

## **The Emerging BRICs: Brazil, Russia, India and China** *An Online Course Review*

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This summary presents issues addressed during the online course *The New Economic Powers: Brazil, Russia, India and China*, authored and moderated by Dr. Linda Yueh, Fellow in Economics, Pembroke College, The University of Oxford, September 2004 to November 2004 (<http://www.alllearn.org/course.jsp?C=293&fb=2>).

If someone asked you to name the countries with the greatest economic power in today's global economy, you would be inclined to mention the United States and perhaps the European Union or Japan. However, if you were asked to identify the countries that will be the economic powers in 2050, would you have the same answer?

During the past few years, attention has been given to the growth prospects of Brazil, Russia, India and China (BRIC for short) for different reasons. Historically, these four countries have had quite different backgrounds, and each have different strategies for growth. This text provides brief economic summaries to set the context, areas of advantage and growth, and challenges for each of the countries as their economies gather momentum in the global economy.

### **China: Transitioning to a Market-Based Economy**

China began reforms in 1979, which started a gradual transition from a centrally-planned economy to one based on open markets. With a gradual transition, market forces are slowly introduced into the market so that businesses, government and consumers can adapt to the changes over time.

Since the reforms began, rising household incomes have increased consumer demand for goods and services, causing expanding retail sales. The government also selected industries to receive financial support in order to encourage growth. As the government has gradually allowed trade since 1990, exports, as a share of gross domestic product, doubled to 30 percent in 2000. Foreign direct investment also increased dramatically—to \$53 billion last year.

With a gradualist approach, the easiest reforms are put into place first, and the more complex changes do not occur until much later. At this time, China has reached the point where it must start to deal with the more complex issues such as unemployment in the urban areas, inefficiencies in the government sector, and rural to urban migration because of the growing rural-urban income gap.

Since its entrance into the World Trade Organization (WTO) in 2001, China has been ordered to liberalize trade and its financial services sector, which has made the state-owned banks less competitive and the number of non-performing loans has increased substantially. Another compliance that China has to contend with is adhering to international economic laws. China will have to reform its legal system in order to comply with the WTO's mandate.

China's growth has been based on extensive growth, which means increases in capital and labor fuel production. This type of growth is not sustainable, because there comes a time, if it has not happened already, where adding additional capital or labor to a production line will not produce the same increase in products as before (diminishing returns). In order to grow at a sustainable pace, productivity improvements must continue. Currently, China does not invest much in research and development, as most developing countries do not, but it must do this in order to keep its economy growing at a substantial pace. China holds a substantial comparative advantage in low technology goods, but over time other developing countries may try to take away some of China's market share. One positive move in this direction includes its recent agreement with India to ease the transfer of knowledge between the two countries.

The quality of life for its citizens, especially in the cities, has improved substantially with the addition of the reforms. However, if China wishes to be a global economic power, rather than just a large economy, it has to address some complex issues. These include addressing the exchange rate policy that has come under scrutiny by a number of countries, complying with the WTO, investing in research and development, dealing with the banks' non-performing loans, having transparent laws and defined property rights, and dealing with the growing income inequality. While China's total gross domestic product (GDP) has increased at around nine percent per year for more than one decade, on a per capita basis, China still relates to developing countries.

### **India: The World's Largest Democracy**

India gained independence in 1947, and grew at an average rate of growth, relative to other developing countries, for a number of decades. India, at its time of independence, had much of its populace facing famine and extreme poverty. The leaders managed to hold a relatively high savings rate, which allowed the government to gather some resources and capital. During the 1960s and 1970s India had an inward-looking trade and investment policy, which included tight controls on imports and exports. This import substitution strategy allowed the country to be self-sufficient, but the costs of many goods for consumers were high because the industries did not face competition from abroad.

In 1980, India began a liberalization strategy; therefore, tariffs and import and export controls were relaxed. This reduced the costs to import inputs, which reduced the costs of some consumer goods. By the late 1980s, licensing requirements were relaxed and price controls were lifted from basic industrial goods such as cement and aluminum. The result of these reforms was real GDP growth, export growth, productivity increases, along with increased government borrowing and spending and an ever-expanding fiscal deficit.

A debt crisis occurred in 1991, along with lobbying efforts for cheaper imports by industry, which prompted the government to adapt additional reforms: industrial licensing was ended, tariffs were substantially reduced, the rupee was made convertible, and private industries were allowed into the electricity and telecommunications sectors. Foreign direct investment was encouraged, and moved into the country with the hopes for increases in consumer demand. Economic growth picked up once again, but the budget deficit was found to be quite challenging to reduce.

India is now making an effort to expand its emerging information technology industry, along with maintaining the industrial sector. Focus has been placed on education specifically for the high technology sector in order to encourage productivity and foreign direct investment. The focus on service industries has allowed India to work around its infrastructure and foreign investment constraints. For more than one decade, India has grown more than six percent per year in terms of real GDP, and productivity is also quite strong. However, there is still much poverty in the country (one quarter of the world's poor is in India), along with a gender gap and caste system.

### **Brazil: Living With Inflation**

During the 1960s and 1970s, Brazil successfully implemented import substitution models, which increased economic growth and allowed its industrial sector to develop and diversify, since it did not have to deal with foreign competition with greater market power. This strategy also helped the country to reduce its reliance on coffee as its main export, so it succeeded on moving from an agricultural economy to a manufacturing one. However, inward-looking strategies, such as import substitution, are difficult to continue as a long-term strategy because they are costly to protect the domestic industries.

Trade liberalization did not occur until 1990, since the 1980s were spent stabilizing the economy after suffering from the oil shocks and dealing with the budget deficit created by import substitution. The reforms reduced tariffs and other trade barriers. Brazil entered the Mercosur trading bloc in 1994 with Argentina, Paraguay and Uruguay, which moved the country further toward the global economy.

Even after these reforms were in place, foreign direct investment has been slow to enter the country, and export growth has not been nearly as high as the other countries mentioned in this text. One reason is that corporate taxes are quite high and there is limited financing for small businesses, which constrains Brazilian exporters. Real interest rates are still high because the public sector continues to borrow heavily. Inflation has been continuously high in the country (it once experienced 2,000 percent), even through the decades of growth. Income distribution is quite uneven as well.

### **Russia: Using the Big Bang Approach**

Russia holds a wealth of natural resources: the country holds 13 percent of the world's oil reserves and 33 percent of the natural gas reserves. After communism fell in 1989, Russia wanted to encourage capitalism quickly, and privatized state-owned industries all at once. Most prices were released from government control one night in 1992. Inflation followed shortly after, so monetary policy was tightened.

However, the Russian economy of today is smaller than the one before communism ended, even though it is growing at a good clip each year. This is because there is much corruption within the government and industry, and those who had the resources and wealth during communism are unwilling to give them up. For example, the prices for natural resources were kept low after the overnight price freeing. So the resources were bought cheaply within the country and then sold outside of the country at market prices, creating hefty profits for a few wealthy people. And since monetary policy was tightened (raising interest rates) in the face of inflation, it made it more expensive for households to borrow money. The financial institutions were not stable enough to handle the sudden privatization, and few had enough capital to provide consumers with the amounts they

wanted. This substantially hindered the ability of ordinary citizens to participate in the market economy.

The shaky confidence caused much foreign direct investment to be removed. The currency was expected to crash after oil demand decreased, and the bailout of the International Monetary Fund (IMF) proved to be the wrong course of action. The ruble was devalued, which improved the competitive position of Russia's exports, so the economic recovery began.

Russia needs to control its inflation and work on reforming its legal and financial frameworks. However, this is a large task because of the remaining corrupt officials.

### **BRICs: Gaining Economic Prominence**

Brazil, Russia, India and China have varied economic histories and strategies for stimulating economic growth. These four countries have also tried to open their economies to global trade and investment, with varying degrees of success.

Much attention has been placed on the growth potential of the BRICs, but there is no consensus about whether these countries will be significant economies in the coming decades. These countries have quite different economic histories, but all have seen high growth rates and have the potential to continue. However, the BRICs are growing from a lower level of economic activity, since they are all developing countries, and can sustain higher growth rates more so than developed countries. If these countries can work through their very complex issues, they may become world economic powers.

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