Panel 3

BRICS and the EU: An Oxymoron?

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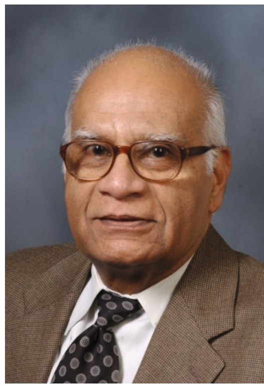

I want to thank the BMW Stiftung Herbert Quandt and the CESifo for inviting me to participate in the 13th Munich Economic Summit, and to introduce the panel on BRICS for Europe as part of the theme of this year's summit, namely 'Free Trade and Prosperity'. It is a privilege to address a group of high ranking politicians, scholars, business leaders, and editors of influential media.

The introducers of each panel were asked, as economists, to set 'a substrate of hard facts' to underpin the discussion to follow. In view of the belief that, despite the recent downturn, the BRICS will continue to outpace developed economies in terms of growth and dynamism; and that current and future trading opportunities with BRICS on the traditional basis of comparative advantage and specialization beneficial to all trading partners are once again large, the panel was asked to address four specific questions:

- Firstly, what can Europe do to enhance trade with BRICS?
- Secondly, what can BRICS do to enhance trade with EU?
- Thirdly, what are the most likely synergies?
- Fourthly, which are the next BRICS countries?

BRICS background

Less than 15 years ago, James O'Neill, Chief Economist of Goldman Sachs noticed that the GDP of Brazil, Russia, India and China were growing faster than the global average and coined the acronym BRIC. South Africa was added to make it BRICS in 2008 and projected that they would dominate the world in 2050. For the 'a substrate of hard facts' on the current situation, see Tables 1 and 2. I will be drawing on them as needed.

As Frances Cameron (2011) notes, with the exception of Russia, the other BRICS did not embrace the O'Neill's acronym and grouping until 2008, and then not only did they embrace the acronym with great enthusiasm, but also held five summit meetings deemed the 'first cycle' in keeping with the five members of BRICS. The sixth

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Table 1

Population and GDP: BRICS and EU comparison

	Population 2012 (in millions)	GDP at PPP (2012)		GDP growth (%)		
		in billion US dollars	Per capita GDP	2000–12	2012–13	2013–14
BRICS total	2,981.9	23,063.0	7,734			
Brazil	198.7	2,291.0	11,530	3.7	2.2	2.4
Russia	143.5	3,272.9	22,800	4.8	3.4	1.3
India	1,236.7	4,730.0	3,820	7.7	4.8	6.2
China	1,350.7	12,205.8	9,040	10.6	7.7	7.7
South Africa	52.3	563.3	7,734	3.6	1.7	2.7
EU27	500.3	14,155.5	28,294	1.2(1)	–0.4	0.1
World	7,043.9	85,986.8	12,207	2.7	2.4	3.2
Share of BRICS (%)	43.7%	28.6%				
Share of EU27 (%)	7.1%	16.5%				

Note: (1) GDP growth rate for the period of 2002–12.

Sources: World Bank's World Development Report (2014), Eurostat, IMF World Economic Outlook (2014).

Table 2

Merchandise and service trade: BRICS and EU comparison, 2014

	Merchandise trade				Commercial service trade	
	World merchandise exports		World merchandise imports		World commercial service exports (% share)	World commercial service imports (% share)
	Largest trading partner (% share)	Next largest trading partner (% share)	Largest trading partner (% share)	Next largest trading partner (% share)		
BRICS						
Brazil	EU27 (20.2)	China (17.0)	EU27 (21.4)	China (15.3)	0.87	1.87
Russia	EU27 (46.8)	China (6.8)	EU27 (41.9)	China (41.9)	1.33	2.50
India	EU27 (16.8)	USA (12.8)	EU27 (11.1)	China (11.1)	3.32	3.08
China	USA (17.2)	EU27 (16.3)	EU27 (11.7)	Japan (9.8)	4.35	6.73
South Africa	EU27 (20.0)	China (11.7)	EU27 (28.7)	China (14.4)	0.34	0.41
EU27	USA (17.3)	China (8.5)	China (16.2)	Russia (11.9)	25.03	20.21

Source: WTO Statistics.

meeting of the initial cycle and the first of the 'second cycle' are to be held in Brazil later this year.

Does this mean there is compelling economic, political and social logic for BRICS to act as an influential group in the world arena? Does the rest of the world, including the EU, treat them as such a group? Apart from normal economic interactions, particularly in trade and investment, are there any significant 'strategic' components to the EU-BRICS relationship and *vice versa*?

Diversity: strength or weakness?

The answer is far from clear. Table 1, for example, clearly shows that there is considerable diversity among BRICS in their population, GDP and GDP per capita measured in terms of purchasing power parities (PPP), economic growth and so on. In our discussion we could go into the question of whether this diversity is a strength comparable to the composition of assets in an appropriately diversified portfolio in terms of the BRICS' ability to take greater risks in the international arena; or whether it constitutes a weakness constraining the ability to both formulate and credibly implement coordinated strategic responses?

Some view the diversity as a weakness, since the BRICS economies are heterogeneous not only in economic structure, but also in terms of their cultures, institutional arrangements, etc. Of the five, China is an authoritarian single party regime and its current president has consolidated his power, Russia is an authoritarian democracy, Brazil is a democracy with an authoritarian past, India is a democracy that tried authoritarianism briefly under Mrs Indira Gandhi and, depending on today's election results, a party with an authoritarian leader could come to power. There are many problems with South Africa's democracy. Should the EU as a champion of democracy be at least cautious in dealing with BRICS an influential geopolitical group?

However, as Table 2 shows, the EU happens to be the largest single destination of exports for all BRICS, with the notable exception of China. For both China and the EU, the United States is the largest single export destination. However, for all other BRICS (excluding China) and the EU, China is the second largest export destination, while for China the EU is the second largest export destination.

As for imports, the EU is the largest source for all BRICS, and China is the second largest. For China, Japan is the second largest source of imports, while Russia is the second largest source for the EU. While none of the BRICS except China is among the EU's first or second largest trading partners, China figures as the second largest single trading partner for the EU. Thus, from a trade perspective it can be argued that firstly, China among the BRICS should be treated differently; and secondly, that the EU should bear in mind that keeping its markets open to imports from BRICS as a group is important. Before returning to the trade issues in answering the first two questions, let me devote a few minutes to what BRICS themselves view as their objectives and their role in the international arena.

The declaration and action plan of the fifth summit of the BRICS at Durban, South Africa on 27–28 March

2013, lays out some of the major objectives of BRICS leaders. In addition, Cameron (2011), European Parliament (2011), Hunya and Stöllinger (2009) and Zerby (2013) also discuss them. I will draw on all of the above.

At their fifth summit the BRICS leaders held open discussions (see www.brics5.co.za). They agreed to establish (i) a New Development Bank and indicated that the initial capital contribution to the bank should be substantial and sufficient for the bank to be effective in financing infrastructure; (ii) to set up a contingent reserve arrangement (CRA) with an initial size of 100 billion US dollars; (iii) the BRICS Think Tanks Council and the BRICS Business Council (the former will link respective think tanks into a network to develop policy options and a future long-term strategy for BRICS, while the latter will bring together business associations from each of the BRICS countries and manage engagement between the business communities on an on-going basis); and (iv) concluded two agreements under the auspices of the BRICS Interbank Cooperation Mechanism: the BRICS Multilateral Infrastructure Co-Financing Agreement for Africa and the BRICS Multilateral Cooperation and Co-Financing Agreement for Sustainable Development.

Since all development banks have to depend on developed country capital markets for resources, whether yet another regional development bank will be able to tap substantial additional resources at an affordable cost is an open question. There is no doubt that an essentially self-insurance type contingent finance by BRICS to address liquidity shocks will be costlier than a global insurance through multilateral agencies.

The leaders expressed the well-known concerns of BRICS and other groups such as emerging markets with regard to reforms of International Financial Institutions, and specifically the redistribution of IMF quotas, permanent membership of the UN Security Council, sustainable development, food and nutrition security, poverty eradication, Millennium Development Goals, etc. in the declaration.

BRICS leaders viewed the institutions such as IMF, World Bank, WTO as creations of Western Powers in which they, and particularly the United States, are dominant. They would like the United Nations and related institutions such as UNCTAD to play a greater role. Interestingly, presumably because of them being members of the G20, they did not view it as being dominated by the West, although membership of the G20 was determined by the G7 and has not changed since its creation out of G22 in 2008!

There are some deep issues in extending the concepts of equity, fairness, voice, exit and others, that are well-defined and understood when applied to groups of individuals, to organisations such as the UN, World Bank, IMF, ILO, G20, etc. whose members are nation states usually represented (although not always) by the regimes that happen to be in power in those states.

In the UN, membership is open to all states that subscribe to its charter. The nature of its governance systems, such as democratic, a monarchic, one-party authoritarianism is not a relevant consideration. In the EU-BRICS context, because not all of the BRICS are democracies, the implicit question in the EU dealing with BRICS as a geo-political group is whether the EU would have to trade-off its concern for promoting democracy by doing so.

In any case, the EU is conducting negotiations over trade and economic partnership agreements, euphemistically called free trade agreements, with BRICS with weak bargaining power. Such agreements constitute attempts by the stronger negotiating partner to extract concessions regarding intellectual property and labour standards that go beyond TRIPS, the ILO convention and other multilateral agreements. The EU's negotiations to conclude 'free trade agreements' with individual BRICS are best viewed as part of the unfortunate rise in preferential trade agreements (PTAs) since the conclusion of Uruguay Round, while the Doha Round of multilateral trade negotiations started in 2001 is still to be concluded. Incidentally the G20 conspicuously failed to deliver on their repeated promises by to conclude Doha before 2011!

I will not attempt to predict either the likely contents of an EU PTA, or any of the BRICS, let alone when such an agreement will be concluded. However, given the patterns of EU-BRICS merchandise trade in Table 2 (unfortunately the WTO database does not provide comparable data for services trade), answers could be given to the first two questions posed to this panel. Firstly, since the EU happens to be the single largest import market for China (and the second largest export market for China), by keeping its markets open to imports from BRICS, the EU can enhance its trade with BRICS. However, China is the world's manufacturing hub, Russia is an energy exporter, nearly two-thirds of India's GDP is generated by services, not all of which are internationally tradable; although from the perspective of employment and poverty, the agricultural sector is crucial. In other words, the competitive advantage of each BRICS is different sectors calling for an across the board market opening by EU. Moreover, despite several bouts of reforms, the Common Agricultural Policy (CPA) of Europe continues to distort world agricultural trade. Since the EU is the largest source of imports for all BRICS, each of the BRICS could reduce barriers to imports from BRICS to enhance its trade with EU.

Hunya and Stöllinger (2009) point out that globally EU is the most important foreign direct investor (FDI). It is among the main investors in each of the BRICS, and the dominant investor in Brazil and Russia, although not in China and India. Clearly, for the BRICS attracting FDI in general, and the associated advanced technology of FDI, from the EU are important. However, from an EU perspective, the intellectual property regimes, as well as the labour standards of BRICS as host countries, could be a deterrent. Whether in the free trade negotiations with the BRICS, the EU will be able to extract concessions from BRICS in these two areas remains to be seen. Besides FDI, the EU is also a major foreign institutional investor (FII). Both for FDI and FII, the domestic regulatory regimes in BRICS matter. On the other hand, the regime with respect to inflows of labour into EU from some of the BRICS is important. The most important synergy between BRICS and the EU is likely to be from the technological spill-over from FDI from the EU into BRICS.

The last question as to which are likely to be the next BRICS countries, is not easy to answer since, given the diversity of BRICS, almost any country in the world is likely to have some commonality with a BRIC. That said, I believe that Indonesia is most likely to become the next BRIC.

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Panel

The panel chair, **Katinka Barysch**, Director of Political Relations, Allianz SE, Munich, directed targeted questions to each of the panel members. She asked **Philipp Mißfelder**, Foreign Policy Spokesman of the CDU/CSU Parliamentary Group, how Europe should deal with the BRICS countries. Unlike the EU, the BRICS have no political programme, replied Mr Mißfelder. They are focused primarily on economic and currency matters. "We cannot dictate policy to the BRICS nor can we expect a country like India to endorse sanctions against Russia".

The United Nations Industrial Development Organization, UNIDO, has a Senior Coordinator for BRICS Cooperation, a position currently held by **Oleg Sepelev**, a speaker on this panel. Mr Sepelev pointed to the impressive development of the BRICS economies, which are now no longer aid recipients but donor countries. UNIDO organises round-table discussions for senior government officials of the BRICS countries in awareness of the potential these countries have within UNIDO and how they can serve as examples for other developing countries. Still, UNIDO does not treat the BRICS in isolation from other countries but pursues all avenues of cooperation.

John Whalley, Director of the Centre for the Study of International Relations (CSIER) at the University of Western Ontario, emphasised that despite the institutional developments, such as the BRICS bank, at the moment the BRICS are not a negotiating group. As a result, EU negotiations must be with individual BRICS members, of which China comes first. In a world of megadeals, China itself is involved in a complicated network of negotiations and will eventually become a part of TTP (Trans-Pacific Partnership). Since power in negotiations is a factor of the strength of a country's economy, there has been some question as to whether China can maintain its target of 7.5 percent annual growth up to 2020. With the on-going improvements in the educational system, Mr Whalley believes this growth rate is still possible. Since it suffers from anti-dumping regulations in particular, China has a strong interest in the many on-going trade negotiations.

Martin Brudermüller is Vice Chairman of the Board of Executive Directors of BASF SE. He is based in Hong Kong and responsible for the Asia-Pacific region of his company as well as serving as Speaker of APA, the Asia-Pacific committee of German industry. He stressed the huge potential for German-Chinese trade, which can act as a catalyst for EU-China relations. Since German trade consists of a large share of intermediate-goods imports from the EU, European countries also benefit from the growth in German exports. In terms of trade agreements, Mr Brudermüller favours 'a pragmatic, step-by-step approach' to EU-China trade relations with an emphasis on removing concrete obstacles to trade one by one.

The last panel speaker, **Xin Chen**, Head of the Economic Department at the Institute of European Studies at the Chinese Academy of Social Sciences (CASS), pointed out that fifty percent of Chinese exports are linked to FDI in China, and "one-third of China's exports to the EU consists of imports from other countries". In light of this, it is essential that China have a role in trade negotiations. In addition, the financial crisis has demonstrated the importance of BRICS institutions as a 'firewall for the future'.

"Why are there no free-trade agreements among the BRICS countries?", Katina Barysich asked. John Whalley mentioned that Indian manufacturing interests have been opposed to such agreements, and T. N. Srinivasan added that the many non-tradable services in the Indian economy make it difficult to reach free-trade agreements in the group. Nevertheless, as Mr Whalley observed, China has now become Brazil's largest trading partner, which will also have repercussions for the whole Mercosur area. Philipp Mißfelder added that Europe underestimates the activity within the BRICS economies, pointing out Brazil's strong relations with South Africa.

In the discussion, **Christoph von Marschall** of Der Tagesspiegel stressed that the transatlantic partnership is driven more by investment and services than by trade, unlike the relations with the BRICS economies. For this reason the free trade agreements should be open for other countries to join in future, but at the moment it would make no sense for China to join the TTIP negotiations. For **Simon Evenett**, Professor of International Trade and Economic Development at the University of St. Gallen, the "BRICS countries are very good at playing off one EU country against the other", which prevents the EU from being a strong negotiating partner.

Maria Luiza Viotti, Brazilian Ambassador in Berlin, does not regard the BRICS as a negotiating group, but the BRICS economies are important for each other and they have helped sustain the dynamism of the world economy during the recent crisis. They have even helped the IMF assist countries that have particularly suffered. Although the crisis has dampened growth in the BRICS countries, large middle classes have developed there, forming an important consumer market. She felt that the WTO should be used more as a forum for improving trade relations.

William Drozdiak wondered why so little attention is being devoted to Africa, although this continent will have some of the fastest growing economies in the coming years. Martin Brudermüller replied that BASF is in fact reopening some of its operations in Africa in light of the continent's huge potential. Because the barriers to trade are larger, Africa has some of the largest potential gains from free trade arrangements, John Whalley observed. For S. N. Srinivasan, if the African countries grow as fast as the IMF projects, this in itself will attract the attention of the markets.

William Zhang, China Elderly Foundation, noted that if TTIP is meant as a true trading group, and not a 'NATO version of an economic body', there is no reason for not inviting China to join in, especially since Chinese input and products are so widespread. This led to the question of whether TTIP is more of a political than an economic endeavour. TTIP started out as a technical, economic partnership, Philipp Mißfelder pointed out, but in the wake of the NSA revelations and the Ukraine crisis, many politicians have changed their position on the agreement. The transatlantic community nevertheless remains strong and is open to bilateral trade relations as well.

"Are the various bilateral agreements of EU countries with the BRICS a disadvantage?", Katinka Barysch wanted to know. Martin Brudermüller agreed that a more global scheme would be preferable, but "it's a matter of how we get there". Separate agreements are part of a 'pragmatic, step-by-step approach' on the way to a more global arrangement. With regard to the importance of investment and services in relation to trade, he pointed to the growing Chinese investments in Germany encouraged by the German government, hoping that other countries in Europe would follow suit. The position of Xin Chen is that China should be included in the global trading club. TTIP as an economic agreement among partners would be no problem for China, but it would a problem if it takes on a political dimension. Mr Chen pointed out that more than 70 percent of Chinese outgoing FDI is in East Asia, so TTP may be more important for China's interests. Since China is already 'embedded in the global value chain', it makes no sense to exclude China from trade agreements.

In the final round of questions from the floor, **Jackson Janes**, President of the American Institute for Contemporary German Studies, Johns Hopkins University, wondered whether selling TTIP as 'the new NATO', as some have suggested, was a constructive strategy. **Peter Jungen**, Chairman of *Project Syndicate* asked whether competition in the future between China and the EU might not be over the pace of innovation, especially since Europe seems to be falling behind in the area of venture capital and angel investors. Finally, **Clare Pearson**, Corporate Social Responsibility Manager Asia for DLA Piper UK and based in Beijing, gave her perspective on China's dealings in Africa. China has a keen understanding of connectivity and for this reason is particularly adept at doing business in Africa: "if the water is too clear, the fish can't swim in it", she observed. "We don't need things to be transparent but just social and connected."

Philipp Mißfelder disagreed and stated that one of the biggest challenges for the Chinese leadership is how to deal with intransparency. He also felt that NATO has positive associations for many Europeans. Now that the EU elections are over, the anti-TTIP and anti-globalisation campaigns have receded. "TTIP now seems to be doing well in public opinion", but this of course could change. For this reason transparent negotiations are essential. Martin Brudermüller admitted that there is an innovation race between Europe and China, but he welcomes competition with a high-tech China, especially since Germany is most successful in high-tech countries. "It's the job of the companies to stay competitive."