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A Contractual State (or Republic) of the BRICS

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Abstract. The purpose of this article is to reveal the limitations of the Regional Integration Agreements (RIAs) laid down by the neoclassic market fundamentalism. The author then goes on to describe these limitations as a few controversies. For example, at one point, capitalism requires free enterprise, free competition and well-established property rights. However, it is proven in the article that the RIA in Europe supposes that the EU countries band together to provide financial stability facilities to support and bail out weaker member countries such as Greece or Portugal. This common policy means there must be some elements of the command economy that make the rich EU countries pay for the poor ones, which is certainly not capitalism but something closer to communism or socialism. Such common policies bind national sovereignty. The author makes use of a theory that tries to break through the limitations put in place by the neoclassic economics, i.e. institutionalism. The article concludes that one can solve the problems of making choices through mutually beneficial agreements. Based on that proposition, the author introduces the BRICS as a model for future RIAs.

1. Introduction

The BRICS Summit was first called on in April 2010 and later acquired the status of an informal forum without any underlying legal regulatory framework or specified articles of conduct [1]. The 2010 BRICS Summit was aimed at creating common playing rules to coordinate their relations on a wide range of political, economic, social, cultural, and scientific issues in the modern world economy. The economic issues were about the reform of the international financial architecture and the world system of currencies, broader participation of the emerging economies in the global institutions and a new multilateral world economic and political order. The BRICS also discussed poverty and inequality between the developed and developing nations as well as the use of energy preservation technologies. They discussed environmental issues, etc. [2]. These goals and objectives are revised and renewed at each summit of the BRICS and are stated in common documents, mutual declarations and communiques. The main regulations of the common declarations issued on behalf of the leaders and heads of state of the BRICS are not imperative by nature. They are recommendations similar to most resolutions adopted by the international economic and political institutions that are part of the United Nations [3].

The BRICS declarations take shape of additional norms parallel to the existing rules of the international commercial, economic and humanitarian law. For example, the number of the participants in the BRICS is fixed in comparison with the UN. The number of the UN member states may change depending on the willingness to expel the existing members and adopt new states or territories. From this perspective, the consulting body of the BRICS, having a certain liking to the UN General Assembly, is not a flexible format of international cooperation.

The significance of the BRICS Summit in the system of informal international consulting institutions is revealed in the constancy of the membership and mutual declarations. A change in the principle of constancy and sustainability, and the introduction of flexibility may lead to the loss of the purpose and the general idea of the BRICS Summit as a closed grouping of countries. From this perspective, the BRICS concept is opposed to open regionalism propagated by the Asian Pacific Economic Cooperation (APEC). On the other hand, the BRICS Summit is open to participate in the resolution of international problems of social and economic inequality and oppression [4].

It was also for objective and clear reasons that the BRICS Summit and the BRICS Development Bank emerged. The funds provided by the IMF and the World Bank were not sufficient to satisfy the growing demand for investment on part of the emerging and rapidly growing economies. Moreover, the way the funds were distributed among the member states of the IMF and the World Bank was seen by many as unjust. Most of the funds was given to the advanced nations, which gave them a competitive advantage. Such allocation of financial capital allowed the advanced countries to more quickly overcome the crisis. The developing countries, on the other hand, had to struggle [5].

Thus, it was a good timing for the BRICS Development Bank to come up with a more attentive and sensitive approach unlike the existing international financial practices of the IMF and the World Bank. They both usually represent the interests of the advanced countries due to a simple fact that their funds are distributed according to the quotas and voting rights. And the privileged access to the funds is given to the countries who own the largest quotas, i.e. the advanced countries. It has been so ever since the mid-1940s, and despite the recent revisions in the quotas, it is still the case [6].

The BRICS Development Bank has tried to find its own niche in the system of the international financial institutions. It has created playing rules and clear boundaries within which it works to provide more flexible conditions of drawing loans and making schedules of repaying the debt, etc. [7].

The flexibility does not mean, however, that the BRICS Development Bank is going to make loans for free. It just does not force upon the borrowing nations the structural adjustment policies and conditionalities. It may also reschedule the repayment of debt if a country is unable to service the debt right now, and charge less than the IMF or the World Bank do [8].

2. The democratic image of society

It is believed that F. Hayek's democratic image of society is about the government which is built on the sequence of choices in a chain of actions starting from the acceptance of a constitution to acts, regulations and other norms of a bureaucratic procedure [9].

Since the beginning of the regional integration process in Europe in the mid-1950s, this democratic image was surely in view. However, it is clear today that no grouping of countries, including the EU, will ever reach political integration, at least peacefully. It was especially the case after the failure of the European Constitution. The potential to adopt such documents depends on the consensus between the entities wanting to integrate on the issue of delegating respective powers to supranational institutions [10].

For example, the ratification of a constitution implies the highest degree of consensus between the participants on the key issues of social organisation, political leadership and economic life in a group of countries. A unified super-state breaks political and economic borders, the independence of monetary, fiscal and financial policies as well as national currencies. In the late 20th and early 21st centuries globalisation and international (or regional) economic integration have made countries address such issues [11].

After seven decades of the seemingly seamless unification processes and growing interdependence and interconnectedness in Europe, the member states became reluctant to give up full sovereignty to supranational institutions. This unwillingness was caused by the world financial and economic crisis of 2008 and the euro debt crisis of 2010 that showed that the EU countries could not stand up to the test of staying together. They expressed unwillingness to pay for the debts of the other countries of the union. They were depressed by the inability to control the flow of goods and services, labour and financial capital across their borders. Initially they wanted this because they thought that this process was supposed to be voluntary under the union's agreements [12].

Finally, they got fed up with the bureaucracy telling the countries what to do and how to it. And they started to look into the past when they could do everything they wanted, when they had their own currencies, when they produced the goods they used to, when they exported and imported the goods they required and when budget deficits were covered with no regard for other nations' willingness or unwillingness to permit that. This is one of the reasons for the currently increasing role of more independent and democratic institutions in the EU which have more rights at the national level, especially parliaments [13].

Nevertheless, the significance of international consensus and agreement on general issues of national and regional development has not entirely lost the attention of the society. That is why the role of consulting groupings such as the BRICS is becoming more significant in the world economy and international economic relations. Groupings such as this usually consist of independent, sovereign states with wide responsibilities given to national legislative and other social institutions [14].

It is purposeless and inefficient for groupings such as the BRICS to work out documents which may lead to the formation of sophisticated monetary or political unions, since a common constitution and common law are a standard collection of universal norms and general play rules that restrict many activities. These rules and regulations are the basis of the interaction between integrating countries that have very specific, hardly complimentary and hardly converging characteristics in the spheres of politics, economy, society, culture and language. All attempts to harmonise these things may lead to opposite results contrary to all purposes and expectations. They will eventually produce autarchy or abhorrence. This process also gives birth to nationalist sentiments aimed at restoring independence, national identity and national currency. Britain's exiting the EU is one of the most striking examples of this [15].

Geo-economic benefits can be achieved through effective norms which require unanimous consensus between the participants of the international exchange of goods and services. Their consensus can be achieved on the basis of direct democracy. Otherwise, any attempt to delegate a choice to a third party will lead to a situation in which representative democracy reduces the efficiency of norms and play rules [16].

The process of coming to a consensus on something becomes a bureaucratic nightmare or a vicious circle of bureaucratic absurdities that come to life due to the fact that in order to agree on something, the participants require a common ground which is supposed to harmonise different national legislative systems that have existed for centuries. Some of them may sound ridiculous to other nations, but the people got used to them [17].

The worst thing of all is that one cannot eliminate the stupidities in the law by creating a new common law for many nations simultaneously. And the harmonisation of the stupidities will produce more absurdities on the supranational level. These common absurdities will look like an arithmetic average. The outcome will be more bureaucratic stupidities and absurdities, because the people of different countries will not be able to get used to the arithmetic average of their legislative absurdities plus the absurdities of other nations divided by a certain harmonising denominator created by a group of technocrats who do not understand national differences altogether [18].

3. The model of the contractual republic of the BRICS

The performance of the virtual contractual republic and the common virtual market of the BRICS can be assessed on the basis of comparative analysis of two organisation types – a contractual republic and an exploiting union (Table 1). One of these two options can be used to establish a republic or a union of the BRICS.

The newly created institutions should also take into account the alternative rules and norms of the member states of the BRICS. And finally, they should analyse the analogues from the past and academic research of the BRICS.

Table 1. The comparative analysis of the two organisation types for the BRICS.

The characteristics of the BRICS as a republic or a union	Contractual republic	The union of exploitation
Purpose	To maximise GDP and GNI and to reduce transaction costs	The most influential member state seeks to maximise the rent in the union through exploitation, including larger tax revenue compared to other countries of the group
Objectives (functions)	To set up a guarantor in transactions between the member states and to ensure their property rights	The leading country of the group aggressively intervenes with economic and social relations in the labour and capital markets that do not play the role of sole guarantors
Means (making use of the monopoly for oppression)	The means are limited by social agreement and consent	The means depend on the political will of the member country which controls the union
Mechanisms used to solve the principal–agent problem	If a principal is a member country, the mechanisms of democratic control are determined by consensual rules and by means of looking for alternatives. If the principal is the virtual contractual republic, then the preference is given to the norms of voluntary subordination on part of the member states to the common law, including the tax code	If the principal is a member state, then the mechanisms of democratic control fail. If the principal is the union, it tends to use oppression and power and also attempts to use excessive control which leads to an extreme version of exploitation in a union – a totalitarian state
Budgetary constraints	Democratic procedures to agree on a common, consensual budget are very tight	Procedures to adopt a common budget are very lax, and the member states are free to set tax rates and tend to have very wide fiscal competences
Major revenue posts	Member states get revenue by collecting taxes they receive from activities on the common virtual market	The revenue is generated mostly through confiscation taxes and non-tax receivables
Major expenditure posts	Much of the budget revenue is spent to ensure justice and social order. The member states make expenses commonly agreed upon in consensual documents and treaties	Most expenses are committed to defense, social control, police, justice, governance and also to impose obedience to the directives and rules adopted at the supranational level
Regular means to finance budget deficits	To finance budget deficits, the member states take loans on the common virtual money market	To cover budget deficits, the member states use the loans of a common central bank loaned out to the government as well as loans taken on the regional market

Taking a close look at the features that characterise the union of exploitation, almost all of them can be attributed to the European Union (EU), because, first of all, the leading EU countries receive the largest benefits from the integration [19]. Second, they affect the decision-making process in the supranational bodies and national parliaments. Third, they make weaker member states follow the decisions of their legislative, judicial and administrative institutions. Fourth, the most advanced member states of the euro zone may freely use the printing presses to issue the common currency. And finally, all EU member states are still free to set specific tax rates and pursue independent fiscal and budgetary policies.

4. The basic outcomes and recommendations

EU policymakers believed financial integration should have been done very quickly. So, they employed shock therapy. Surely, that was a mistake, because people who got used to buying everything expensive, especially credit, may go crazy about the whole thing, which was what actually happened in several countries of Europe. Greece is just the most notable example of financial mismanagement [20, 21].

As is known, the lowest interest rates in the BRICS are currently in China. Brazil, Russia, India and South Africa have much higher rates. In these circumstances, harmonisation can be done through a couple of alternatives. It is what the consensus is for to agree at least on one of them.

First, the BRICS may commonly agree on a rate which would be a sort of an arithmetic average, i.e. it would be higher than the current Chinese rate, but lower than the rates in the rest of the BRICS. For China it may be damaging, for higher rates generally lead to stagnation in economic growth. For the other four countries of the group such a rate would be more attractive, because credit would be cheaper and more available and not produce a heavy debt burden.

Second, China may not consent to any changes in its domestic rate altogether, because changes in both directions cause economic difficulties. It may stimulate economic activity but also create credit bubbles.

Third, Brazil, Russia, India and South Africa may also not consent to a reduction in their debt service rates, because these rates are part of the capital market mechanism that plays the role of attracting foreign investors, and the decrease in the rates will cause capital flight. Also, the debt service rate is an anchor benchmark to determine the repo rate that is a monetary policy instrument which is used regulate the supply of money. So, any decrease in the repo rate will lead to a larger supply of money and hence to inflation.

Thus, the above options may both attract and distract the governments of the BRICS to agree on the common debt rate. At the end of the day, if the BRICS will still attempt to introduce it to the common virtual debt market, the implementation will imply that first the transition rates will be set individually for each of the BRICS using a combination of market-oriented decisions and government policymaking. The market decision is shown in picture 1. As soon as the market decision is taken, the governments then will adjust the resulting rate to the current situation in the BRICS according to macroeconomic circumstances. That means there must be some bodies in the BRICS that will consist of a group of professionals from different fields including monetary, fiscal, financial and legal authorities. They will conduct surveys of the economies on a quarter, semi-annual and annual basis and come to a common decision and set the rate. The purpose of this transition period is to provide the basis for convergence of the individual semi-common rates. As soon as these individual rates get closer to each other, the decision-making process will be entirely left at the door of the virtual common debt market of the BRICS. The analytic bodies may still be working even after that, but their responsibility will only be concerned with monitoring the macroeconomic conditions in the BRICS to abide the convergence criteria.

To sum up, the mechanism of setting the common debt rate in the BRICS means that at first the rate for each individual member of the BRICS will be calculated on the basis of the Chinese average rate of debt service which amounted to 2.4% in the year of 2017. We think that the proposed model should focus on this particular rate since it is the lowest among the BRICS and because China has a competitive advantage in making loans compared to Brazil, Russia, India and South Africa. As is known, according to the theory of comparative advantage by David Ricardo, countries willing to take part in the international trade should export the goods they produce more cost-efficiently and import the goods that cost too dearly to produce domestically. In our example, the expensive good in Brazil, Russia, India and South Africa is capital. Since their interest rates are higher than China’s, they will import Chinese loans through the common virtual debt market of the BRICS to the competitive advantage of China in providing capital.

The setting of the semi-common rate of interest or debt service rate implies that the Chinese credit supply curve should be transferred to the charts of Brazilian, Russian, Indian and South African capital markets. There the credit demand curves will intersect with the China's credit supply curve in an equilibrium point. The result would be four equilibrium rates of debt service in Brazil, Russia, India and South Africa.

According to our calculations, the semi-common interest rate for Russia and South Africa will amount to approximately 3.5%, and that for India and Brazil – about 3%. The use of that rate will lead to a significant decline in the cost of borrowed capital in Brazil, Russia, India and South Africa. In Brazil it will fall from more than $US20 billion down to about $US4.5 billion. In India it will go down from $US13.5 billion to $US5.0 billion and in South Africa from $US1.3 billion to $US0.7 billion. If Russia would run government deficit equal to the previously supposed level of $US5 billion, the cost of borrowed capital would fall there from $US0.5 billion down to $US0.2 billion.

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