the comparison with the other three, discuss the suggestions learned from their experiences, and then explore the way to strengthen the partnership of Russia with other three countries.

1. Economic Development of Russia and China

China is now standing out among the BRICs in its high economic growth. China started to take reform and open-door policy in 1978, and since then the Chinese economy has enjoyed high economic growth based on the introduction of market economy and positive imports of foreign capital and technology through establishment of special economic zones. After the accession to the WTO in 2001, the economic growth rate accelerated to over 10%, helped by the increased direct investment that flooded into China on a heightened expectation of further promotion of the market opening policy. As a result, China had ranked the world's 7^{th} largest economy in 2003 when the report "Dreaming with BRICs" was published. China maintained the high real GDP growth of over 10% until 2008 when the world was thrown into a financial crisis triggered by the collapse of the Leman Brothers.

In the process of this economic growth, the Chinese government was quite adroit in managing the transition of economic system from the old planned economy to market economy. To facilitate the smooth introduction of new systems, the government took an experimentalism where they first implemented the new policies on a trial basis in limited regions and areas and then broadened the scope based on the result of the trial. Setting gradualism as a basic stance, they also took a policy of gradual transition of economic system, raising the privatization ratio by increasing new start-up companies while preserving state enterprises to some extent. This approach sharply contrasted with the experience of Russia which was forced to endure prolonged slow growth caused by the social disruption resulted from the rapid transition of all systems including the transfer of ownership from national sector to private sector in the process of transition to market economy following the collapse of the Soviet Union.

What supported the Chinese high growth rate was an affluent and cheep labor force of migrant workers from rural areas, together with the introduction of foreign capital and technology. These production factors of capital and labor contributed to strengthening of China's competitive advantage, which is called "Factory of the World", by dramatically increasing the exports of labor-intensive products of textile and electric industries. The big population of 1.3 billion has always gathered the attention of many foreign enterprises as a potential source for enormous market expected to be realized in the future. In this sense, Russia's situation differed from China in that the former had a more matured economy than the latter. As of 2003, Russia's population was 140 million, or about one tenth of China's, while per capita income which provides an indication of wage level was about $3000 in Russia, more than double of that in China, and therefore there were not enough low waged workers that would support the labor-incentive manufacturing industry in Russia.

In addition to the two factors noted above, the supply capacity of natural resources, especially of energy, caused a big difference between China and Russia in their pace of economic growth and development patterns. While China turned to net importing country of energy in the latter half of 1990s, Russia continued to be a net exporting country of energy, boasting of the world's largest exporter of petroleum and natural gas. In a big energy power of Russia, petroleum and natural gas industry had long been dominating as a leading industry, with fuels and energy related products having a share of about 70% in its exports (2012). The pursuit of economic and industrial development relying on the abundant raw materials was a reasonable choice for Russia since it had lacked, unlike China, the strength of low labor cost.

The result was, however, an economic structure that was easily subject to the fluctuations of prices of crude oil and other energy products. As commodity prices tend to fluctuate more widely than the ordinary products, Russian exports with energy products accounting for the major share had been greatly influenced by the change in energy demand both from the transaction volumes and transaction prices. Thus the Russia economy had doubly suffered from its high dependence on exports, experiencing ups and downs reflecting the change in exports. (The export share in the nominal GDP in the BRICs countries was 25.9% for Russia, 24.9% for China, 16.1% for India and 10.7% for Brazil in 2012.) Furthermore, the growth of the middle class seems to remain very slow due to the uneven distribution of wealth which is often seen in resource-rich countries.

Having worried about these problems, the Russian government issued in 2008 "Development Strategy by 2020", in which it declared its intention to achieve various targets to diversify the economy and raise the people's living standard, through such measures as i) departure from the resource-dependent economy, ii) fostering of high-tech industry and intellectual service sector,

iii) diversification of export items, iv) enhancement of educational level, v) expansion of the middle class, etc. In August 2012, Russia formally became a member of the WTO and since then had a brighter prospect in lowering import duties and inducing foreign capitals in such service sectors as telecommunication, insurance, and finance. Although there are still some problems such as slow pace of lowering import duties with introduction of some new tariffs, some business people have shown positive assessment on the expected phasing out of import duties and simplification of customs procedures. In the business environment survey of the World Bank, Russia ranked the 92nd out of 189 countries in 2013, rapidly rising from the 120th out of 183 in 2012, and coming to the top among the BRICs countries. This rise in the ranking reflected a better evaluation on procurement of electricity and taxation. Although the general improvement of investment environment is only half done, some bright signs are coming within sight.

Learning from the experience of China, accession to the WTO is likely to benefit Russia both in reality and in expectation for the improved business environment through the enhanced market opening. Direct investment in Russia increased both in 2011 and 2012 centering around the manufacturing industry. If Russia succeeds in attracting more foreign capital and technology, there will be better hope for diversification of the economy and improved living standard through the solution of agendas the government declared in 2008.

2. Experience of India and Lessons to Russia

India is a big country with the world's second largest population next to China, and 7th largest land area in the world. As it continued a prolonged but relatively modest growth since its independence in 1947, India was often cynically called a "Sleeping Elephant", likening India's big body and slow progress to an elephant. India has long maintained without any change a parliamentary democracy that may easily reflect the interest of all levels of people to be incorporated in its economic policy, and elections have been regularly held for federal and state parliaments. However, its mixed capitalism consisting of centralism and individual ownership, which had been under a strong influence of the government, has started to change gradually since its turnaround to liberalization and opening door policy in 1991.

Partly influenced by the effect of that policy change, also backed by people's enhancing expectation for the future of the BRICs, the growth rate of the Indian economy was accelerated since 2003. In some phases the annual growth rate of its real GDP even reached nearly double digits, pushing India's presence higher in the international economic society. Since 2011, however, the growth rate has been largely decelerated due to the longstanding problems of continuing deficits in the budget and the trade and current accounts, in addition to the acceleration of inflation.

Despite the image of an advanced economy which is created by India's representative major companies like Tata Group and Infosys Technologies, development level of the Indian economy as a whole is still not high. Its per capita income was low at around 1500 dollars in 2012. This is about one tenth of Russia's (about $14,000 in 2012) and one fourth of China's (about $6000), remaining within the category of lower middle income country in the definition of the World Bank.

Unlike Russia, which enjoys a rich endowment of energy and mineral resources, India has no abundant natural resources for export except for iron ores. As is often the case with the emerging developing countries with low income level, agriculture accounts for the larger share in the industries, at 18% of nominal GDP, largely exceeding those of other BRICs countries (10% for China, 5% for Brazil, and 4% for Russia, all as of 2011)

Among other industrial sectors, service sector has a larger share in India like in Russia with smaller share of manufacturing sector. As of 2011, manufacturing accounted for about 14% of the nominal GDP in 2011, almost the same with Russia (16%) and less than half of China (30%). Service industry like IT business and finance has served as a driving force in the economy, while manufacturing sector failed to grow strongly on the whole despite its strength in some categories like automobiles and medicines.

One of the reasons for this weak presence of manufacturing industry lies in its underdevelopment of so-called agro industry, i.e., a part of manufacturing that produces agriculture-related goods such as foods and textiles using the agricultural products as raw materials, despite the fact that the agriculture is one of the major industries in India. The share of the agro industry in the nominal GDP is only a bit more than 2% , which is quite small as compared to about 10% in Vietnam and Pakistan which have about the same level as India of per capita income in Asia.

In the deep background, there has existed a top priority agenda for maintaining a unified nation under the inherent specific circumstance that India is a nation with many races, many religions and many languages. For this reason, policies heavily weighing on equality and support for the weak, such as i) ensured employment, ii) protection of small-scale production, and iii) balanced development among the regions, were implemented in priority to the growth and expansion oriented policies. Thus the growth of labor intensive manufacturing industries such as agriculture related manufacturing has been retarded as labor laws have set strict conditions for dismissal of workers, making employment adjustment hard for the companies. It was also hampered by the introduction of production reservation system under which the production of specific products is permitted only to small scale producers, restricting the entry of large companies in the production of those products. In addition, despite the initial goals after the independence in 1947 of fostering labor-intensive textile industry in around the rural areas, the growth was strongly affected by the fact that the heavy industrialization centered on iron and steel industry had been actually promoted by the government in the years that followed.

The underdevelopment of the agro-industry has brought two problems to India. One is the delay in the shift of employment to non-agricultural industries. While the ratio of agriculture production in the GDP declined at a certain speed to the present level of a little under 20%, the ratio of farmers in total employment declined less rapidly, still remaining at more than 50%. It is higher than most of the other Asian countries. As a result, the rise in income level in India was hampered by this delay in the shift of employment from agriculture to more labor-intensive agro-industry that has a large capacity to absorb labor as well as higher labor productivity than agriculture.

The second is the slow growth of agriculture-related products in the export of India. The share of those products in the export remains at 21%, far lower than that of Pakistan (68%) and Vietnam (42%), both of which have the comparable per capita nominal GDP to India. Generally the agriculture-related products will constitute major export items in the lower middle-income countries to contribute to the expansion of their exports. However, it is not the case with India. The weakness of export of the agriculture-related products is one of the factors for the longstanding problem of large trade and current account deficits.

Looking back to Russia, the government has set it a policy goal to foster high-technology products and intellectual service sector to break away from the resource-depending economy. In fact, movement toward machine and high technology industrialization has been gradually in progress, as is seen from the increased investment of automobile makers including from Japan, the Skolkovo innovation center, an emerging high technology business area near Moscow, and the IT parks located in the suburb of Kazan. The experience of India shows that the gradual transformation of industrial structure while maintaining its existing strength is the surest way, even if it seems a long way round, to the sophistication of the economy. Therefore, it will be important for Russia to continue to foster such manufacturing industries as chemical, petrochemical, and mineral related industry while exerting the strength of resource-rich country in such products as crude oil, natural gas and iron ore.

3. Two resource rich countries—Russia and Brazil

Russia and Brazil have much in common among the BRICs countries. The first is that both countries have abundant natural resources. In Russia energy products such as crude oil and natural gas account for a major part of its production and export, while minerals take a larger share in Brazil.

For this reason and geographic distance between the two countries, the trade of Russia with Brazil is the smallest among its trades with other BRICs countries. Russia’s total trade (export and import combined) with Brazil amounted to $5.5 billion in 2012, accounting for less than 1% of Russia’s trade with the world ($839.5 billion). On the other hand, Russia’s trade with China, amounted to $82.4 billion, or about 10% of the Russia’s total, as they are in a mutually complementary relationship in their export items with Russia exporting mainly natural resources to China while China exporting manufactured goods to Russia.

The higher ranked items in Russia’s exports to Brazil include products of fuel, fertilizer and chemicals such as kalium chloride, uric acid nitrogen, aluminum, and ammonium. The upper ranking items in Russia’s import from Brazil include agricultural products such as beef, pork, chicken meat, sugar, coffee, and soy bean.

The second similarity between Russia and Brazil is their relatively larger size of economy and population in the world. Both countries have nominal GDP of about $2 trillion with population of more than 100 million, ranking between 5th and 10th largest in the world. Both countries have a per capita nominal GDP of more than $10,000, and belong to the higher income group in the BRICs. It is to say both have a solid domestic market with more than 100 million consumers with a certain level of purchasing power on average.

The economies of Russia and Brazil achieved a high growth since 2000 until recent years chiefly thanks to the increased demand on energy and mineral resources from emerging countries, especially from such big countries as China and India with a large population size which have accelerated their economic growth recent years. In 2010, however, the two economies began to stagnate as China and India experienced a deceleration of the economic growth, decreasing their imports of resources and agricultural products from Russia and Brazil as well as the accelerating price rises forced them to tighten the credit. The economic downturn became clearer since 2011 in Brazil, and since 2012 in Russia.

In addition to the economic slowdown, Brazilian economy seems to have been further burdened by the twisted economic policies and tardy progress of structural and systemic reforms to be made.

Currently, the inflation rate has remained at a high plateau despite a slower economic growth, beginning to take on an aspect of stagflation. They have taken mismatched economic policies in Brazil with the Central Bank implementing tight money policies to control the acceleration of inflation, while the government taking a fiscal stimulus like income tax reduction and cut in the social security burdens to stimulate the demand. This fiscal stimulus runs counter to the recovery of the fiscal discipline that has long been expected, rather causing the inflation to hover at a high rate. In addition, the current account deficit has expanded as the gross demand has continued to increase supported by a solid consumption whereas the past expansion of the economy has shrunk the production capacity with tightness emerging in capital and labor availability.

This co-existence of the inflation and the current account deficit is a big risk to the economy of the emerging countries, a factor that the investors keep their closest eyes on. Therefore, the Brazilian currency real sharply dropped in the foreign exchange market since 2013. Together with India and Turkey and some others, Brazil was given a dishonorable name of “Fragile 5” by the US investment banks, and has been closely watched as a possible originator of the disorder in the world economy.

Many inconveniences and additionally accrued costs are pointed out by foreign companies that have invested in Brazil. They include i) high tax rates and tax accounting costs due to its complicated taxation system, ii) enormous logistic costs arising from a poor infrastructure in Brazil, iii) large volatilities in currency and price, etc. For example, the tax rates defer from county to county in Brazil and taxation system is complicated with various tax breaks allowed in each of them. As a result, companies have to devote 2500 hours annually to process the tax declaration, outstandingly long hours among the emerging countries. Further, logistics infrastructure is far lagging in Brazil with the ratio of mileage of paved roads and railroads to national land area lagging behind the other Latin American countries including Argentina, Chile, and Mexico with which Brazil has been under a severe competition. In order to continue to receive foreign investment, it is most important for Brazil to solve these problems and improve its business environment for foreign companies.

Looking at Russia, on the other hand, despite its continued economic slowdown, there is no twist in the economic policies as is seen in Brazil. Although the inflation rate remains relatively high, it is well controlled as compared to the past high inflation periods, and the current account is in surplus in Russia. For this reason, the ruble is not included in the “Fragile 5” although Russia also has many problems and challenges for foreign companies to operate in Russia.

The greatest risk factor for Russia, however, will not be in such economic situation and investment environment, but rather in the geopolitical problem of Ukraine affairs. The involvement of Russia in the political turmoil of Ukraine reinforced the tendency of the falling ruble. As the economic sanctions by the advanced countries such as the EU and the US are considered to continue, there is a high possibility that the stagnation of the Russian economy will deepen and the ruble will further decline. There will be no double that it is an urgent issue for Russia to try to find common ground in its involvement in Ukraine. Yet, they must not forget to tackle the domestic economic problems including the improvement of investment environment.

4. In Conclusion～Expected Cooperation of Russia with Other Three Countries

Among the Russia’s trade with the rest of the BRICs countries, the most outstanding is the big volume with China. The trade between Russia and China has been on an expanding trend since 2000. Among the total trading amount (export and import combined) of $844.2 billion in 2013, trading with China accounted for over 10%, while that with India and Brazil remained small in size at 1% or less, respectively.

Reflecting this big amount of trade between Russia and China, direct exchange between the Russian ruble and the Chinese yuan started in November 2010 in both foreign exchange markets in Moscow and Shanghai. In fact, it was more than one year earlier before the direct exchange between the Japanese yen and the Chinese yuan started in June 2012 that the direct exchange of their currencies was put into practice between Russia and China.

It can be said that the direct exchange of the ruble with the renminbi has played a part of internationalization of the ruble that the Russian government has pursued. The internationalization of the ruble was declared as a national policy just after the start of the Putin administration in 2000, and renewed by the Medvedev administration as a policy goal to make it a reserve currency.

According to a hearing research made in 2012 by the author in Moscow, among the major importers of machineries from China and others, there was an expectation for a reduced foreign exchange cost through the direct exchange of the currencies without intermediation of the dollar, suggesting a big potential merit in the ruble-renminbi transactions.

In some parts of China, there is also a move to make the ruble go into circulation. The Eastern part of Russia has a border with Chinese provinces of Heilongjiang and Jilin, especially having a long one with the Heilongjiang province. The two countries have a strong connection in distribution especially in this district, with about 20% of the total transactions of the trade between the two countries being made through this province.

Suifenghe city in Heilongjiang province, which is located near the border with Russia, was formally admitted by the Chinese government, for the first time in China, as a “specific district for foreign currency use” and in December 2013 the ruble went into circulation. Actually the ruble was used before this formal circulation as the city was visited by many Russian business people and individuals coming for shopping. So this was only the confirmation of the current situation by the central government. To the Province of Heilongjiang it is the symbol of deepening relationship with Russia through the border city on the one hand, and it is located as a part of Northeast development measures by the central government on the other. To Russia also, this will not only contribute to the economic development of the Fareast, an important agenda for the Russian government, but also it constitutes a policy to meet the goals of both countries as the circulation of the ruble has an aspect of its internationalization.

In contrast to the cooperation with China, the cooperation between Russia and other BRICs countries has no outstanding progress. The only, albeit a small, development, is an effort to conclude an economic partnership agreement with India. Russia and India established in 2006 a joint study group for an EPA, but the framework for the two countries changed to include

Belarus and Kazakhstan as Russia formed a customs union with the latter countries. However, even in this expanded framework, they are far away from the conclusion of the agreement except for a confirmation for a collaborative study.

Looking at the whole picture of the BRICs, financial cooperation seems to be steadily progressing. In June 2009, the first summit meeting of the BRICs countries was held at Ekaterinburg in Russia. It was the first meeting, 5 years after the acronym coined in 2003, for the four countries to start to establish a collaborative relationship. Since then the summit has been held every year and the 6th meeting is slated for July 2014 at Fortaleza in Brazil. In addition to the four countries, South Africa started to join the summit since its third meeting held in 2011 at San’a City in Hainang Province, China. There have been an increasing occasion that the acronym BRICS is used to represent five countries instead of the former BRICs.

According to the published information, financial cooperation has been cited as one of the fruits of these summit meetings. At the fifth meeting held in 2013 at the City of Durban, South Africa, it was agreed to set up a common fund with the pooled foreign exchanges in the scale of $100 billion to mutually accommodate with the fund at the time of emergency. At the same time, it was also agreed to establish a so-called BRICS Development Bank, an initiative that has long been debated to make the money available to improve their infrastructures.

This original effort to establish a financial cooperation among themselves draws a clear line for the advanced countries and reflects their confidence in their availability of funds that has increased in line with the expansion of their economy. The set-up of a foreign exchange reserve fund is also a measure to cope with the emergency by the BRICS themselves, who have realized that they cannot always rely on the advanced countries at such crisis occasions, since the advanced countries have so developed and intertwined financial and capital markets that they may be more seriously hit by the financial crisis.

Although after the subsequent discussions the BRICS Development Bank was reportedly agreed, to be set up with an initial capital of about $50 billion, other details such as the manner of operation, management and the location of headquarters are still undecided. Its demarcation is not clear with the existing Asian Development Bank (ADB) and the emerging initiative of Asian Infrastructure Investment Bank (AIIB) that China and ASEAN countries are trying to establish. There may be a clearer picture for both the AIIB and foreign exchange reserve fund at the next meeting in Brazil.

As is noted above, some progress has been seen in the currency swaps between Russia and China with which Russia has the biggest transaction in trade, and effort for financial cooperation is in progress among the five countries of the BRICS. It may be most beneficial to all that they seek to conclude a FTA or an EPA in the framework of the BRICS in order to promote further economic development. Especially this kind of efforts will be indispensable for Russia in order to strengthen economic relationship with India which is far lagging in its development phase from Russia and with Brazil which is located far removed from Russia but has rich natural resources.

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