International agreements and the New Development Bank

Presentation to the Standing Committee on Finance

May 2015

Parliamentary Budget Office

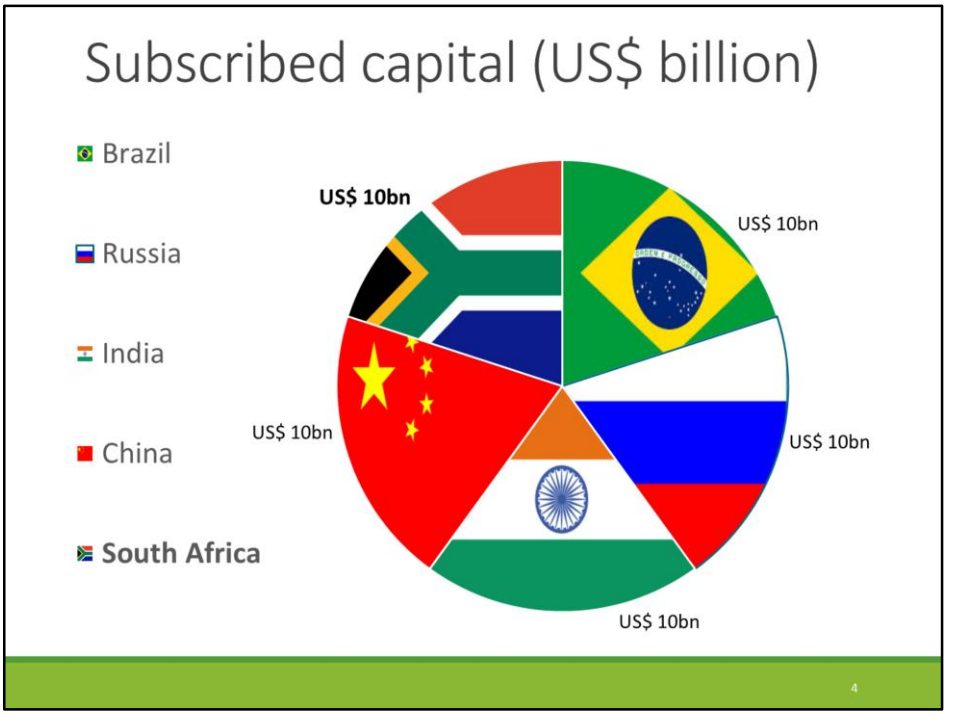
PARLIAMENT

International agreements

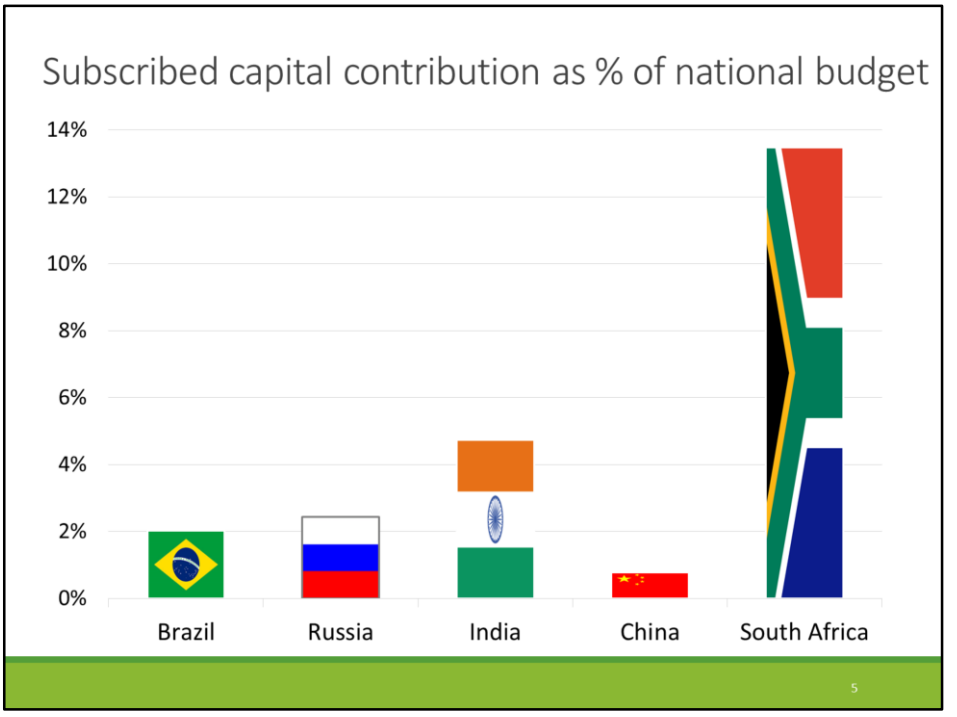
- Various legitimate practices that nevertheless can compromise/limit oversight of public finances
  - *Example of loan guarantees and contingent liabilities discussed in PBO's Budget presentation and SOE report*
- International agreements may have this effect if they commit the country to future payments or risks in a way that is subject to less oversight than comparable commitments domestically
  - *This is a challenge internationally*
- Committee Section report on the process of ratifying international agreements
  - *Procedure does not allow substantive oversight*
  - *PBO will provide input on this, in consultation with Legal Services*
  - *NT and SARS could provide more information on expected impact and risks (in relation to public finances) of agreements presented to Parliament*

The New Development Bank

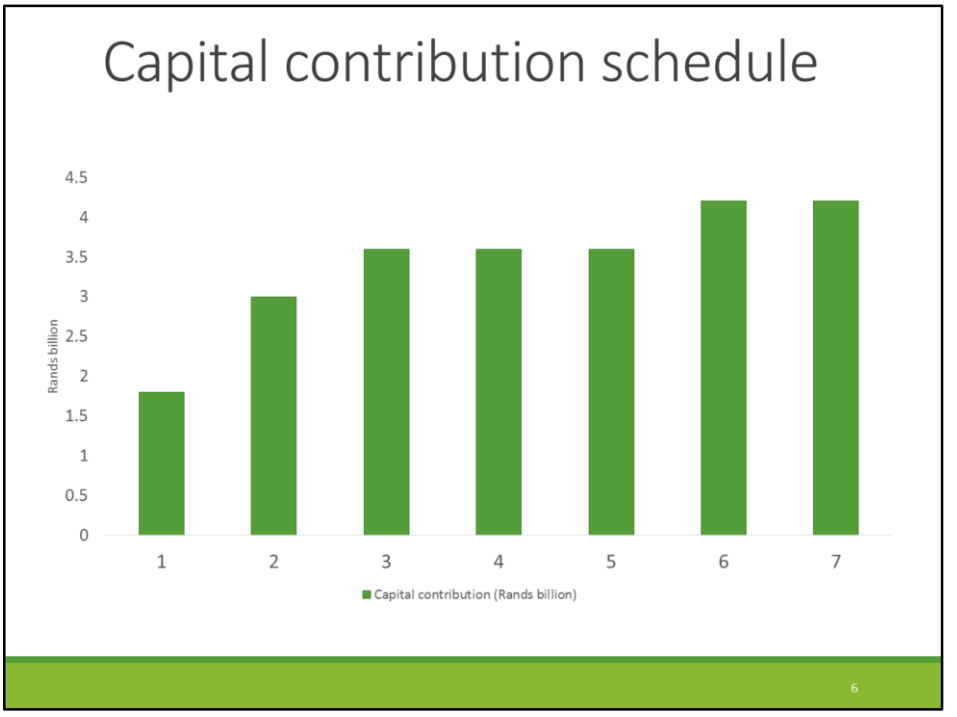
- Agreement to establish BRICS New Development Bank signed June 2014
- Objections to costs and conditions of IMF and World Bank
- Two primary objectives of the bank
  1. Lend funds for development projects
  2. Provide foreign currency should a country experience a shortage in its foreign exchange reserves
- Standing Committee on Finance asked to approve treaty
- Presentation attempts to broadly explain the treaty and identify risks



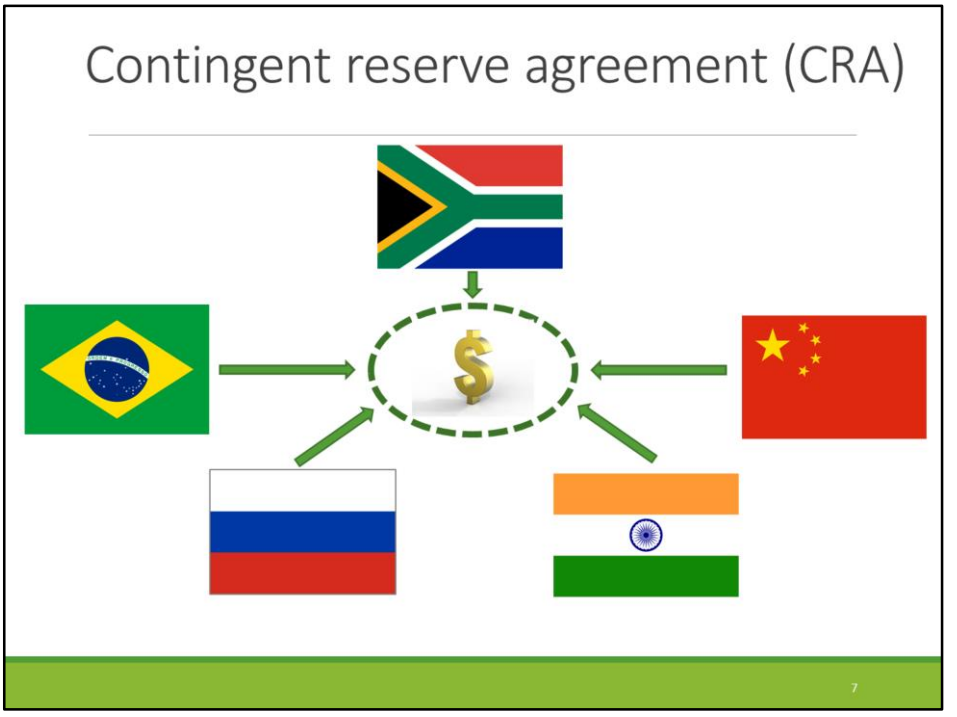
- Only 50% of the committed US$100bn capital has been subscribed – i.e. is required to be paid
- The initial contributions required are equal in US$
- US$ 10bn per county



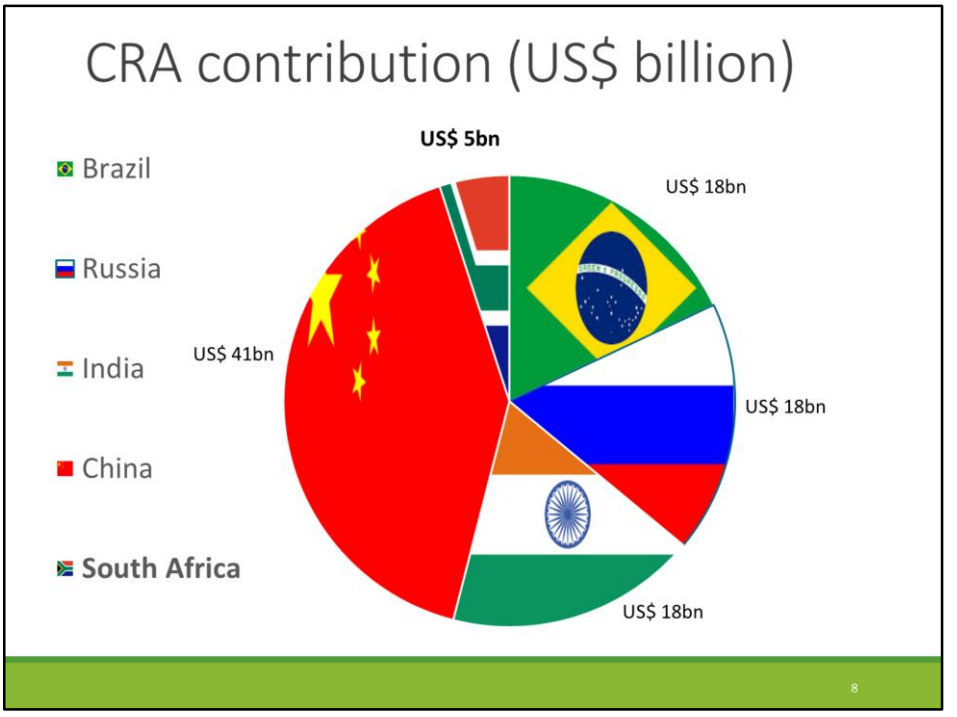
- However the burden relative to each country's national budget – general government expenditure – varies
- South Africa's contribution is equal to 13.5% of its national budget for 2013/14, compared to Brazil (2%), Russia (2.4%), India (4.7%) and China (0.8%)



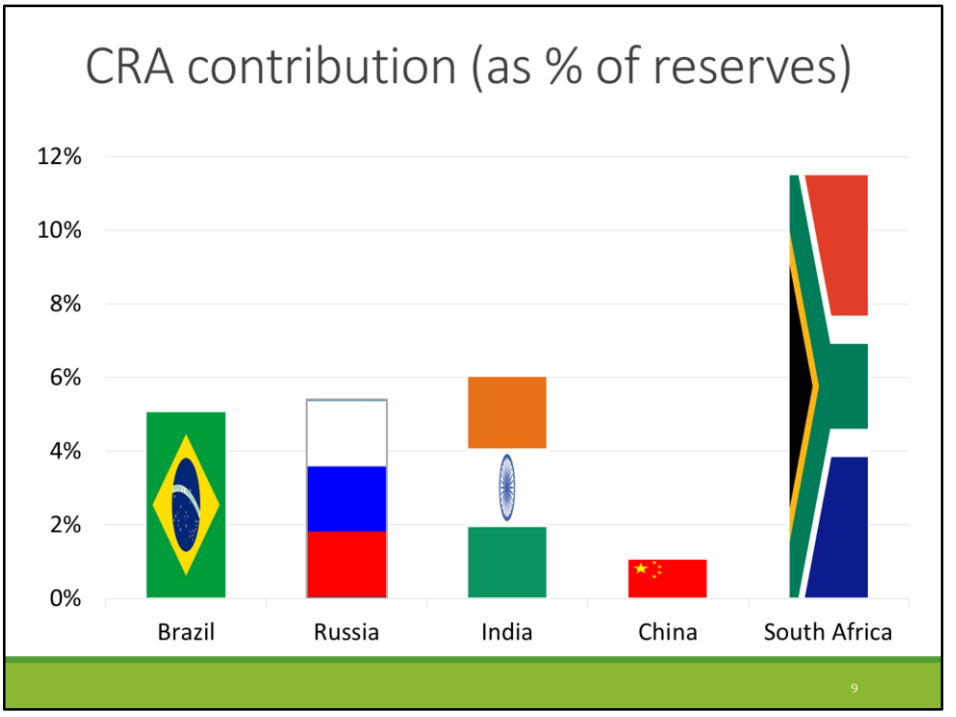
- The initial capital contribution will be paid over 7 instalments
- However only US$ 2bn out of US$ 10bn is covered in the instalment schedule



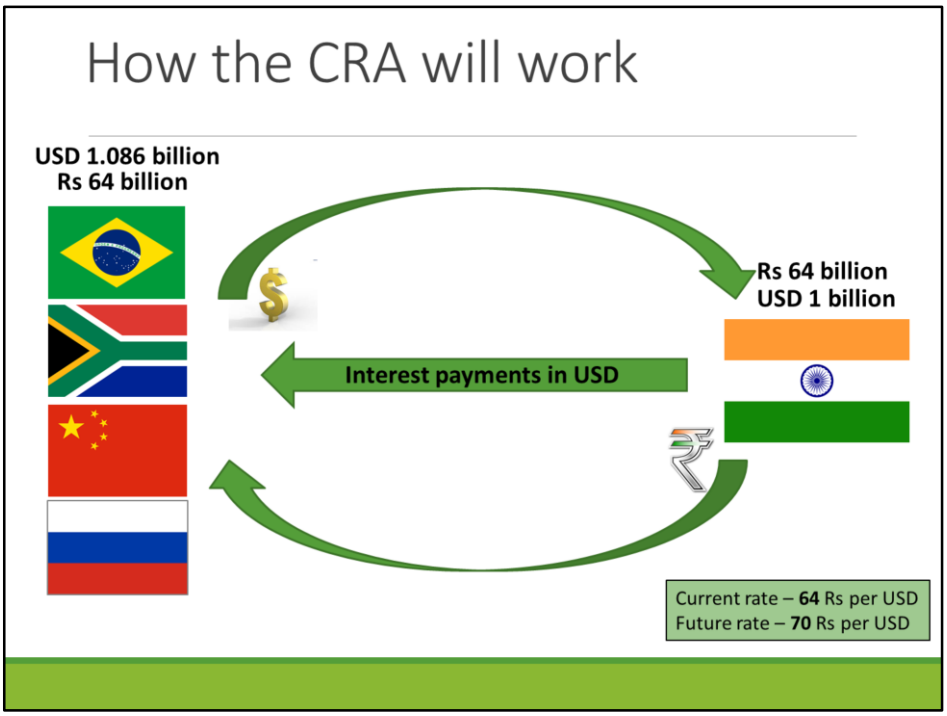
❑ Purpose – to provide emergency funds should a member experience a shortfall in their own foreign exchange reserves
❑ Each member country ring-fences a portion of its foreign exchange reserves (in US$)



- The CRA contributions total US$100 bn
- The contributions differ between member countries
- China contributes 41% of the total CRA (US$41 bn)
- Brazil, Russia and India each contribute US$18 bn
- South Africa contributes US$5bn



- Despite China contributing 41% of the CRA, its contribution is only 1.08% of its foreign reserves
- South Africa's modest contribution to the CRA (5%) equates to 11.52% of its foreign reserves



❑ Assume India experiences a shortfall in foreign currency reserves and applies to the CRA for funds
❑ Through the CRA, US$ 1 bn is transferred to India
❑ In exchange, India transfers Rupees to the CRA to the value of US$ 1 bn. Using the current exchange rate (assume 64 Rupees to a US$), this equals Rs 64 bn. Assume the swap contract is for six months.
❑ India pays interest to the CRA on the US$ 1 bn borrowed over the six months according to an international floating interest rate
❑ At the end of the swap contract, the CRA gives India its Rs 64 bn back and India returns the original US$ 1 bn, plus an additional amount (US$ 0.086 bn**) to compensate for any decline in the value of the Rupee. The additional amount is determined by what is called a forward exchange rate. A forward exchange rate represents a prediction made today about what the rate will be in 6 months time. The forward rate is agreed upon at the beginning of the swap contract and must be honoured by both parties (in this example we assume the forward rate is 70 Rupees to a US$).

**Since the Rupee has depreciated by 8.6% → [(64-70)/70 = -8.6%], the US$ returned to the CRA must equal US$1 bn * 1.086 = +/- US$1.086 bn

Implications (1)

- Treaty signed, but still has to be ratified
- Once ratified, South Africa is bound, and has to honour commitments
  - Initial capital contribution: US$10 billion (+/- R120 billion)
  - Ring fence CRA contribution US$5 billion (+/- R60 billion)
- Capital contribution withdrawn from the National Revenue Fund
- CRA contribution must be ring-fenced from foreign reserves
- Risk that recipient country will not be able to pay interest and/or return US$ to the CRA
- Greater burden on SA than fellow BRICS

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- Although South Africa has signed the agreement and treaty, it still has to be ratified.
- Once ratified, South Africa is bound by the agreement and treaty to honour its commitments- particularly the capital contribution and the ring-fenced CRA component
- If approved, payments from government would need to be withdrawn from the National Revenue Fund, first to capitalize the bank (US$10 bn) and secondly should an application to the CRA be approved (US$5 bn). The Constitution (Section 213(2)) states that money can only be withdrawn from the fund through an act of Parliament. Thus, should the CRA be called upon, Parliament could potentially amend or block the transfer of reserves. Amendments in violation of the CRA agreement and treaty could, however, expose South Africa to international judicial action.
- The ring fencing of 11.52% of our own reserves is a risk since it shrinks our pool of available reserves. This is problematic since reserves are important indicators of our ability to repay foreign debt and for currency defence, and are used to determine credit ratings of nations. Further, the possibility that the member country receiving funds from the CRA will not be able to pay interest and/or return the USS$ is a risk.
- While the capital contributions made by member countries are of an equal

amount, South Africa's is considerably larger as a proportion of its national budget (13.5%)

Implications (2)

- South Africa has limited influence over BRICS' decision (only 6% of votes)
- No provision made for BRICS' capital contribution in 2014 MTEF
- A provision in 2015 MTEF may affect country's ability to meet expenditure and deficit targets
- South Africa will have access to BRICS's CRA (up to US$ 10 bn)
- BRICS' African regional centre may increase South Africa's profile on the continent

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- Requests for funds are decided upon by voting. South Africa has limited power to block requests – having only 6 per cent of the votes – should the decision not require consensus.
- National Treasury has noted (28th April 2015) that it has not made budgetary provisions for the US$10 billion capital contribution in the 2014 MTEF. It noted that it is exploring options for the 2015 MTEF. This poses a risk to the fiscus as financing the country's participation in the bank may prove a challenge given its commitment to slowing expenditure growth and reducing its budget deficit

Thank you

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This report has been compiled in response to a request sent on the 8th May 2015 from the Chairperson of the Standing Committee on Finance in Parliament. The Committee asked the PBO to comment on the treaty relating to the establishment of the New Development Bank.

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