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**Article**

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# Brazil, Russia, India, China and South Africa: Strong Economic Growth – Major Challenges

by Mechthild Schrooten

Brazil, Russia, India, China and South Africa – the so-called BRICS countries – all show high economic growth rates. They suffered only shortly under the turbulences of the international financial crisis in 2008/2009 and were able to recover quickly – in contrast to most industrialized nations. In recent times of economic fragility in industrialized countries, the BRICS are playing a decisive role for global economic stabilization.

The BRICS countries opt for different catching-up strategies. Although they have experienced remarkable growth rates over the past years, similar income levels like in the most important industrialized countries are still beyond reach in the medium term. Additionally, BRICS states still show considerable deficits in terms of access to education and regarding their health systems. Such infrastructural problems, however, can be important obstacles for future development.

The group of so-called BRICS countries comprises Brazil, Russia, India, China, and South Africa.<sup>1</sup> These states possess quite different economies regarding their history, resources and global economic strategies. However, they have one thing in common: relatively high global economic growth rates and high growth potential in international comparison. In total, over three billion people live in the BRICS countries. With 1.4 billion inhabitants, China is the biggest country, followed by India with 1.1 billion. Brazil has nearly 200 million inhabitants, Russia about 120 million. The smallest country with 53 million inhabitants is South Africa. In comparison: The European Union is home to 502 million people. Within the EU, South Africa would be the fifth biggest country before Spain. On the whole, 40 percent of the world population live in BRICS states. Against this backdrop, these countries are not only important resource suppliers for industrialized states, but also significant sales markets and important economic actors.

## Growing Global Economic Importance

The BRICS countries' share in global economic performance is still significantly lower than their share in world population, despite considerable growth over the past years. Their contribution to global production has increased from 15 percent in 1995 to nearly 25 percent in 2010 (Figure 1).<sup>2</sup> Global economic dynamics of the BRICS countries have been strong for years; this holds especially true in comparison to industrialized countries. The catching-up process has already resulted in a tangibly increased significance of these countries on the global scene. Similarly, the percentage of important industrialized countries in international production is decreasing (Figure 2). The comparative value for the USA

<sup>1</sup> The acronym BRICS was coined by the investment group Goldman Sachs, which saw over-proportional potential for development in these countries.

<sup>2</sup> Data in purchasing power parity. Data source: International Monetary Fund (2011): World Economic Outlook Database, April 2011.

has gone down from 23 percent in 1995 to 20 percent in 2010.<sup>3</sup> Over the same period, Japan's share in global production went down from nine to six percent.<sup>4</sup> Also for Germany we detect a decline from six to four percent in global production.

### Stabilizing Effects during the Financial and Economic Crisis

If we look at BRICS states as a group, we see globally stabilizing impulses during the financial and economic crisis of 2008/2009.<sup>5</sup> Especially in the cases of the extremely dynamic economies of India and China the crisis did not really slow down their economic catching-up process (Figure 3). India's overall economic growth was even slightly higher in 2009 than in the year before: officially 6.8 percent compared to 6.1 percent. According to official statements, China experienced only a minimal decline in its GDP growth rate in the years of crisis. Brazil briefly suffered a growth cut, but quickly reverted to its dynamic growth path. Considering growth dynamics, South Africa has come in last for years in the group of BRICS countries. Its GDP went down by almost two percent following the economic and financial crisis, but was above the pre-crisis level already in 2010. Russia, by contrast, experienced a strong slump in 2009. By now, its economy seems to be on the mend.

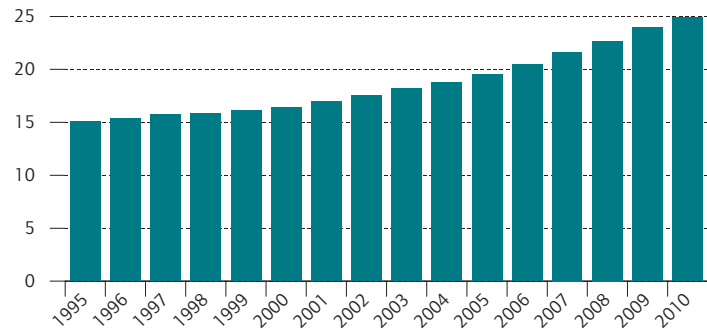
### Different Growth Strategies of BRICS Countries

Regarding their economic policy, the BRICS countries prefer different growth strategies. This is mirrored in their respective current account.<sup>6</sup> China and Russia have been experiencing a current account surplus for years. Especially in China, the export economy is the main driving force for its overall economic dynamic. In contrast, domestic consumption is still at a low level. The resulting high savings ratio makes the country an important net creditor on the international capital market. In Rus-

Figure 1

#### BRICS Countries' Share in Global Production

In percent



Source: International Monetary Fund (2011): World Economic Outlook Database, April 2011.

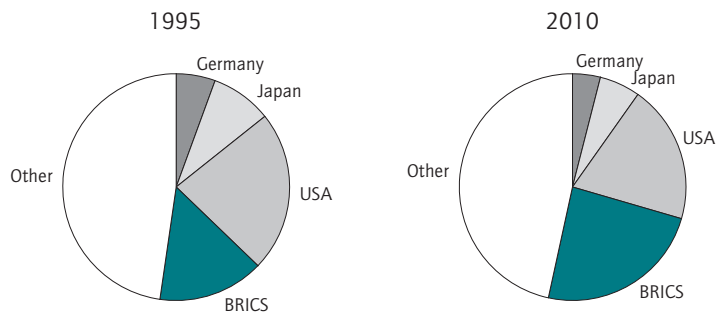
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The BRICS countries' share in global production is clearly increasing.

Figure 2

#### Share of Selected Countries in Global Production 1995 and 2010

In percent



Source: International Monetary Fund, I.c.

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Industrialized countries are losing importance.

sia, exports of energy carriers play an important part.<sup>7</sup> Such an export orientation based on natural resources is limited in the long run. Still, the Russian export economy has not yet attempted significant diversification.

In contrast to China and Russia, India's economic growth is massively supported by strong capital imports. Consequently, India currently shows a current account deficit. One reason for this is its exchange rate policy, which

<sup>3</sup> International Monetary Fund, I.c.

<sup>4</sup> In terms of purchasing power parity, China now holds a higher share in global production than Japan. See Erber, G., Schrooten, M. (2011): Japan am Scheideweg - Staatshaushalt bleibt die Achillesferse. DIW Wochenbericht Nr. 31/2011.

<sup>5</sup> Fichtner, F., Bernoth, K., Bremus, F., Brenke, K., Dreger, C., Große Steffen, C., Hagedorn, H., Junker, S., Kuzin, V., Pijnenburg, K. (2011): Sommergrundlinien. DIW Berlin.

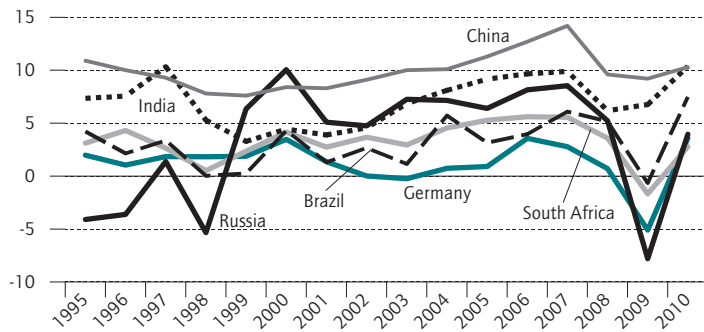
<sup>6</sup> The current account sums up the balances of trade and service, the income and asset transfer balance and the balance of current dispositions. In contrast, the balance of payments is an indicator for an economy's monetary integration into global economy.

<sup>7</sup> Engerer, H., Schrooten, M. (2009): Russland im Sog der Internationalen Finanzkrise. DIW Wochenbericht Nr. 3/2009.

Figure 3

**Growth Rates of BRICS Countries and Germany**

In percent compared to the previous year



Source: International Monetary Fund, I.c., 2010 preliminary estimate.

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BRICS countries had mostly above-average growth rates in the past 15 years.

is more flexible than China's. Unlike in China, foreign investors experience hardly any capital market limitations in India.<sup>8</sup>At the moment there is considerable liquidity on the international capital market looking for attractive investment opportunities in a currently difficult global economic environment. If such capital inflow consists of portfolio investments, there is always the risk that investors suddenly withdraw their capital when the country risk is reevaluated. For this reason economic development which is mainly based on foreign capital inflow is considered as risky in the long run. Also Brazil and above all South Africa show long periods of current account deficits. In Brazil, booming domestic demand is the main reason for strong imports. In South Africa, current account deficits are also a result of regional integration contracts, which force countries like Namibia to invest a considerable part of their own current account surplus – and thus their domestic savings – in the neighboring country.

**Income Gap to Industrialized Countries still Substantial**

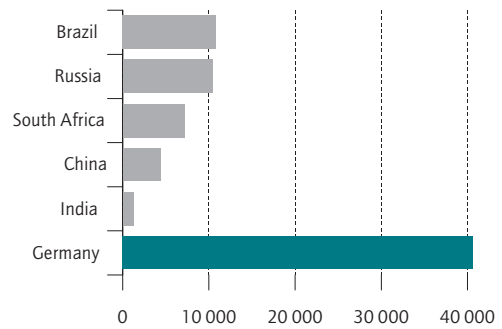
Nominal per-capita GDP according to the IMF was 10,816 USD in Brazil, 10,437 in Russia, 7157 in South Africa, 4382 in China and 1264 in India in 2010 (Figure 4). This shows once again that this group of countries is far from being homogenous. Furthermore, the simp-

<sup>8</sup> See International Monetary Fund (2011): India: 2010 Article IV Consultation – Staff Report, Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for India. Washington, D.C.

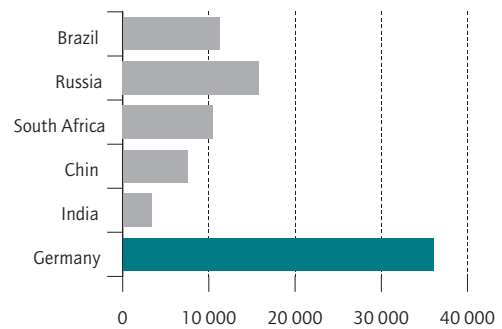
Figure 4

**Gross Domestic Product 2010 Nominal and in Purchasing Power Parity for BRICS and Germany**

Per capita GDP - nominal in USD



Per capita GDP - PP in USD



Source: International Monetary Fund, I.c., 2010 preliminary estimate.

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The income level of BRICS states is still significantly lower than in Germany.

le comparison of nominal per-capita GDP with Germany (based on IMF data) makes the substantial gap between BRICS states and industrialized countries clearly visible, which hasn't diminished despite their strong growth dynamic.

Assuming the BRICS countries kept their current overall economic growth rates, it would still take decades for them to have similar income levels like the industrialized countries (Figure 5).<sup>9</sup> For example, Chinese per-capita income would still not have reached the German income level after 25 years.

In order to enable a clearer comparison of income, GDP in purchasing power parity is often used. Taking this

<sup>9</sup> For this calculation we used the average overall economic growth rate of the years 1995-2010. For Germany, this was 1.3 percent.

into account, the BRICS states take a different order for the year 2010. Now Russia is leading (15,837 USD), followed by Brazil with 11,239 USD. South Africa ranks third (10,499 USD). China comes fourth (7,519 USD), while India once again brings up the rear with 3,339 USD (Figure 4). A comparison of per-capita GDP in purchasing power parity with Germany (2010: 36,033 USD) shows that the income gap between BRICS countries and industrialized countries is still significant. However, it is less striking than in a simple opposition of nominal values.

### Development Is More than Income Development

Still, economic development and wealth cannot exclusively be measured with income development and income distribution. It is rather qualitative factors which in the end influence quality of life. Life quality is hard to measure, though – often a satisfaction indicator is used. Measuring problems develop exponentially in international comparisons, since cultural factors have to be taken into account as well. Against this backdrop, the Human Development Index (HDI) becomes more important,<sup>10</sup> as it focuses on quantitative data and offers starting points for international comparison. It goes beyond the orientation on per-capita income and includes other factors like access to education and life expectancy.<sup>11</sup> If we include these parameters, the developmental gap between BRICS countries and industrialized nations becomes even clearer (Figure 6).

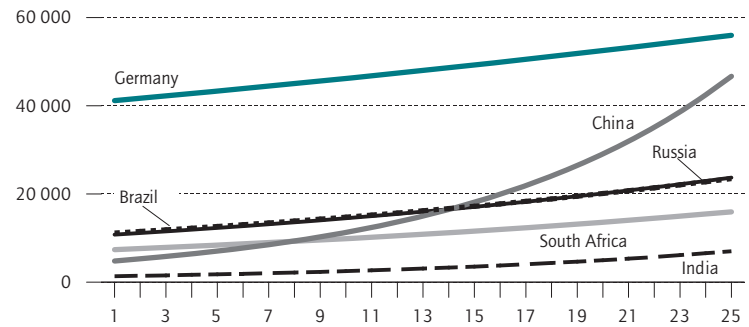
The UN annually publish a ranking of economies and values of these indicators. A total value of the indicator close to 1 means a high degree of development. For years, Norway has ranked first in international comparison. Expenditure on health (public and private) and education (public) of most BRICS countries so far are significantly lower than in Germany, which is about 15 percent of GDP according to the World Bank. This applies most of all to India (health expenditure: four percent, public expenditure on education: three percent). Consequently, the HDI value is low. Public intervention in the fields of education and health provides an opportunity to give the catching-up process a sound and sustainable basis.

<sup>10</sup> The UN have been calculating the HDI for 20 years. The education index is calculated with literacy as two thirds and access to school education as one third. The HDI however leaves out distributional dimensions and gender issues as well as a number of other socially relevant factors. By definition, the HDI has a value between 0 and 1. The closer to 1, the better.

<sup>11</sup> The HDI offers an approach to measure the degree of self-realization of individuals in a given economy – the “capability approach”. Sen, A. (1999): *Development as Freedom*. Oxford.

Figure 5

### Development of Economic Performance with Continued Past Growth Rates



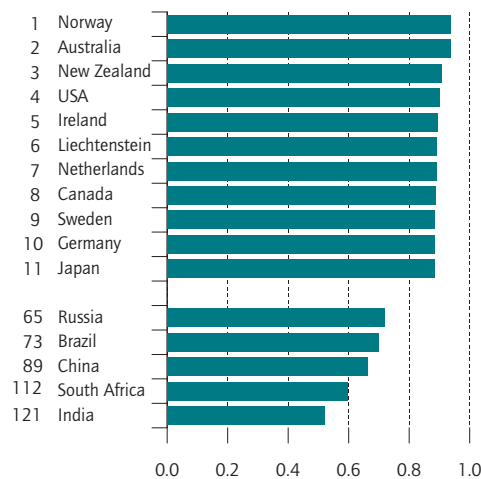
Source: Calculations by DIW Berlin.

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The convergence of income levels with the industrialized countries will still take decades.

Figure 6

### HDI of Selected Countries



Source: UN DP (2010): *Human Development Report 2010*. New York.

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The HDI also shows a considerable gap between industrialized countries and BRICS states.

Principles of the human capital theory argue that long-term economic capability of an economy depends largely on the people’s access to education. Indirectly, there is also a connection between human capital and the capability of an economy’s health system: For health not

only influences decisions on education, but also the duration of the ability to work.

Both figures are included in the calculation of the Human Development Index. Education is represented by access to the school system, health by a country's life expectancy. Thus, the HDI not only gives information on the current situation of a given economy, but it also provides clues on its potential for development. The simple ranking of economies already shows considerable need for catching-up for the BRICS states if they are to achieve a similar level like the industrialized countries.

## Conclusions

In the current financial crisis, the BRICS countries are stabilizing the global economy. Their weight in global production has significantly increased over the past years – partly due to a relatively modest development in the industrialized countries.

But it is also clear that these countries will still need a lot of time to catch up with the industrialized world when it comes to income levels. This result is also supported by a wealth analysis based on the Human Development Index. In this respect, Russia holds first place within the BRICS group.

The HDI also takes human capital aspects into account and mirrors an economy's potential for development. For the sustainable and long-term promotion of economic growth there are mainly three economic starting points, which are closely connected.

1. Fight against extreme poverty. Income distribution in all BRICS states is strongly asymmetrical. We find few very rich people and a lot of poor people. Such a situation leads to a misallocation of resources. The government is needed to implement a sustainable tax system for redistribution.
2. Access to education. Access to education can in many cases only be guaranteed by a public education system. Equal access to education for both sexes diminishes illiteracy and improves the qualification of employees. Many studies show that the access to education and economic resources for women leads to positive economic effects in general.
3. Health system. Health systems of all BRICS countries are faced with considerable challenges, especially in regard to child and maternal mortality. This is another field where the government is needed to develop and support sound prevention programs.

JEL: F02, O15, O57

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