Introduction

Only 25 years ago university students were taught that economic growth around the world was governed by dependence theory, which established that growth in developing countries was inevitably slower than in advanced countries. According to this theory, advanced countries’ privileged position was at the expense of developing countries and there was thus no possibility of convergence. The framework was dominant in Latin America and other developing countries, as the data appeared to provide firm support to the argument, with developing countries’ failing to grow more than advanced ones.

The last twenty years have seen a fundamental break with the past. Developing economies grew fast, rapidly converging to advanced economies living standards (see Chart 1 and 2). The dependence theory is likely to be shelved into history books, and younger generations in our countries will be exposed to more hopeful theories and data.

This development has coincided with the dramatic irruption of China into world trade and finance in the last two decades, which has arguably played a key role. The obvious channels through which China has been changing the fate of the rest of developing countries have been trade, and, more recently, funding. There is a third “soft” channel that has been slow in entering the scene but is bound to become an equally powerful: ideas.

Each country’s path of development is unique, and Chinese experience happened under specific set of circumstances not easily replicable elsewhere. That said, the lessons from its growth experience are underemphasized and should be more prominently present in global discussions. In this note we first shed
light on the standard channels by which China has helped developing countries, and then focus on ideas. We conclude offering perspectives on what the future may bring in terms of China’s role in promoting growth in developing countries, including its increasing leadership in support of globalization and multilateralism.

**China’s impact on developing countries**

A) Trade and finance

During the last fifteen years, China’s contribution to world growth increased systematically and accounted for more than one-fourth of global growth in the last twenty years (Chart 3). Chinese growth had more intense spillovers to developing countries than advanced economies’ growth, as it has been more intensive in imports. China has become the most important merchant in the world (Chart 4). Its imports have been relatively more skewed towards commodity imports, which has derived in a steep increase in the average price of commodities (despite dip of recent years), a key impulse for commodity-exporting countries. The effect of the evolution of Chinese economy in commodity prices is now quite startling, representing close to 70% of global demand in some key commodities (see Chart 5).

China has also contributed critically to ease of financing of the world economy. It has accumulated huge external assets during this period (see Chart 6) both as a consequence of large current account surpluses but also through scaling up its external balance sheet (leveraging higher external assets with higher external liabilities) (see Chart 7).

The impact of China on world financing conditions has also increasingly benefited developing countries. The total direct exposure is still limited (see Chart 8) but has increased in the last five years. During 2003-13, China focused on accumulating external assets in safe US assets (see Chart 9). By depressing the base rate, global borrowing costs for developing countries were kept at bay at a time a booming world economy would have pushed...
interest rate higher. During the last 5 years, China has shifted its external asset accumulation strategy, transitioning from portfolio asset accumulation towards lending and investing directly, to a large extent into developing countries.

In the last five years, China has become the world leader in accumulating loan/deposits type of assets (see Chart 10). This has been especially helpful for cash-strapped low-income countries, in which China has become main lender, above World Bank, IMF and private sector from elsewhere in the world (Horn et al).

B) Lessons from its growth path

1. The early stage of high growth

Having achieved systematic high growth that lifted 850 million people out of poverty in just two decades, China is the most successful story of a development path, for which it offers inspiration and key lessons for developing countries. Developing countries should pursue a path depending on their own circumstances, and in that process benefit from actively strive to learn key elements of Chinese strategy.

Chinese experience of high, steady growth offers a particularly acute contrast with our experience in Latin America, which is marked by boom-bust cycles, periods of high hopes only followed by despair. Excesses in good times derive in full-fledged currency, banking and/or sovereign crisis, which corrode basis for sustainable growth as they put kids out of schools, decimate confidence in the political system, push families to migrate and turn entrepreneurs into short-term speculators.

China’s experience to achieve such sustainable growth is based in five key pillars, which Latam countries could have greatly benefited to incorporate in their policy frameworks. A key leitmotiv is that China has been aware of natural limits of each of the key pillars for growth on the basis of the different stages of development. This section focus on
pillars that sustained growth until at least the global financial crisis.

First, as in other Asian countries, sustainable growth must rely on exports as a fundamental engine (see Chart 11). Domestic markets, even considering the size of China, eventually impose limits. Too many times developing countries have engaged in “import-substitution” tendencies, for instance, a few years ago in Mercosur. In this regard, it’s not enough to reduce trade tariffs and barriers, but also have a competitive currency, that fluctuates but does not appreciate excessively during high-growth periods as it is typically the case in other developing countries (See Chart 12), introducing too much risk to export-oriented business undertakings.

A second key lesson from China is to limit needs of external funding by having high domestic savings (see Chart 13). In addition, external funding comes primarily in the form of equity rather than debt (as it has usually been the case in Latin America) (see Chart 14). China is now one of the developing countries with less external debt in the world (see Chart 15). This is an advantage as global bank and bond flows have been driven by search for yield. They have been volatile and massively procyclical, deepening the pain at most difficult times.

Foreign direct investments are more stable, investors are in for longer, sharing the risk of their investments, and their investments spill over to the local economy through technology transfer, human capital formation.

A third lesson is that infrastructure is crucial. Other developing countries have fallen too easily to populist demands for current spending, sacrificing infrastructure which then becomes a bottleneck for growth.

Fourth, build-up of generous buffers in the form of Central Bank reserves is key to provide financial and external stability and avoid abrupt currency movements (See Chart 16 and 17).

Fifth, when there is a preference from the government and society for a significant public sector weight in the
economy, then publicly owned enterprises play a prominent role in some sectors of the economy. They do not necessarily need to drag the whole economy with unacceptably slow productivity. On average, private sector does tend to exhibit higher productivity, including in China. However, when publicly owned companies are allowed to compete, open up their capital structures to allow private participation, have the effective oversight from an external agency like SASCA, China has shown important successful stories. This should be a powerful lesson to Latam countries that have debated for too long on the exclusive axis of big/small state, and much less on effective/unproductive state. Opening up to competition, setting the right incentives for executives and an effective control structure, are all crucial ingredients for success.

2. Second phase: administering transitions

As China accessed higher stages of economic development, new engines of growth were needed. China has successfully managed such transitions, but challenges emerge.

Infrastructure returns eventually hit significantly decreasing marginal returns. China’s share of investment on GDP grew significantly until 2010 (see Chart 18), since when it is gradually giving greater space for consumption.

China has also been transitioning from heavy industry to lighter (cleaner) industry, from low end to high-end manufacturing, from manufacturing to services (see Chart 19), and from investment to consumption.

China is also successfully transitioning from exports based on foreign direct investors to exports from domestic firms (see Chart 20). Even though China GDP per capita is still far lower than advanced countries, it has managed to become a global leader in some sectors (drones, electric cars, to name a few).

More recently, China has also started to transition away from a domestic debt-based model of economic growth. While domestic debt is in a way an inevitable corollary of high propensity to save from Chinese households and is...
typically far safer than external debt as a source of financing, it can lead to financial instability (see Chart 21 for a comparison with other crisis-stricken countries). Having exhibited the capacity to grow without recurring to rapid debt growth is then a milestone in Chinese growth model (in all other cases, cooling of debt build-up took place amidst collapsing economic growth).

The ability to embrace these transitions in a timely fashion before “hitting a wall” should serve as an important lesson for developing countries. One aspect to consider, however, is that fallout from these difficult transitions in overall economic activity at a time of global economic weakness has been partly mitigated by a reinvigoration of public investment (see Chart 22). This process involved reverting a decades-long process of greater role for private investment in total investment. Given higher productivity of private sector investment discussed above, such development could eventually represent a drag on sustained high productivity growth going forward.

**Future perspectives**

Going forward there is considerable scope for further positive impact of China on developing countries

China is likely to keep on playing an increasingly key role supporting developing countries’ trade and funding opportunities through bilateral engagements. Infrastructure based lending through the Belt and Road initiative (BRI) is likely to improve connectivity with the developing world and hence contribute to global integration through roads and bridges.

Developing countries are likely to continue to absorb lessons from China’s growth experience to improve policy frameworks and avoid costly crisis. China could usefully help in this process by playing a more active role in showcasing the lessons from its growth experience in order for developing countries to be better able to reap the benefits of eschewing risks of past approaches.

However, we believe that the most promising effect of China on developing countries’ growth will be related to its

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**Chart 16.**

**International reserve assets**

As a share (%) of GDP

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**Chart 17.**

**International reserve assets across countries**

2019 Q1, as a share (%) of GDP

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**Chart 18.**

**Consumption and Investment**

As a share (%) of GDP

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increasingly assertive role as guardian of global trading system, multilateralism and globalization process.

From a protracted period of time, the US built a global order based on an increasingly open multilateral trading system which served developing countries well. When openness intensified around the 1990s, progress intensified. It seems the US has now decided to retrench from the world it created. China, as the largest merchant in the world, becomes the natural substitute in this role, and it is indeed taking very important steps to assume such leadership.

China is a living example to the rest of the world of potential achievements of opening the economy and believing in globalization. Thus, is naturally suited to play this leadership role in multilateral and globalize era.

While significant progress has been done, we believe further steps could be important to fully realize the potential of China’s role in the globalization process. In particular, China could take further concrete action to strengthen multilateralism both through newly-created institutions (BRI, AIIB, BRIC bank) that support Chinese foreign lending, and also by supporting pre-existing international lending organizations.

For newly created institutions to fulfil their great potential, there is further room for improvement. For instance, to keep developing a platform to coordinate with other lending institutions (as recently announced), achieve greater transparency and disclosures. Among other objectives, this will help address the challenge of excessive debt burdens that, as discussed in previous section, need to be carefully managed for them to be supportive of growth.

But China should also continue to push for an increase in the effectiveness of existing multilateral institutions. Without greater involvement from China (and other developing countries), multilateral institutions are set to continue to lose influence.
The sphere of Bretton Woods institutions is a natural one for China to express its values. The International Monetary Fund and the World Bank are institutions that provide fertile ground for cooperation, strengthening Chinese plans of a “shared vision for humanity”.

Bretton Woods institutions do not necessarily need a global politically liberal order, they have been Westphalian in nature. In line with Chinese vision, they have abstained from pressuring or withdrawing support to countries based on their political systems.

The IMF has pushed, in line with Chinese vision, for a liberal trading regime and the deepening of globalization. While originally too cavalier about risks of rapid reform, the IMF has developed, over time, more streamlined, nuanced and country-specific recommendations to foster growth.

The discussion about China’s role in these institutions has been overly focused on the issue of voting shares. However, a greater contribution from China can go way beyond this matter. For example, it should demand greater participation of Chinese experts in these institutions. For example, more Chinese technical assistance (TA) experts would be necessary. Too many times, developed country experts provide advice by describing the details of their current institutions and policy frameworks, but can provide little guidance on the transition process on how they actually transitioned to such state of affairs.

China’s approach to international lending differs from traditional method as it is focused on infrastructure and with few strings attached. This could help to mitigate the practice of funding unsustainable budgets in exchange for reforms that do not lift growth as too often end up occurring on paper but not in spirit.

There is promise, however, in China’s role in providing conditionality lending in exchange for multilateral trade openness. This is likely to have an impact in global trade at a time that rising trade tensions are raising generalized increase in protection.
In order to further support the globalization process, China should also continue with its own openness to be able to continue to lead by example. Recent unilateral reduction in restrictions for FDI, reduction in trade barriers, and openness to global capital markets, go in the right direction. While international experience shows that a gradual approach to openness to avoid dislocations is necessary, the direct and indirect effects for the global order of China’s stance on globalization is of paramount importance.

Another crucial angle to support integration is to promote circulation of foreigners to study and work in China. The presence of Chinese students, professors and professionals abroad is less than those that come to China. In order for China to adopt an effective leadership role in safeguarding global trading system, it would benefit from greater understanding of its culture and economic model from the rest of the world. Reducing working visa restrictions, further promote learning of Chinese abroad, and funding a greater number of foreign student scholarships in China seem natural steps.

By attracting more talent, progress can be made towards the purpose of playing a more effective role in other developing countries to better understand China’s development path. China could benefit from investing in a few centres of excellence of public policy that attract visiting top public policy leaders. Universities in the US are usually focused on academic abstract thinking and less on development public policy challenges and recommendations. Incentives of professors are skewed toward writing papers on purely mathematic economics that are of limited practical use to practitioners.

There is a massive opportunity for China and other countries to provide global policymakers more applied schools of thinking that can shape up global debate. Also, it is increasingly crucial for developing countries analysts and policymakers to understand the dynamics of macroeconomic conditions in China as it has a key impact on commodity prices (see Chart 23 and 24) and their own economic activity.

By being a supporter of global trade and global capital flows, China will continue to support its own development as well as that of other developing countries. No effort should be spared to successfully defend, and further develop, a system that lies at the core of its own success.


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