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BRICS New Development Bank

In June 2014 Brazil, Russia, India, China and South Africa signed the Inter-Governmental Agreement and Articles of Agreement to establish the New Development Bank. The countries also signed the treaty establishing the Contingent Reserve Arrangement (CRA). The bank's main objective is to provide funds for infrastructure and sustainable development projects in member and other developing economies and will be headquartered in Shanghai, China, with an African regional centre located in Johannesburg. The Fortaleza Declaration stipulates that the Bank will initially have available capital of US$100 billion. To begin with, the five founding members will each contribute US$10 billion (+/- R120 billion) to capitalise the bank.

A secondary objective of the bank is to provide funds should a country experience a shortage of foreign currency reserves – known as a liquidity shortfall. Reserves are important as they are used by governments to pay interest on funds borrowed in foreign currencies and to pay for goods and services acquired from outside of the country. Central banks may also choose to use the reserves to strengthen the local currency – by using it to buy the domestic currency – should it experience rapid depreciation. Reserves, therefore, can act as a shock absorber against events that negatively affect a country's exchange rate.

Traditionally, countries experiencing reserves shortfalls have relied on funding from the International Monetary Fund. Some countries have objected to the costs and conditions attached to such funding which is partially the motivation for the creation of the CRA.

South Africa, according to the CRA agreement, will ring-fence US$5 billion (+/- R60 billion) of its own reserves, a portion of which will be transferred to another BRICS country should they experience a liquidity shortfall. In exchange, the recipient country will transfer the equivalent value of its domestic currency to South Africa – known as a currency swap contract – and pay interest on the US dollars borrowed. At the end of the swap contract, the recipient country pays back the US dollar value of the domestic currency it transferred to South Africa according to a pre-determined exchange rate. Swap contracts are not without risk. Greater than anticipated depreciation in the recipient country's currency would result in it returning fewer US dollars to South Africa than the value determined by the market exchange rate.

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 to provide reserves should a member country's request be approved. 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. If approved, payments from government would need to be withdrawn from the National Revenue Fund. 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.

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 slow expenditure growth and reduce its budget deficit.