

## II. Change in China

# The Chinese Economic Model

by Dr. Yan Wang

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*remarks as delivered on Panel 2 of the December 12-13 Schiller Institute Conference. Sub-heads have been added.*

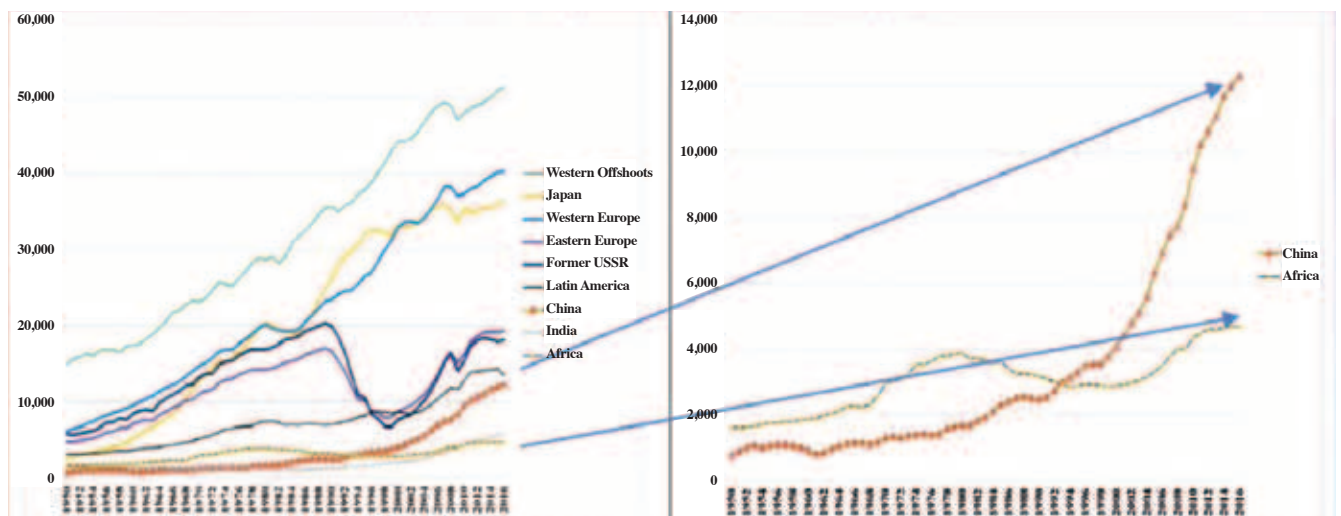
I would like to thank the Schiller Institute for inviting me. It's a great pleasure and honor to speak and share my research results.

Let me start with a story of my youth. I grew up in China during the Cultural Revolution. I was sent to the countryside when I was 15 years old. I witnessed the poor living conditions in northeast China, without running water, without electricity, without a toilet.

As you know, China started reforms in the late 1970s, early '80s. It was motivated by the strong desire to catch up with the industrial world, but we found it very difficult.

FIGURE 1

### Why is Catching Up So Difficult? Development Since the 1950s



Maddison Project Database, version 2018.

Fig 1a: Major economies, Real GDP per Capita in 2011 US\$, Multiple Benchmarks

Fig 1b: Africa and China Real GDP per Capita in 2011 US\$, Multiple Benchmarks

Today's presentation is primarily based on my book co-authored with Prof. Justin Lin, *Going Beyond Aid*.

As you can see in **Figure 1**, in the 1980s, China's per capita income, measured by PPP (Purchasing Power Parity) dollars, was very low, even lower than that of Africa. China's income per capita was one-half that of African countries. After 40 years of rapid growth, China has lifted 800 million people out of poverty, and the economy has grown into the second largest economy in the world. The per-capita income has been quite low, currently at \$10,000 per capita. Like Africa, China used to be trapped in poverty, for centuries. So Chinese leaders have a strong desire to catch up.

But why did China start development cooperation? In part because traditional north-south development cooperation, or aid, has not been effective. After \$4 trillion had been spent in development aid since the 1960s, you can see in **Figure 2** that a lot of countries are stuck in a poverty trap, and their economies are stagnating.

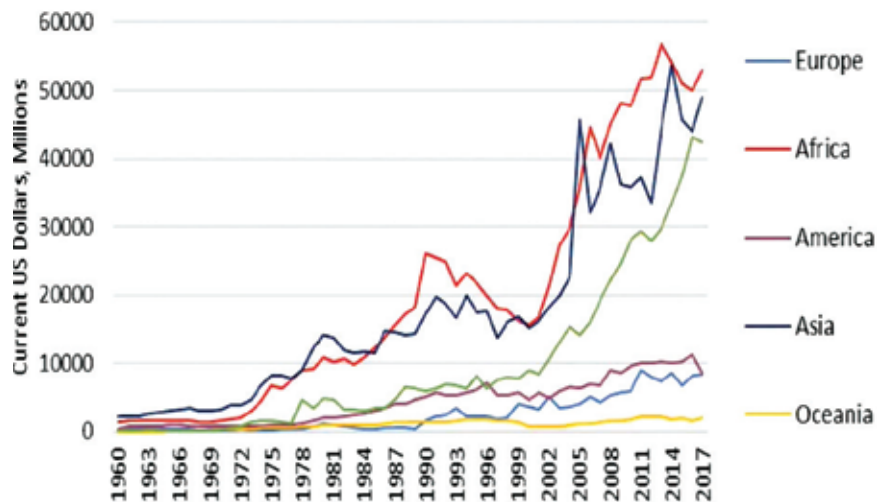
### Development Cooperation Based on *Ren*

So, China's development cooperation is based on a tradition from Confucianism *ren*. *Ren* means humanity, benevolence, altruism, and empathy. We also believe that teaching fishing is better than giving fish. So, based on China's own development experience, we can combine trade, aid, and investment to help African countries. Through trade, aid and investment, China can utilize its comparative advantages in three aspects. China has a comparative advantage in building infrastructure: hydropower, highways, and railways, and with lower costs, thanks to the low-cost engineers and economies of scale. Second, China has comparative advantage in 45 out of 97 subsectors in trading of goods. Third, emerging Asian economies like China have high savings rates and patient capital. What is patient capital? Patient capital is long-term capital with longer than 10 years maturity, and invested in a country's development.

The Chinese lending history to Africa tells an important story. China started loan cooperation and aid in the 1960s and '70s. The famous TAZARA (Tanzania-Zambia) Railway was completed in 1974. China has sent many medical teams and doctors to African countries

FIGURE 2

### Total North-South Official Development Allocation to Developing Countries, 1960-2017



Source: based on data from OECD DAC, Airflow.data. Accessed in May 2019.

Note: Aid includes grants, "soft" loans (where the gift element is at least 25% of the total) and the provision of technical assistance. Only aid to those countries listed in the OECD list of developing countries counts as ODA.

over many years. And after 2000, Chinese banks started to issue loans to Africa for infrastructure development.

The sectoral distribution of Chinese investment in Africa is 33% invested in transport; 33% invested in energy, including electricity generation, power grids and so forth; 2% invested in agriculture; and the same invested in technology.

Some famous African projects implemented by China are the Mombasa-Nairobi Standard Gauge Railway in Kenya; the Maputo Bay Bridge in Mozambique; and the Wanbao rice farm in Gaza province, Mozambique. These have all been quite beneficial to African countries.

Chinese leaders proposed in 2013 the Belt and Road Initiative (BRI). The objective is to enhance connectivity across countries through wide consultation, joint construction, and shared benefits.

China has also invested in foreign direct investment (FDI) in African countries. **Figure 3** shows that China leads the BRICS countries in terms of outward foreign direct investment, the peak being achieved in 2016, with \$196 billion of investment. In recent years, it has been declining.

It is often asked, how many jobs has China created? There was a study by Ernst & Young (EY) which shows that China implemented 259 projects in Africa, during this period. The number of *projects* is lower; however, the number of *jobs created* is higher than any of the



Mombasa-Nairobi Standard Gauge Railway



Maputo Bay Bridge in Mozambique



A Chinese invested Wanbao rice farm in Gaza province, Mozambique, April 4, 2018.

Photos courtesy of Dr. Wang

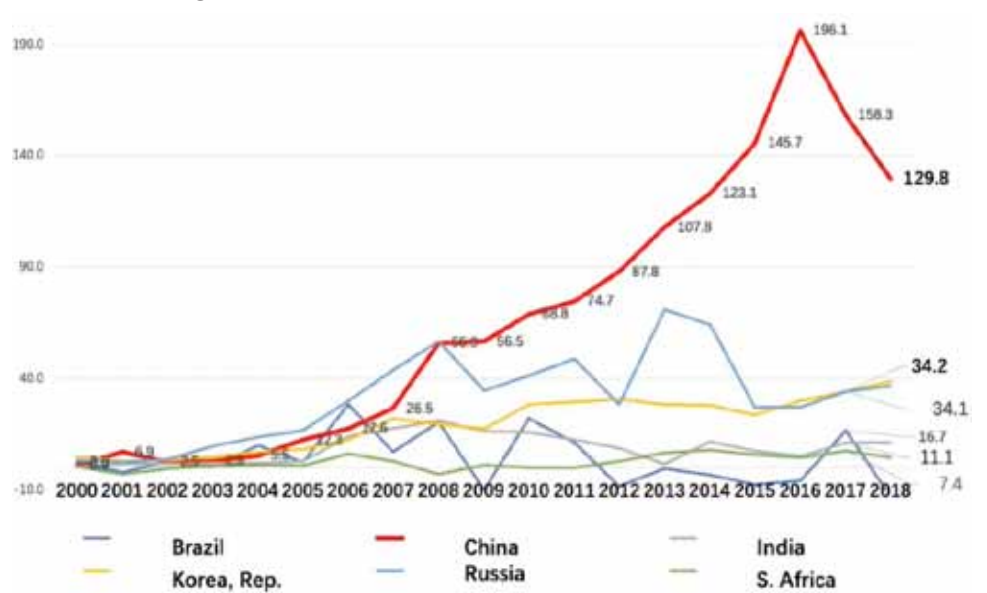
countries above, including U.S., France, and United Kingdom. In total, 137,000 jobs were created between 2014 and 2018.

Looking into the future: is the financial gap being reduced? The answer is no. Long-term capital is actually declining. We think that development finance will need to go beyond aid, beyond official development assistance, known as ODA, to combine trade, aid, and investment. Financing will come less from official development aid, and more from “other financial flows,” (OOF), including OOF-like loans and equity investment. Developing countries’ share of global investment overtook that of high-income countries in 2015. However, there is still a shortage of long-term capital. Global foreign direct investment (FDI) has declined.

Prof. Justin Lin and I think we need to expand the definitions of development

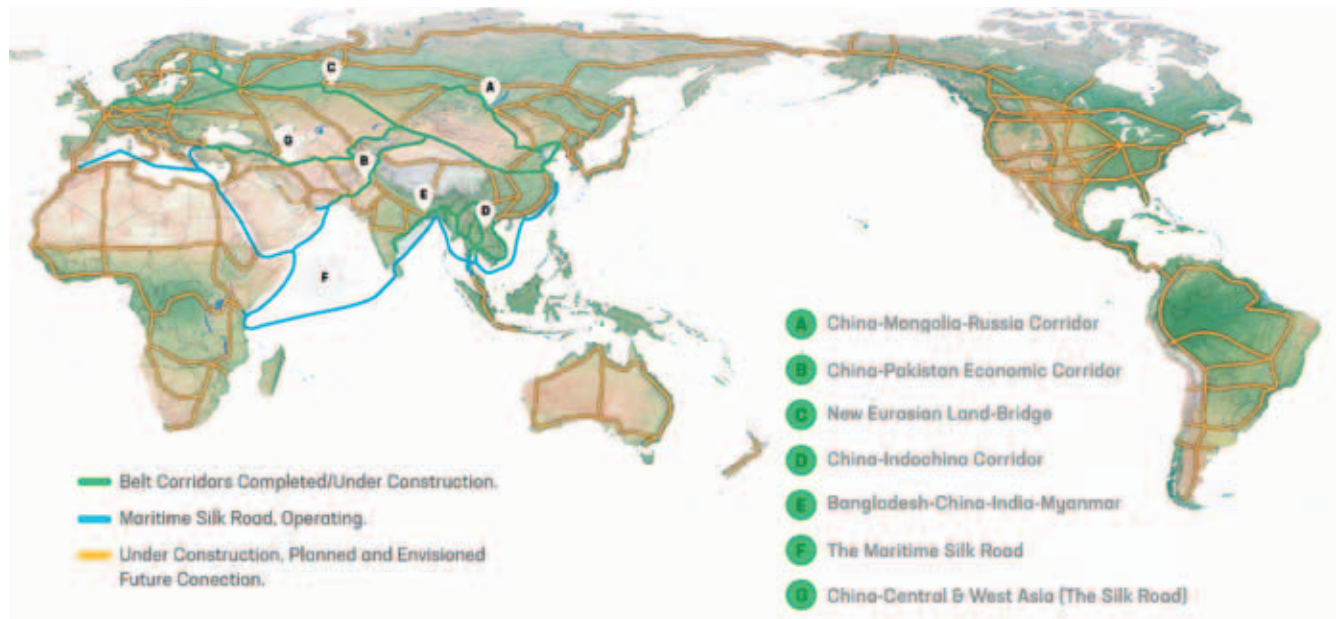
financing and have expanded the definition to four layers of financing. The core layer is official development assistance (ODA), as defined by the OECD (Organization for Economic Cooperation and Development). The second layer is other official flows (OOF), including export buyer’s credit. And the third layer is

FIGURE 3  
Outward Foreign Direct Investment Flows from BRICS Countries: 2000-2018



Source: UNCTAD Data.





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*Development corridors of the Belt and Road Initiative.*

OOE-like loans, including blended loan financing provided by the Asian Infrastructure Investment Bank, the CDB (Caribbean Development Bank), the EXIM Bank (Export-Import Bank of the United States) and other development banks, such as the World Bank. And the fourth layer is OOE-like investments provided by funds, including sovereign wealth funds. This includes the China-Africa Development Fund, the Silk Road Fund, the United Kingdom's CDC [Colonial/Commonwealth Development Corporation], and the newly established U.S. DFC, Development Finance Corporation. So this definition is broader and more inclusive.

### Debt Sustainability

The last issue is regarding debt sustainability. We consider that the IMF-used debt/GDP is a narrow and misleading measure. This ratio does not distinguish what sort of debt is used, whether it's domestic or foreign, whether it's U.S. dollar-denominated or domestic currency-denominated. Secondly, we look at how debt was used—to finance consumption, meaning pensions and salaries, or finance investment? Of course, the results are different. Third: Will GDP be affected in the long term, as GDP is in the denominator? So, if GDP growth increases after long-term investments, the [ratio] will be reduced. Our view is that one must look at both sides of the balance sheet of the governments, including assets and liabilities. It is *public sector net worth* that matters.

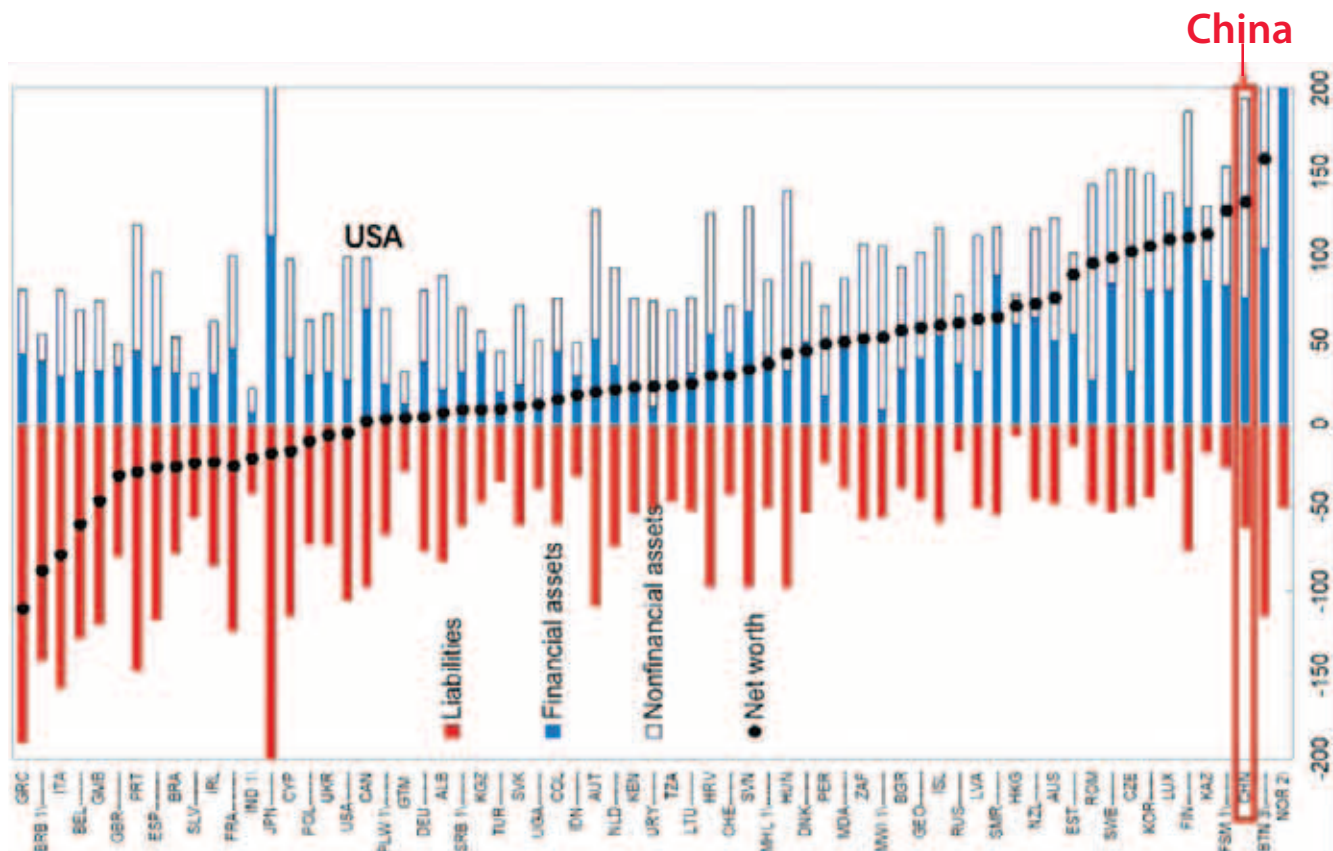
The IMF study in 2018, “Managing Public Wealth,” (see **Figure 4**), looked at both assets and liabilities of governments, and it concludes that “public sector net worth matters”—the black dots in the chart. In this chart, the red bars represent liabilities, the blue bars represent non-financial assets, and the black dots represent net worth. As you can see, the U.S.A. is in the middle, with just a little bit, barely any net worth. China is on the right-hand side, third. China has the largest net worth of public sector, the third highest net worth among these countries.

So, is there a “debt trap”? There is no empirical evidence to support the so-called debt trap diplomacy [accusations]. Essentially, infrastructure such as hydro-power and power grids; and roads, ports, and bridges, are assets of the public sector that are used to create jobs and generate revenues. The Chinese state sectors are holders of patient capital. There is no evidence [of] “asset seizures.” There is no evidence [that] there is a debt trap. Instead, China has shown considerable forbearance and flexibility in dealing with debt.

It is important to look at the restructuring of Chinese debt by outcome and year. Before the 2008 financial crisis, there were several rounds of debt write-offs; China cancelled debt for African countries. However, after the 2008 financial crisis, there were fewer and fewer incidents of debt write-offs, but rather more rescheduling and refinancing. According to this study, there are more possibilities of rescheduling and refinancing.

FIGURE 4

IMF 2018 Study ‘Managing Public Wealth’ Shows Public Sector Net Worth (the black dots), Matters



Source: IMF October 2018 Fiscal Monitor “Managing Public Wealth”

### Crisis and Opportunity

I would like to conclude by using the Chinese word *weiji*, which means crisis and opportunity. The current pandemic crisis may lead to a more polarized and fragmented world economy. But there are opportunities for regional trade and integration, such as the BRI and the EU (European Union), the 16+1 regional grouping, and the African Continental Free Trade Area (AfCFTA), and the RCEP (Regional Comprehensive Economic Partnership) for Asia. We believe that more trade and integration will lead to a more peaceful world. We presented evidence for South-South development cooperation by utilizing the comparative advantage of each partner, which is good for industrialization, structural transformation, and beneficial to both sides. China is continuing to learn to become a better partner. Regarding the debt crisis or debt sustainability, we argue that net worth of the government matters and China is a provider of public assets.

There are several restructuring proposals [which]

deal with the debt issue. First, we support multilateralism, and we support the proposal for the IMF to issue more Special Drawing Rights (SDRs), as Special Drawing Rights are counter-cyclical and unconditional. Second, we support the role of MDBs (multilateral development banks), including the World Bank, ADB (Asian Development Bank), and AIIB (the Asian Infrastructure Investment Bank) for more emergency liquidity loans. Third, we support the function of bilateral donors to utilize tailored solutions in debt-distressed countries. Fourth, there is a proposal for debt-for-climate swaps, but all these are to be discussed. In general, for developing countries, it is important to know what the government *owns*—meaning assets—and what government *owes*—meaning liability; and these countries should enhance their capacity for managing assets to generate jobs and revenues.

Thank you very much. Let me stop here, and I would like to answer questions during the Q&A session.