Brave New World?

Brazil and India's Financial Statecraft in the Changing Global Order

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Abstract

Brazil and India have pursued distinct strategies of financial statecraft despite their similarities as large emerging markets, each of which liberalized finance after years of state-led development and financial repression. Although governments in both countries were encouraged by their successful responses to the global financial crisis, and both subsequently have participated in efforts by the BRICS and within the G20 to adjust the global financial system, Brazil has engaged in bolder rhetoric and systemic reform initiatives, while India has been more reluctant to overtly challenge the *status quo*. We explain Brazilian bravado and Indian circumspection by variation in three factors: their relative international economic vulnerability, regional geopolitics, and the nature of domestic political threats to the ruling coalition.

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Global finance has undergone a great transformation in the last fifteen years. Developing countries, led by China, accumulated immense foreign reserves while the reserves of developed countries dwindled. The fiscal policies of many developing countries became more responsible and their fiscal deficits declined, while the fiscal policies of developed countries, especially the United States, resulted in huge deficits. In the 1990s, virtually all developing countries suffered from currency "original sin,"[1] obliging them to transact in the currencies of developed countries and assume the consequent exchange rate risk. A decade later, many had switched to floating exchange rates and were avoiding exchange rate risk by raising growing amounts of money from local currency markets. At the end of the 1990s, Asian financial markets experienced a major financial crisis that spread throughout the developing world. The reigning financial powers such as the United States used these events as a bully pulpit to advocate the virtues of liberal financial markets and Anglo-American approaches to financial regulation. Yet a decade later, a global financial crisis (GFC) emanated from the United States and spread across the North Atlantic to Europe. The crisis raised many questions about the very norms of global finance that been reinforced by the previous crisis. How will the emerging economies interpret the lessons of the GFC, and how will they utilize the opportunities presented by the changing distribution of global financial resources to alter the institutions of global finance? Will they attempt to use their ascendance to transform the institutions and norms of global governance? If so, will the transformation be smooth or disruptive?

This paper inquires into the ways in which Brazil and India, two large and increasingly consequential emerging markets, have employed "financial statecraft" amidst the momentous

changes that have occurred in the last fifteen years. We define international financial statecraft as a national government's use of its monetary or financial capabilities for the purpose of achieving its international policy objectives, whether political, economic, or financial. International financial statecraft can be either defensive or offensive. Defensive financial statecraft (or the "shield") consists of deliberate actions by national government policymakers to use financial regulations or instruments to protect the domestic economy from imported financial crises or foreign pressure. Offensive financial statecraft (the "sword") refers to employment of monetary or financial capabilities in the service of foreign policy goals ranging from influencing the norms of global finance, to lobbying for a permanent seat on the United Nations Security Council, to seeking international commercial advantage.

Brazil and India provide a particularly fruitful comparison. Our claim begins with the premise that the world, rather than being transformed from the bipolar system of the Cold War into a bipolar system led by China and the United States, is evolving towards a more decentralized distribution of power and resources. No doubt, China and the U.S. will be superpowers, whose preferences will play an important role in shaping global finance. But with the advance of global markets, an emerging tier of countries, including Brazil and India, will become increasingly consequential. The dispersion of capabilities among a wider range of countries will make the politics of global finance more complex and dynamic. Both Brazil and India are aspiring leaders of the emerging tier, yet follow somewhat different strategies.

Brazil's strategy has been more assertive. Brazilian leaders have felt much freer to criticize the global powers and, through their regional strategy of financial development, are somewhat more inclined to develop South-South financial ties. India's statecraft has been more circumspect: more cautious in its criticisms of the global powers, and more inclined to pursue a

strategy of financial service exports to advanced industrial countries. Section one offers reasons why we might have expected rather similar choices in Brazil and India in the wake of the GFC. Section two compares the recent and novel forays of Brazilian and Indian policymakers into global financial statecraft. Our third section accounts for the differences in these countries choices of strategy, examining first economic and then political explanatory variables. We explain Brazilian bravado and Indian circumspection by variation in three factors: their relative international economic vulnerability, regional geopolitics, and domestic politics. The paper's conclusion speculates about the future challenges confronting these large emerging market countries as they employ financial statecraft to promote change in the global financial order.

Why compare Brazil and India? Structural parallels suggest similar strategies

Through the 1980s, state-promoted industrialization had been the dominant development strategy in both countries, accompanied in each by pervasive government intervention in banks and financial markets. Brazil and India significantly liberalized both trade and finance in the 1990s. Subsequently, growth accelerated in each, becoming steady in Brazil and positively exuberant in India, while coexisting with single-digit inflation. By 2007, each was a large emerging market of roughly similar size, Brazil with a GDP of $1.4 trillion and India with a GDP of $1.2 trillion at market rates--although when measured at purchasing power parity, India's GDP exceeded Brazil's.

Both countries had widely-respected, although not formally independent, central banks and recent histories of stable, single-digit inflation. Brazil had finally tamed its chronic hyperinflation only in the mid-1990s. After the *real* floated in 1999, the BCB instituted inflation-targeting. By the late 2000s Brazilian Central Bank (BCB) officials, typically drawn from the

private financial sector, regularly received kudos from their peers worldwide. The BCB's most important policy instrument has been the policy interest rate or SELIC, which the central bank announces directly and manages via open market operations. India's central bank, the Reserve Bank of India (RBI), was founded in 1935 under the British. Historically passionate about holding inflation to single digits and maintaining exchange rate stability, the RBI usually has been led by career civil servants with financial expertise, appointed by the Ministry of Finance. The RBI's primary policy instrument has traditionally been reserve requirements, both the Cash Reserve Ratio (CRR), which requires banks to maintain at least 5 per cent of their demand liabilities in non-interest bearing accounts, and the statutory liquidity ratio (SLR), which historically instructed banks to hold not less than 20 per cent of their demand and time liabilities in cash, gold, or government securities. In times of stress, such as the 1990-1 balance of payments crisis, the RBI would raise total reserve requirements to 53.5 percent of total deposits. Beginning in the 1990s, the RBI reduced its reliance on these cruder instruments, moving gradually to use of its treasury securities' repurchase rate as a policy interest rate.

Brazil was forced to modernize and privatize its banking sector in a hurry, as inflation's demise in the mid-1990s revealed waves of illiquid and insolvent banks.[2] Brazil's giant public sector development banks, BNDES and CEF, remain the primary sources of long-term finance, but are not direct competitors with commercial banks. Brazil's banks, now fewer and larger than in the early 1990s, dominate the list of Latin America's largest. Today's big four display the gamut of ownership structures, ranging from majority public-sector *Banco do Brasil*, to private *Itaú-Unibanco* and *Bradesco*, to majority-Spanish-owned *Santander Brasil*. In India, nationalizations immediately following independence (for British and other foreign banks), and then again in 1969 and 1980 (for large Indian-owned banks) had brought all of the country's

large banks into the public sector. Incremental banking reforms begun in the 1990s have enabled private sector banks to have a limited but growing presence. Nonetheless, as of 2007, about 70 per cent of Indian banking assets remained with public sector banks, and financial products, rates, and lending practices remained tightly regulated. Capital markets in both countries also put on weight. Brazil's stock market capitalization grew from only 5 percent of GDP in 1980 to 113 percent in 2009, while India's jumped from 3 to an astonishing 173 percent during the same period. Brazil's corporate debt market, 19 percent of GDP in 2009, outpaces India's, only 4 per cent of GDP. Overall, in the decade of the 2000's total financial assets (bank deposits, insurance assets, stocks and bonds) rose from 164 to 302 percent in Brazil, and from 142 to 334 percent in India. [3] Among the set of large emerging economies, both Brazil and India fall somewhere between the thoroughly privatized and liberalized banking and financial sectors of Mexico or South Korea--and China's state monopoly of banking.

A final structural similarity lay in the size, although not necessarily the composition, of the two countries' links to global financial markets. In 2009, Brazil's total stock of external financial liabilities was 68 percent of GDP--while India's was closely equivalent at 66 percent.[4] Brazil's more liberal inward foreign direct investment regime meant that a larger share of its international liabilities were FDI in plants and equipment, while the Indian authorities had preferred to attract portfolio investments, often in assets marketed to the diaspora community. Both countries also built up their foreign exchange reserves following the emerging markets' crises of the 1990s. By 2007, Brazil's were $180 billion, while India's totaled $276 billion.[5]

In sum, on the eve of the GFC, both countries had liberalized notably, yet retained a vigorous state financial presence. On one scale ranging from 0 to 100 (least to most neoliberal), Brazil received a mean financial policy score of 54.2 and India one of 49.1 in 2007. For

comparison, the U.S.' score was 81.3.[6] Both countries also had relatively recently floated their exchange rates, Brazil in January 1999 and India in the mid-2000s. Their significant structural financial parallels suggest the possibility of similar responses to the GFC.

Deploying the shield: Shared strategies?

In terms of measures used to shield their domestic economies from the spreading international crisis, both governments drew from the same basic policy instruments: fiscal stimulus, traditional monetary policy, capital controls, and the direct use of foreign exchange reserves and public banks.[7]

Both governments reacted to the slowing global economy, whose first transmission channel was through reduced demand for the countries' exports, with *fiscal stimulus* in the form of short term tax cuts and new spending. Among Brazilian finance minister Guido Mantega's major responses was to permit longer repayment terms on automobile loans, thus hugely stimulating car sales. Brazil's federal government also quickly increased infrastructure spending. In March 2008—well before the failure of U.S. investment bank Lehman Brothers in September stimulated the spread of the North American crisis abroad--Indian finance minister Pranab Mukerjee had already announced a $15 billion program of farm loan forgiveness. Though its main cause was to boost the incumbent Congress-Party-led coalition in the coming election, the loan amnesty helped counteract slowing demand. Because both governments possessed fiscal space due to prior macroeconomic reforms, they could mount stimulus packages of comparable sizes: Brazil used about 0.7 per cent of GDP in 2009 and 0.6 per cent in 2010 for crisis-related fiscal support, while India expended 0.7 and 0.4 per cent of GDP in those years.[8] Finally, and

unlike most G7 economies, neither Brazil nor India needed to spend to rescue their banks, which mostly had not invested in the sophisticated securities that generated the crisis.

For both countries, maintaining *autonomous monetary policy*—already problematic in a world of globalized capital markets and floating exchange rates--during the crisis became more difficult. The two big emerging economies were at opposite stages in their own domestic monetary policy cycles when the crisis hit, with Brazilian central bankers trying to loosen and their Indian counterparts to tighten. In the case of Brazil, the government had been attempting to lower the policy interest rate ever since its spike when the exchange rate floated in early 1999. Since then both Brazil's nominal and real interest rates had been among the world's highest, as shown in Figure 1. High rates resulted from Brazil's inflation-targeting regime in the context of often expansionary fiscal policy. Figure 1 shows that Brazil's two periods of rate-hikes during the GFC--necessary to stem panicked investors' "flight to quality" at the darkest periods in the crisis—nonetheless were less than those earlier in the decade, especially the spike in 2002 prior to the presidential elections that brought to power an historic leftist, Luiz Inácio ("Lula") da Silva of the Workers' Party (PT). Brazilian policymakers in 2008 were annoyed that the crisis obliged them to alter their monetary loosening trend. Following the January 2011 inauguration of President Dilma Rouseff, her government began a concerted push to take advantage of low interest rates in major markets in order to bring Brazil's policy rate down (without risking massive capital flight), while also pressuring banks to reduce their deposit-loan spreads.

Meanwhile in India, when Lehman Brothers crashed the RBI had been in a period of tightening. However, as a result of the crash there was a brief but frightening run on ICICI Bank, India's largest private bank and second largest commercial bank overall, as some observers worried that its U.K. subsidiary might have exposure to subprime assets in the U.S.

The fears dissolved only when the Reserve Bank announced its unqualified support for all of ICICI's depositors. Although ICICI eventually righted itself without having to borrow from the central bank, the RBI implemented policy loosening in order to avoid further market turmoil. India's economy remained sufficiently separate from global markets that the government needed to shift two rates, both shown in Figure 2: the CRR for banks and the repo rate for international investors. Following a period of acute fire-fighting, both the BCB and the RBI returned to their previous policy trajectories.

< Figures 1 and 2 about here >

Senior policymakers in both countries also believed that they needed to be able to implement *capital controls* in order for their monetary policy interventions to work. Brazil's most important capital control was a transactions tax, the IOF, on all cross-border operations, which was similar to a domestically-oriented tax, the CPMF, that had been used both to encourage particular investment behaviors and as a revenue measure. Brazilian policymakers treated the capital controls regime as an instrument for frequent fine-tuning—similar to their frequent adjustments to the policy interest rate, the SELIC. Occasionally policymakers became so frustrated with short-term capital inflows pushing up the exchange rate that they raised taxes on capital inflows to prohibitive levels, as when in late 2010 the IOF on Brazilian government bonds briefly reached 98 per cent for foreign portfolio investors holding the bonds only 24 hours. Policymakers' overall goal of incremental liberalization showed in the fact that some additional financial policy measures implemented were simultaneously insulating in the short-term and globalizing over the longer term, as with the decision to let local-currency-denominated Brazilian sovereign bonds directly trade on the London Stock Exchange, which Brazilian policymakers hoped would discourage speculative inflows to Brazil itself.

Brazilian policymakers under the left-leaning Lula da Silva and Rousseff governments also remained committed to certain capital and investment controls that not directly relevant to the management of short-term capital movements, but which had arguably useful effects. For example, foreign banks must constitute themselves as subsidiaries of the parent (a legal form that obliges them to raise much of their initial capital locally), rather than as bank branches. *Financial Times* columnist Gillian Tett concluded that this requirement in fact encouraged foreign banks to identify more with the host rather than home economy during the recent crisis.[9]

India also implemented capital and investment controls, although many market participants found them clumsy. In general, India's capital controls had been categorical or quota-driven, rather than incentive and market-based as in Brazil. The basis for India's system has been the distinction among three types of private investors, each with decreasing privileges: local citizens, the Indian diaspora (known as Non-Resident Indians, or NRIs), and other foreigners.[10] In 2004 the RBI, which also serves as the main financial regulator, had created a five year plan for gradual liberalization as part of India's commitments in the services trade (GATS) negotiations through the WTO. The RBI's principal response to the global financial was simply to postpone previously agreed financial services liberalization plan. This was particularly infuriating for NRI investors (owners of about ¾ the common stock in India's two largest private banks, ICICI and HFDC), who were still smarting from a 2007 incident in which the RBI's deputy governor, alarmed at the speed of financial opening, had suggested that NRIs in the financial sector ought to be considered as ordinary "foreigners," which would have retroactively reduced some of the privileges associated with their intermediate status.[11]

Our fourth category of defensive statecraft includes a variety of *state-controlled financial resources* that executive branch policymakers can grab and redeploy in a crisis. In the view of

many senior economic policymakers in emerging economies, this is a capability that major powers routinely have enjoyed, but which the IMF and other "Washington Consensus" reformers would deny peripheral countries on the grounds that it is incompatible with free market precepts.[12] When the crisis hit in mid-2008, both Brazil's and India's governments had two types of state-controlled financial resources potentially at their disposal: large foreign exchange reserves and the assets and institutional capabilities of public sector banks. The BCB employed its ample foreign exchange reserves to assume the foreign currency component of debts of Brazilian firms and banks abroad whose falling exports had suddenly rendered these loans hard to service, while the finance ministry turned to the public banks to implement emergency support and expansionary policies. The BNDES, an industrial development bank hitherto specialized in long-term support for Brazilian firms, began offering trade credit and working capital to Brazilian transnational firms operating abroad whose normal (foreign) sources of financing had dried up due to the global crisis. The bulk of Brazil's domestic fiscal stimulus was channeled through the BNDES, which received $58 billion in direct transfers from the Treasury in 2008-9, which the BNDES channeled to larger business borrowers, while on-loaning about a third to Brazilian banks to serve smaller firms.[13] In India, the RBI spent nearly $63 billion of its foreign reserves to stabilize the value of the rupee and help Indian corporations keep current on their foreign debt payments. Despite inflation worries, the RBI also moved counter-cyclically by reducing banks' reserve requirements and their short-term lending rate.[14]

In sum, policymakers in both countries responded to the threat of financial contagion by employing a full panoply of policy instruments, both those prescribed by the neoliberal canon, such as shifts in the country's policy interest rate, and less traditional ones, such as transferring a large sum of money directly from the national treasury to a big public bank and ordering it to

lend it out, competently but posthaste (as in Brazil), or having the state temporarily assume responsibility for the foreign currency obligations of its private firms, suddenly cut off from their accustomed access to working capital lines in global markets (as in both Brazil and India). Of course, had the underlying macroeconomic foundation not been essentially sound, neither the orthodox nor the heterodox policy interventions would have worked.

External financial swashbuckling: Brazilian bravado, Indian circumspection

Yet on the dimension of "offensive" financial statecraft, or the national government's use of the country's financial capabilities to influence a range of international outcomes, the choices made by recent Brazilian and Indian leaders have diverged somewhat more.

Officials in both countries have tapped the nation's financial capabilities to support home country firms abroad. As of mid-2009, Brazil's public sector development bank BNDES had a portfolio of $15.6 billion in credits to support exports of both goods and services such as heavy construction and engineering throughout South America.[15] India's external financial strategy centers on increasing global financial service exports. Extensive diasporic networks, expertise in business-process outsourcing, and the experience gained from its relatively sophisticated equity market infrastructure have enabled India to become the sixth largest exporter of financial services in the world, albeit with only a little more than 2 per cent of all global exports in financial services.[16] India's government has articulated plans to expand its share of financial service exports and become a major international player in this sector.[17]

Possession of non-trivial national financial capabilities has led to coveted international political recognition for both countries, first and most notably through the financial G20. The U.S. initially had organized the financial Group of Twenty (G20) large economies in 1999 as the

Asian financial crisis (AFC) was winding down, for the first time inviting large or strategic emerging economies such as China, Brazil, India, Turkey, Mexico, Indonesia, Argentina and Saudi Arabia to join the G7/G8 powers in deliberations on global financial reform. However, the main technical committees tasked with suggesting post-AFC bank regulatory reforms were associated not with the financial G20 but instead with the Financial Stability Forum (FSF) housed at the Bank for International Settlements (BIS) in Basle, whose only "developing country" members were Singapore and Hong Kong. However, in late 2008 U.S. President George W. Bush's economic advisors concluded that the resources of the traditional post-war powers would be insufficient to carry off a coordinated stimulus sufficient to halt the financial panic, which was spreading globally. Bush therefore urged Brazilian President Lula da Silva, then the organization's rotating chairship, to convene the first ever G20 heads of state Summit in Washington, D.C. Shortly thereafter all the G20 countries were invited into the FSF (renamed the Financial Stability Board) and the BIS.

Meanwhile, since 2006 Russia had been promoting meetings of informal meetings of diplomats from the four countries selected in 2001 by Goldman Sachs' Jim O'Neill as large emerging markets for investors to watch: the BRICs (Brazil, Russia, India and China). Russia hosted the first BRICs leaders' summit in April 2009, where the four agreed to jointly pressure the dominant industrial economies for greater voting shares in the International Monetary Fund; upward adjustments for China, India and Brazil followed later that year. Although Russia's Fund quota had already slightly exceeded its proportion of the global economy, it proved willing to support the others in this goal. The BRICs group—since 2011 BRICS, with the addition of South Africa—has had too many differences of domestic political regimes and geostrategic goals to enable them to forge common positions on most political issues. But they are united in the broad

strategic goal of desiring a more multipolar world less dominated by the United States and Western Europe, and on the related more specific aim of reducing the dominance of the U.S. dollar and North Atlantic states in global financial markets and governance.

Under the center-right administrations of President Fernando Henrique Cardoso (1995-8, 1999-2002), Brazil had actively engaged with most of the world, traveling frequently to Europe and the U.S., as well as around Latin America and Lusophone Africa. Cardoso strengthened MERCOSUR (the Common Market of the South, including Argentina, Uruguay and Paraguay) and subsequently promoted a regional political cooperation process for all of South America, formalized in 2006 as UNASUR (Union of South American Nations). Under the center-left administrations of his successor, President Luíz Inácio (Lula) da Silva, Brazilian leaders sharpened their focus on forming "South-South" alliances with other developing countries, including its South American neighbors, East Asia, Africa and the Middle East. Under Lula, Brazil provided both rhetorical and modest monetary support for Venezuela's proposal to create a multilateral *Banco del Sur* as an alternative to the IMF for South American countries.

During the GFC, President Lula and senior policymakers became quite bold in some of their public pronouncements, in some cases embarrassing more traditional Brazilian diplomats and politicians. Thus in July 2008 President Lula da Silva bragged that the "financial tsunami" that had hit the United States and other developed nations was only a "marelinha" (small wave too small to surf on) in Brazil. In mid-March 2009 Finance Minister Mantega boldly promoted Brazilian public debt securities as a "safe alternative" to U.S. Treasury bonds. Later that month, during a state visit to Brazil by the ardent multilateralist, British Prime Minister Gordon Brown, President Lula publicly blamed the financial crisis that had punished "black and brown people" on "white people with blue eyes who before the crisis appeared to know everything and now

demonstrate that they know nothing."[18] After the IMF announced in April 2009 that it would issue its first international bond offering, the Chinese, Brazilians and Indians all pointedly subscribed for large amounts: $30 billion, $10 billion and $10 billion, respectively, allowing President Lula numerous opportunities at home to point out proudly that Brazil had, under his watch, been transformed from an international debtor to a creditor. In June 2009, Foreign Minister Celso Amorím imprudently declared to the press that the G8 was "dead," leading to a subsequent rebuke by Brazil's partner in the BRICs club, Russia—also a G8 member. A bold Turkish-Brazilian effort in May 2010 to broker a deal between Iran and Western critics of its nuclear program provoked a reportedly furious U.S. Secretary of State Hillary Clinton to note the U.S.'s "serious disagreements" with Brazil over these efforts.[19]

In September 2010, Mantega was the first senior policymaker to publicly name the rising tension over global imbalances—either caused by or reflected in "weak" and "strong" currencies—as a "currency war." On the strength of Brazil's vocal criticism of countries that manipulated their exchange rates to generate a trade advantage, U.S. Treasury Secretary Timothy Geithner journeyed to Brazil in hopes of securing a joint U.S.-Brazil statement criticizing countries that intervened to keep their currencies undervalued. But joint statements with the U.S. criticizing China didn't fit with official Brazil's new self-image, so Mantega instead let it be known that, in Brazil's view, the U.S. was equally guilty of contributing to global imbalances by loose monetary policy, which generated low interest rates and put pressure on countries like Brazil fighting excessive capital inflows. Later Mantega went further, declining to criticise BRIC partner China at all, while complaining persistently about the U.S. as a source of global imbalances. This stance was somewhat disingenuous, since a coordinated stimulus sufficient to rescue the global economy surely required a major effort by the U.S.

In contrast to the bold statements and independent positions that its leaders had taken during the 1970s heyday of the Non-Aligned Movement, Indian leaders have been much more circumspect in the recent era of India's economic ascendance. Indian political leaders and senior economic policymakers have participated enthusiastically in global economic fora, from the G20 and BRICs groupings, to high profile transnational gatherings such as the World Economic Forum at Davos. But their public pronouncements have been more modest than Brazil's. In fact, Indian business leaders, rather than politicians or senior economic policymakers, have been the main source of self-confident statements about India's role in the 21st century world. Thus in 2008 Lakshmi Mittal, CEO of Arcelor Mittal, wrote in the *Economist* that the global economy was at the point of a major power shift toward emerging economies, noting that "[t]he developed world should be thankful for this trend. As consumers in the advanced economies retrench from unsustainable levels—American consumer spending alone accounts for 21per cent of global GDP—shoppers in the BRICs will take up the slack."[20]

Indian politicians have not entirely refrained from international pontificating. In the context of U.S.-China trade disputes that clouded the September 2009 meeting of the G20 in Pittsburgh, Prime Minister Manmohan Singh lectured India's G20 partners on the evils of protectionism. In April 2010 finance minister Pranab Mukherjee flatly rejected Prime Minister Gordon Brown's proposal for a tax on all financial transactions worldwide (a version of the "Tobin tax") at the G20 meeting. Brown's idea had been to use the monies raised to "reform the global financial system," which many of those present understood as code for providing additional resources for compensating Western European governments for the money they had spent and would spend on rescuing their troubled banks. Mukherjee made clear that any extra taxes on Indian banks would not be used to rescue wealthy Europeans, but would need to go

towards extending basic financial services to the millions of unbanked poor in India. In November 2011, India joined China in a formal statement critical of the advanced economies for their sins of macroeconomic mismanagement.

Nonetheless, as compared to Brazilian leaders during these same years, Indian politicians have been less assertive in demanding changes to the institutions of international finance and more willing to settle for marginal changes within the *status quo*. Thus at the Cannes G20 meeting in November 2011, Prime Minister Manmohan Singh applauded the signing of the Convention of Mutual Assistance in Tax Matters and declared, “The era of bank secrecy is over.”[21] India also has been an enthusiastic participant in various incremental financial projects advanced at meetings of the BRICS. One such was the late 2011 announcement that the five countries would begin listing stock index futures and other basic derivatives on one another’s stock exchanges. As a country in great need of investment in infrastructural projects, India formally proposed that the BRICS establish a development bank in February 2012. Unfortunately, a conflict quickly broke out over India’s preference for a rotating chairmanship versus China’s insistence that, as the likely major source of funds, its nationals should permanently head such an institution. In the New Delhi BRICS meeting at the end of March 2012, India’s concerns about the “BRICS bank” delayed the advance of the project, and Manmohan Singh, prime minister of the largest recipient of World Bank assistance, expressed a preference to reform the World Bank rather than create a new institution.[22] At recent G20 meetings, India has again given high priority to its initiative to encourage countries to share tax information in an effort to curb tax evasion and the funding of terrorism.

One sees, thus, a not so subtle contrast between Brazil and India in the degree to which each has sought to employ its newfound international financial prominence to promote itself as a

global player assertively transforming global finance, with Brazil more obviously enthusiastic about playing such a role. Nonetheless, the members of the BRICS share a common goal of "international financial reform," the core definition of which is greater influence for themselves in multilateral financial governance. Thus the BRICS have sometimes been an effective lobby within the G20. In 2009 they made it clear that they would not agree to raising additional resources for the IMF to use in responding to the global financial crisis until the other members of the G20 acceded to their request for greater developing country representation in the Fund. In early 2012, once again, Fund Managing Director Christine Lagarde requested an increase of $600 billion, many for Western Europe. The BRICS made their assent conditional on a further increment to their voting power within the Fund—which has been promised, although not yet implemented. At each of their biannual meetings the BRICs have signaled their disapproval of the global dominance of the U.S. dollar. In March 2012 the five formally pledged to move, albeit incrementally, from dollar to local currency invoicing for bilateral trade and investment. China, with its $3.2 trillion in foreign reserves, has more financial capabilities than its BRICS partners. Both Brazil and India worry over their structural trade deficits with China, which in 2009 displaced the U.S. as the principal trading partner of both countries. Sometimes, as in the case of the BRICS development bank, China's superior economic power impedes their cooperation.

Accounting for similarity and divergence in financial statecraft

Our investigation has found both similar and divergent financial statecraft in our two cases. Both countries used most of the same tools of *defensive financial statecraft*. The major difference was that the underlying financial policy framework in Brazil was more liberalized, both at the time the crisis hit and after the coping measures taken by each government. The

medium term trend in both countries is toward greater financial policy liberalization—but only up to a certain limit. Neither in Brazil nor in India are policymakers inclined to yield the tools giving them potential defensive financial statecraft capabilities for the future, as incumbent leaders in both countries believe certain kinds of state intervention were critical to their countries' relatively easy time during this period of global turmoil. With respect to *offensive financial statecraft* the differences between Brazil and India are somewhat larger. While both have been happy to employ their greater global prominence to lobby for enhanced participation in multilateral economic governance, Brazil has been more willing to publicly criticize U.S. global financial leadership. Plausible reasons for Brazil's more assertive financial statecraft and India's relatively more cautious approach since 2007 are rooted in their different political economies. We begin with economic differences, and then move to political factors.

Despite the parallels deriving from Brazil and India's status as large emerging markets that liberalized their financial sectors after years of state-led development and financial repression, Brazil is less vulnerable than India to disruption caused by international economic markets. The variation plausibly spawns differences in their strategies of economic statecraft.

Brazil is a more developed emerging market. India has grown faster than Brazil since 1990, with India's per capita income increasing 4.2 times to 2011, compared to Brazil's 2.3 times in the same period. Nonetheless, in 2011 Brazil's per capita income of $11,500 (in terms of purchasing power parity) was more than three times greater than India's per capita income of $3620, Moreover, we may take the share of each country's population with daily incomes less than $1.25 as an indication of the proportion of a country's population that lacks the financial resources to participate in growth, and that also has been excluded from most of the benefits of growth. In 2009, only 6 per cent of Brazil's population lay below this poverty line, as compared

to a third of all Indians.[23] One consequence of limited effective demand in India's internal market is that in recent years foreign trade has been a relatively more important driver of economic growth. In 2011, Brazilian trade in goods and services amounted to only 25 per cent of GDP. In India, trade's share of GDP was 54 per cent. This divergence in the share of trade in the economy is quite recent, reflecting India's slow but steady trade liberalization since 1991. According to the Heritage Foundation's index of "trade freedom," which measures policy indicators on a scale of 0 to 100 (low to high), India increased its trade openness from less than 20 in 2000 to 51 in 2009, a period during which Brazil moved from 51 to 72.[24] That is, Brazil's trade regime was and remains more liberal, but India has opened more rapidly, generating rapid growth but also greater vulnerability to trade disruption and price volatility.

As Figure 3 demonstrates, Brazil's merchandise trade usually is either balanced or in surplus, and the country has benefitted from the commodity boom since the early 2000s. India suffers from a structural deficit in merchandise trade that has grown substantially since 2001. A key factor in India's structural deficit is that it imports three-fourths of its crude oil needs, while fuel accounts for about 36 per cent of Indian merchandise imports. In contrast, the 17 per cent of Brazil's imports that are fuel are roughly balanced by energy exports. Though India's merchandise trade deficit is almost always reduced by its surplus in invisibles, including remittances,[25] its current account usually remains in deficit. India's deficits since 2003 have been substantially larger than Brazil's, as shown in Figure 4.

< Figures 3 and 4 about here>

As discussed above, the two countries have accumulated similarly-sized stocks of financial inflows. Nonetheless, Indian policymakers have felt more anxious about capital account volatility than have Brazilian policymakers. Policymakers in Brazil may be counting on their

home financial markets being more developed, in the belief that greater domestic financial depth and breadth enables countries to better cope with the economic volatility that accompanies integration with global financial markets.[26] India's equity market is at least as sophisticated as Brazil's, but Brazil's debt, commodities and derivatives markets are more advanced, Brazilian banks operate in a more competitive and generally better regulated market, and as we saw above, Brazil's capital controls regime has been more flexible. One recent study suggests that greater integration with global financial markets reduces economic volatility--but only when countries have flexible exchange rates, which Brazil has had since 1999, while India has tentatively floated the rupee only since 2007.[27] Overall, Brazilian policymakers can be more confident of their economic position vis-à-vis global markets—which likely gives them confidence to speak out.

Important variations in the political circumstances of Brazil in India also contribute to the different approaches to financial statecraft that the countries have followed. The differences occur at both the international and domestic levels.

The countries' *different geopolitical positions* are an important factor. Both countries are regionally dominant states. Brazil, as illustrated by its leadership in the MERCOSUR and UNASUR processes, is capable of helping to coordinate collective action among the countries of the region.[28] Enhanced regional political cooperation since the early 1990s has enabled both Brazilian state financial officials and private sector financial actors to pursue a regional and South-South strategy of international financial expansion.[29] Brazil's largest commercial banks, as well as its securities exchange, BM&FBovespa, in the top five worldwide by market capitalization, plausibly intend to become the continent's dominant foreign financial players.

In contrast, India is bordered by Pakistan, its arch enemy; by China, the global power and Asian rival with which it has festering disputes along its 2000 mile border; and by smaller

countries that bear long-standing historical resentments against their behemoth neighbor. Although in recent years India has taken measures to improve its relations with its neighbors, it still glaringly lacks the capacity to lead coordinated action in the region, as is highlighted by the difficulties in initiating cooperative endeavors through the South Asian Association for Regional Cooperation. The enmity that has historically characterized India's relations with its neighbors has until now closed the door on a possible strategy to expand into regional financial markets.

Differences in Brazil and India's *relations with the United States* also affect their respective strategies for international financial statecraft. Brazilian leaders today believe that the U.S. needs Brazil's help in Latin America more than the reverse. Brazil, even before the discovery of vast oil deposits along its southeastern coast, is energy independent, and its long relationship with the U.S. gives it room to challenge the hemispheric (and global) hegemon while still remaining a close and inevitable ally. In contrast, India feels less able to take its recently closer relations with the U.S. for granted. It was partly due to India's energy needs and partly because of a desire to balance China with the United States that Indian Prime Minister Manmohan Singh signed the 2008 Civilian Nuclear Agreement with the United States. These new and relatively fragile links diminish any impulse for assertive financial statecraft.

Domestic regulatory politics also facilitate more assertive statecraft in Brazil than in India. Brazil has arrived at a rough domestic consensus on pursuing measured financial liberalization and regional financial expansion, a strategic mix that suits both national foreign policy goals and the interests of large Brazilian banks, both private and public, as well as the major actors in Brazil's active capital markets. The privatization (and internationalization) of Brazil's banking sector has been largely completed, and there is little domestic opposition to the state's role in supporting Brazilian banks' regional expansion. In India, though few involved in

financial sector policymaking oppose liberalization, there is considerable controversy over the pace of reforms. The dispute complicates India's financial statecraft.

Relentless liberalizers with an institutional base in the finance ministry push for privatizing India's public sector banks, limiting the RBI's role to inflation targeting, enabling a larger role for foreign financial institutions in Indian markets and the formation of closer links between foreign and Indian firms. Meanwhile calibrating conservatives, often associated with the RBI, defend the role of public sector banks, praise the RBI's regulatory role as essential to preserving financial stability, and are cautious about opening Indian markets to foreign firms. The liberalizers' approach is to accept global financial norms and link India with foreign firms and global markets in a way that limits the use of the "sword" of external financial statecraft to advancing India's interests within the system. The financial conservatives, especially the dwindling few who defend Indian institutions prior to the 1990s reforms, are more inclined to use the shield of financial statecraft to protect India's financial institutions from further change. Even though the conservatives' strength is in decline, the controversy that they have created has increased India's use of the shield and made its use of the sword less decisive.

Finally, the circumstances of *domestic partisan competition* also help to explain the divergence in Brazil and India's financial statecraft. While each country has a highly fragmented party system, the domestic ideological placement of each ruling coalition differs. In Brazil, the Workers' Party ascended to power from the left of the political spectrum when Lula da Silva won the office of the President in 2002. In India, partisan competition since the 1990s has seen the rise of two centrist coalitions – the United Progressive Alliance led by the Congress Party and the National Democratic Alliance led by the Bharatiya Janata Party.

The Workers' Party (PT) has ruled Brazil since January 2003. From 1989, when Lula lost presidential elections to Fernando Collor, to late 2002 when he defeated Jose Serra, the PT leadership underwent a significant transformation from an ideologically committed programmatic party to a more centrist catch-all party. The change was in part a pragmatic response to pressures stemming from the international political economy that made certain pro-market policy positions essential for electoral and governing success for Lula, but also reflected incentives created by political competition in the context of Brazil's democratic political institutions.[30] Under the leadership of President Fernando Henrique Cardoso (1995-2002), the modest rightward shift of the Brazilian Social Democratic Party (PSDB) from its center-left origins facilitated the Workers' Party transition to that center-left ideological space. The lack of a serious electoral rival on its left also reduced the costs of the centrist drift of the Workers' Party. Nonetheless, there remains considerable internal opposition to the change from key constituencies within the party, especially from members of white collar unions in the public sector. Some groups have broken their alliances with the PT, including the Landless Movement (*Moviemento dos sem Terra*) and Brazil's Green Party.[31] Neither Lula nor his PT successor, Dilma Rousseff, who assumed the presidency in January 2011, has made many concessions to the left in domestic economic policy, but a modestly confrontational international rhetoric is popular with many PT voters—as well as with many nationalist Brazilians spanning the political spectrum. Were the PSDB-led coalition to return to power, our expectation would be for modest softening in the rhetoric of Brazil's externally-oriented financial statecraft, but little alteration in its substance, which reflects broadly-held views that Brazil should participate more actively in global governance. Underlying Brazil's self-confidence is the perception that, both within the

Western Hemisphere and internationally, the U.S. needs Brazilian diplomatic cooperation as much or more as Brazil needs that of the U.S.

In contrast, India's domestic party politics has driven its external financial statecraft in a more moderate direction. Despite the Congress Party's historic identification with non-alignment, ever since the end of the Cold War it had been reorienting its foreign policy to be closer to the United States.[32] After the Congress-led United Progressive Alliance (UPA) came to power in 2004, further movement toward the United States was restricted by the reliance of the UPA coalition on outside support from India's Communist Party of India-Marxist, CPI(M). However, in 2008, in response to Prime Minister Manmohan Singh's resolute commitment to the Civilian Nuclear Agreement with the United States, the CPI(M) withdrew its support from the government. When the UPA cobbled together enough support to win a vote of no-confidence and later gained victory in the 2009 general elections, it freed itself to promote more friendly relations with the US. Though there has been disappointment on both sides that the momentum achieved during the Bush years has not been sustained, during the 2010 summit with US President Barak Obama, Prime Minister Manmohan Singh declared, "I attach great importance to strengthening in every possible way India's cooperation with the United States. This is truly a relationship which can become a defining relationship for this 21st blessed century of ours."[33] Singh's statement underscores the willingness of the Congress Party leadership to stake out a pro-American position despite continuing powerful currents of anti-Americanism in India's domestic politics. Its commitment to building a positive relationship with the United States contributes to its reluctance to engage in financial statecraft openly challenging the U.S.

While the BJP's Hindu nationalism could lead it towards a more muscular foreign policy, as it did when India conducted nuclear tests in 1998, there are good reasons to suppose that the

BJP-led National Democratic Alliance, were it to lead India again, also would hesitate to challenge the U.S., even rhetorically, in its externally-oriented financial statecraft. First, the BJP's more explicitly critical stance toward China would hinder efforts to cooperate with this leading Asian power. For instance, when BJP Prime Minister Atal Behari Vajpayee sent a letter to President Clinton explaining India's nuclear test he invoked a nuclear China as India's main security theat. Second, the BJP does not carry the baggage of non-alignment. On the contrary, the BJP-led coalition historically has differentiated itself from the Congress Party's foreign policy by being explicitly pro-American. Ties with Americans improved during the 1977-9 tenure of the Janata Party government in which the BJP was an important constituent and also during the rule of the BJP-led National Democratic Alliance (NDA) from 1998-2004. The BJP's close ties to wealthy non-resident Indians (NRIs) in the United States also help to ensure a moderate financial statecraft, because the Hindu nationalists would be loath to alienate these American citizens who are both major contributors to Hindu nationalist organizations and sizable investors in India. Finally, when in power 1998-2004 the NDA implemented a number of reforms, such as the Insurance Regulatory and Development Act and more liberal ceilings on FDI, that integrated the Indian economy with investors from the industrial core economies.

Conclusions: Strengths, vulnerabilities and cautions going forward

As countries become progressively more integrated into global financial markets, they are increasingly likely to use the tools of financial statecraft. But when are countries likely to use the shield in a defensive mode and when are they likely to wield the sword to assertively advance their interests? The scope of this study, covering two emerging economies with a number of structural and economic similarities at the time of a commodity boom, affords only speculative,

preliminary observations. Nonetheless, we offer some suggestive hypotheses with the intention of provoking future research. We began with the relatively common sense observation that countries whose economies are more vulnerable to disruption by volatile global financial flows are more likely to be cautious in wielding the sword of financial statecraft. In our study, India with its chronic trade deficit and recent large current account deficits was more circumspect in its public pronouncements while Brazil, enjoying a trade surplus and manageable current account deficits during the period, took public positions more critical of the global financial powers.

One of our more interesting findings is that regional geopolitics influences the selection of strategies for financial development. Brazil has over the years developed cooperative relations with its neighbors, particularly since widespread democratization in Latin America in the 1980s. This facilitates its regional strategy for financial development, and inclines it more towards a South-South strategy of financial expansion. India's relations with its neighbors, on the other hand, are characterized by resentment, and in the case of Pakistan, intense enmity. India's problematic regional relations, in addition to the general low level of economic development in South Asia, make a regional strategy less viable. At the same time, its connections through diasporic networks and business processing outsourcing direct it towards a strategy of financial service exports in advanced industrial countries. Pursuit of this strategy, we contend, makes India more circumspect in its criticisms of global financial powers.

Finally, we have noted that the circumstances characterizing domestic partisan competition have contributed to the differences in Brazil and India's financial statecraft. Brazil's Worker's Party ascended to power from the left. As it pragmatically moderated its economic policy, its modestly confrontational international rhetoric helped to placate leftist critics within the PT and social movements outside. Partisan competition in India is characterized by two

centrist coalitions – the Congress-led United Progressive Alliance on the center-left and the Bharatiya Janata Party on the center-right. Since 2008, each of these leading parties has taken pro-American positions in defiance of India's left. This position, in combination with India's strategy for financial sector development, has made India less inclined to utilise confrontational rhetoric as part of its financial statecraft.

Brazil and India's choices of financial statecraft strategies have broader consequences for global financial governance. As these large countries have become more affluent, their actions, along with those of other emerging economies, become more consequential for the future of global financial markets. Three challenges confront Brazil and India if they are to succeed in creating global financial institutions and policies that support their long-term developmental goals. First, can they overcome their differences and work together to achieve their joint objectives? Their inability to resolve their disagreements during the Doha round of negotiations at the World Trade Organization—or even to unite around a common "Southern" candidate for the heads of the IMF or World Bank in 2011 and 2012--highlights the formidable challenges that they face. Second, will they overreach in their demands for reform? Brazil has shown periodic bravado that exceeds its ability to deliver outcomes on the international level. India has been more circumspect as its vulnerabilities, including rivalry with China, limit its ability to achieve its objectives. Finally, while Brazil and India have achieved remarkable economic success in the last twenty years, exercising influence at the global level requires reaching agreements with the still powerful countries of Europe and the United States. If their ascendance leads to refusal to compromise with Europe and the United States, Brazil and India's overreach may lead to a stalemate that would prevent international negotiations from achieving needed reforms.

We end our analysis on a somewhat ambivalent note. It would be comforting to conclude that, if countries like Brazil and India play their cards right, they could negotiate reforms that produce global financial markets that are potentially somewhat more efficient and equitable for all. But also plausible is the more pessimistic assessment that the governments of Brazil and India, along with those of their fellow BRICS countries, are playing with fire in their attempts to dethrone the central, nay the hegemonic, role played by the U.S. currency, U.S. financial markets, and more or less collaborative financial governance by the advanced economies since the mid-20th century. It is safe to say that neither Brazil nor India—nor of course the larger international political economy--would be well-served by heightened international financial turmoil. Our net hope, therefore, is for continued incremental change.

Figure 1: SELIC rates

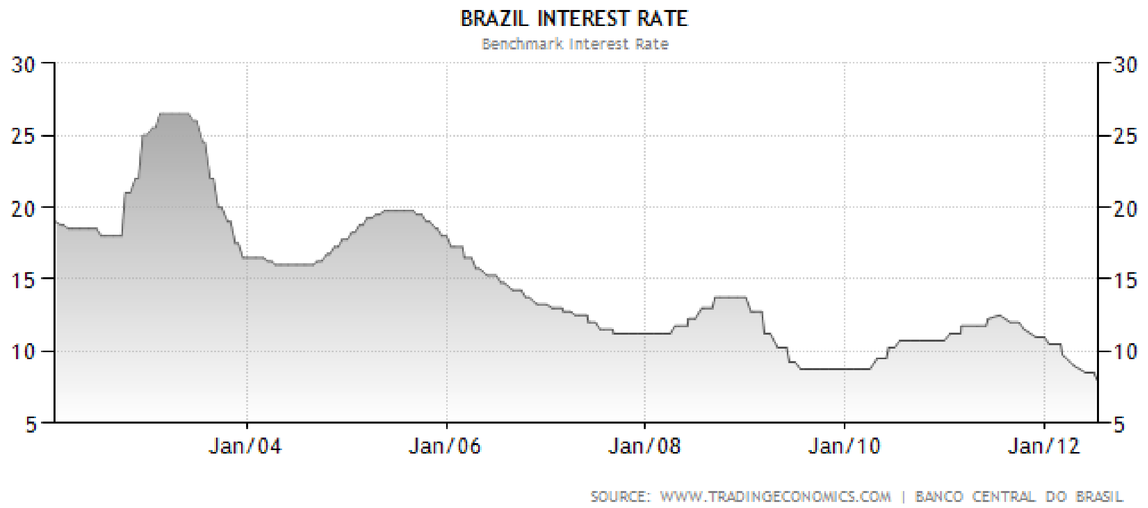
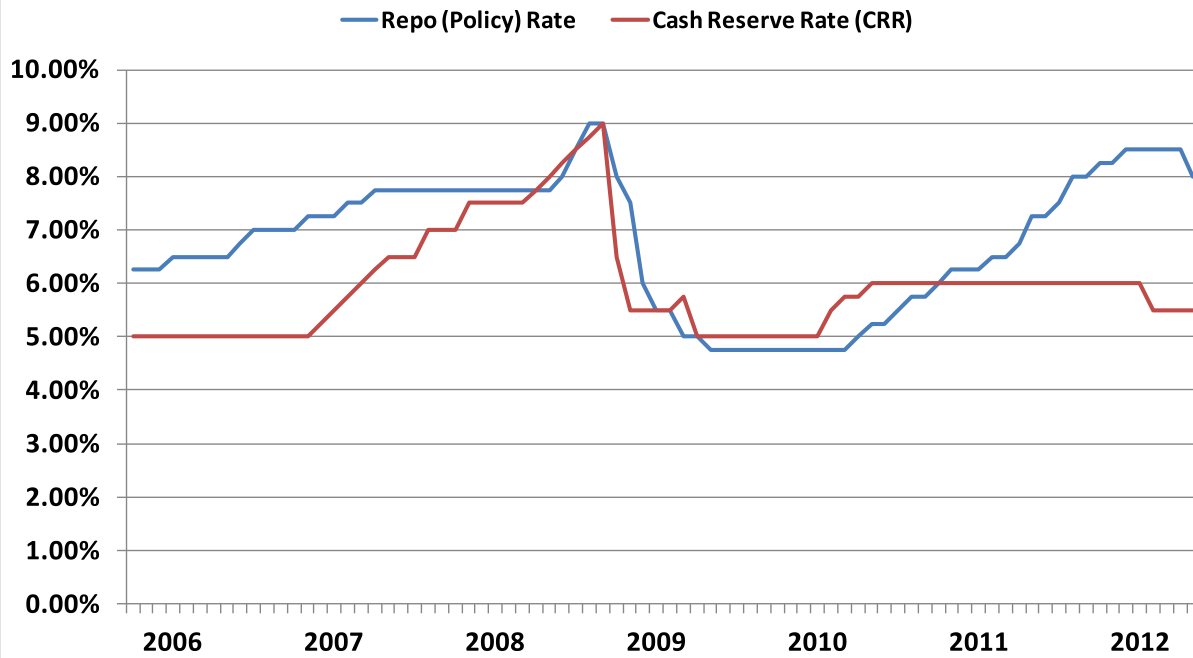


Figure 2: India's Repo and Cash Reserve Ratio Rates, October 2005-May 2012



Source: <http://www.allbankingsolutions.com/Banking-Tutor/Chronology-Repo-Rate-India.shtml> accessed on August 19, 2012.

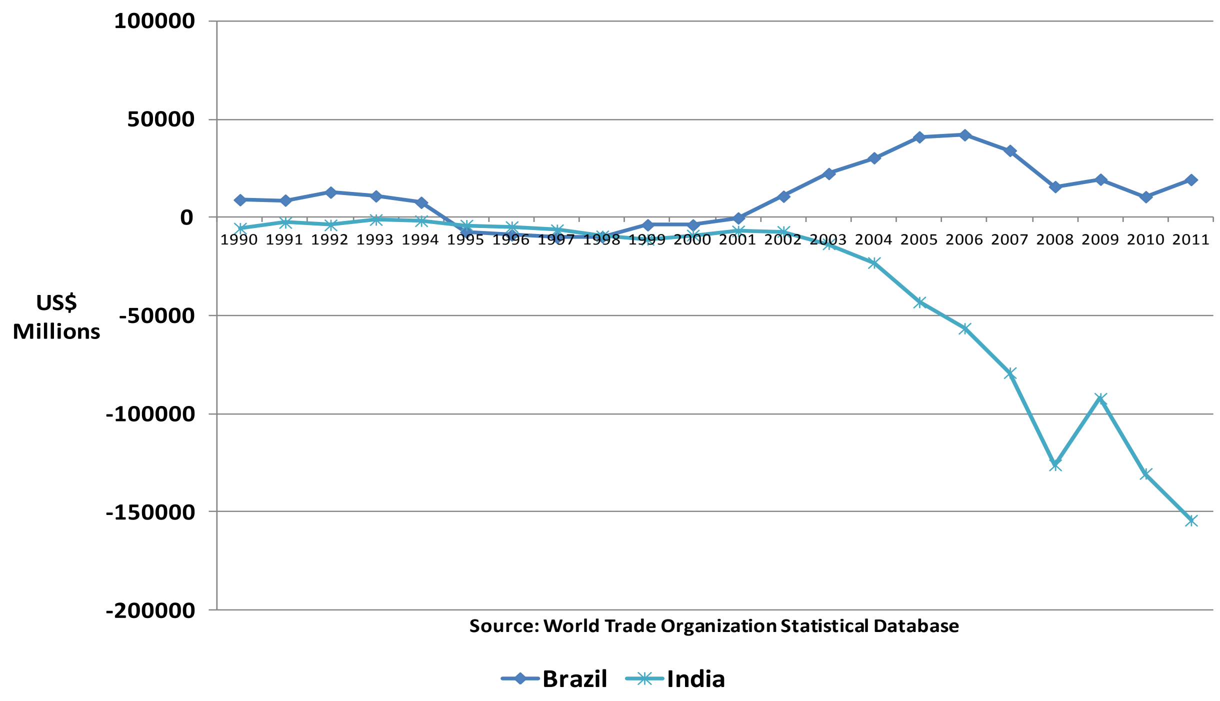


Figure 3: Brazil and India Merchandise Trade Balance, 1990-2011 (US$ Millions)
100000
50000
0
-50000
-100000
-150000
-200000
US$ Millions
1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011
Source: World Trade Organization Statistical Database
Brazil
India

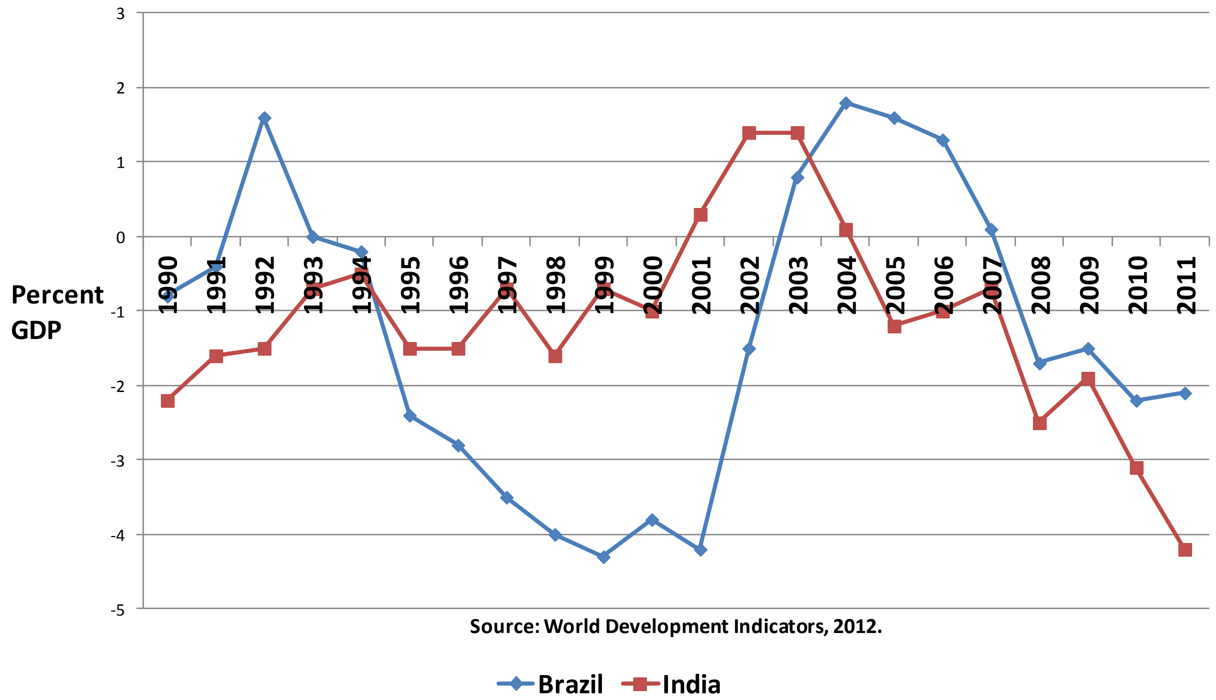


Figure 4: Brazil and India's Current Account Balances as Percent of GDP, 1990-2011
3
2
1
0
-1
-2
-3
-4
-5
Percent GDP
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
Source: World Development Indicators, 2012.
Brazil
India

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[6] Financial policy liberalization calculated as the mean for the scores for monetary, investor, and financial freedom from the Heritage Foundation's *Index of Economic Freedom 2012.* www.heritage.org/index/ That same year, relatively illiberal China received a score of 45.2, and South Korea and Mexico, among the most open of emerging economies, ones of 66.3 and 62.3 respectively.

[7] Detailed information in this and subsequent sections has been derived from the authors' close reading of the financial press, supplemented by interviews in both countries. We take responsibility for errors that remain.

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