

Review

China in Africa: the Washington Consensus versus the Beijing Consensus

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Deborah Brautigam, *The Dragon's Gift: The Real Story of China in Africa*, Oxford: Oxford University Press, 2009

Vivien Foster, William Butterfield, Chuan Chen, Natalyia Pushak: *Building Bridges: China's Growing Role as Infrastructure Financier for Sub-Saharan Africa*. Washington: The World Bank, PPIAF, 2009.

Stephan Halper, *The Beijing Consensus: How China's Authoritarian Model Will Dominate the Twenty-First Century*. New York, Basic Books, 2010.

These three books complement each other in describing the truly astonishing growth of China's aid, investment, and trade in Sub-Saharan Africa since 2000. For China, foreign aid, investment, and trade are not really distinct categories. As Deborah Brautigam emphasizes, these parts are bound together by intricate financial arrangements under China's Export-Import Bank with other commercial arrangements orchestrated by the Ministry of Commerce, within which the Department of Foreign Aid is nested. Foster, Butterfield, Chen and Pushak are World Bank economists who bring additional data to bear on aid by China compared to Western sources. Stephan Halper focuses more on the political implications of the remarkable rise of China, and worries about the decline of the United States and its "Washington Consensus" as a model for developing countries.

In contrast to China's, foreign aid agencies of the mature capitalist countries in the Organization for Economic Cooperation and Development (OECD) are typically lodged in ministries of foreign affairs, which decide on worthy poor recipients. The U.S. Agency for International Affairs (AID) is lodged in the State Department. Then, the Development Assistance Committee (DAC) of the OECD parses out the grant elements to calculate how much aid each of its members "gives" to poor countries for development and welfare improvement. Included as aid are loans at below market rates of interest, contributions to the World Bank, cash grants, grants in kind such as surplus agricultural produce, and so on. Periodically, the DAC shames its member donors into committing themselves to pre-specified amounts of such aid (measured as a fraction of their GNPs—typically less than 1 percent) for, say, Africa by some common future

date. These pledged contributions almost always fall short, but nevertheless the OECD countries' positions as benevolent donors to poorer countries is preserved.

Because China is still fairly poor by most per capita income measures, and because most of its "aid" projects are mutually beneficial commercially, it largely escapes the stigma of a donor-suppliant relationship. Each project is designed and financed to be potentially in the mutual economic interest of both China and the recipient countries, most of which are in Africa. But China now has aid projects throughout the developing world in Asia and Latin America. In July 2010, the Chinese and Argentine governments announced a gigantic \$10-billion project to rebuild Argentina's huge but dilapidated railway network while providing finance for new locomotives—no doubt Chinese made. That Argentina had defaulted on its old debt did not hinder the agreement, but gave China an entrée.

Generally China avoids giving or lending cash up front to the recipient countries. Rather, most deals are quasi-barter. Chinese construction and engineering companies, employing a large phalanx of skilled Chinese workers and some local workers, receive funding directly from, say, the China Export-Import Bank. Then over several years the host country agrees to repay the bank in commodity terms—oil or, say, iron ore, whose production and marketing may be facilitated by the construction project itself. To increase leverage in assuring repayment, China may also provide follow-on maintenance crews for the railway, port, or power plant—as well as dangling the possibility of complementary projects in the future.

Because of China's huge and growing industrial production at home, its need to import vast amounts of industrial raw materials, foodstuffs, and other primary commodities is obvious. However, several years ago when first learning about these quasi-barter deals, i.e., infrastructure for commodities, with developing countries, I was puzzled. China produces a wide variety of consumer manufactures that it exports on a large scale without needing to undertake complementary overseas investments. By extension, China could just buy the commodity inputs it needs in organized world commodity markets—which often provide very convenient forward covering facilities against price risk. Undoubtedly, China still purchases many imported inputs in conventional open markets. But, increasingly, it secures access to minerals and some agricultural products by negotiating complex overseas aid and investment programs in return. Why?

Over the last 30 years, the building of infrastructure—roads, ports, railways, power plants, and buildings of all kinds—in mainland China has been massive. All three books mention that the consequent "learning by doing" by Chinese construction and engineering firms has influenced China's comparative advantage in world trade. The human capital acquired by Chinese engineers and skilled workers within largely state-owned construction enterprises is so immense that these engineering skills are now used with high payoffs in foreign countries.

But complementary to the application of engineering skills first at home and then abroad is China's high level of domestic saving. Particularly in the last 10 years, saving has sometimes

reached 50 percent of GDP while its massive domestic investment was “only” was about 45 percent GDP. Consequently, this “surplus” saving manifested in trade surpluses provides the wherewithal for large foreign investments to complement domestic ones. Britain had such engineering skills in the 19th century coupled with high saving and trade surpluses to finance massive overseas investments—as with the initial building of the Argentine and Indian railway systems. The U.S. in the 1920s and post World War II had such skills, which it combined with large overseas investments—think Bechtel Corporation for large dams and power plants the world over. However, the sharp declines in U.S. saving rates since 1980 would have undermined U.S. hegemony in international construction projects even without well-funded Chinese competition.

Currency Mismatches: The Plight of Immature Creditors

More subtly, there is a further monetary explanation of why so many of China’s overseas investments are combined with aid under the fairly strict government control of, say, China’s Export-Import Bank or the Department of Commerce. Because these foreign aid—investment projects are under the control of state-owned financial intermediaries, they become effectively *illiquid*: they will not be suddenly sold off and become part of hot money flows back into China.

China is in the historically unusual position of being an *immature* creditor: its own currency, the renminbi, is hardly used at all in financing its huge trade (saving) surplus. Instead the world—particularly the Asian part of it—is still on a dollar standard. The dollar is the invoice currency of choice for most of Chinese exports and imports and for open-market, i.e., nongovernment, controlled financial flows. So we have the anomaly that the world’s largest creditor country cannot use its own currency to finance foreign investments.

The lag in the international use of the RMB is partly because China’s domestic financial markets are not fully developed with interest rate restrictions as well as residual capital controls. But a more fundamental constraint is that the U.S. dollar has the first-mover advantage of being ensconced as “international money”. World financial markets shun the use of more than one or two national currencies for clearing international payments—with the euro now in second place, but the euro’s use in payments clearing is still pretty well confined to Europe’s own backyard (Eastern Europe and former European colonies). Thus dollar dominance makes the internationalization of the RMB very difficult—although the People’s Bank of China (PBC) is trying hard to encourage the RMB’s use in international transacting on China’s immediate borders.

The upshot is that China’s own currency is still not used much in lending to foreigners. Foreigners won’t borrow from Chinese banks in RMB or issue RMB denominated bonds in Shanghai. Thus, apart from direct investments abroad by Chinese corporations, private finance for China’s trade surplus would have to take the form of Chinese banks, insurance companies,

pension funds, and so on, acquiring liquid foreign exchange assets—largely in dollars. But their domestic liabilities—bank deposits, annuity or pension liabilities—are all denominated in RMB. The resulting *currency mismatch* makes the risk of dollar devaluation prohibitive for private international financial intermediation.

China's current large trade surpluses, which run at about \$200 to \$300 billion per year, would quickly cumulate to become much greater than the combined net worth of all of China's private financial institutions. Because these "private" institutions (would) refuse to accept the risk of holding dollar assets on a significant scale, the problem of intermediating China's saving surplus internationally is left to the central government. The problem is worsened by American "China bashing" to appreciate the RMB, the expectation of which makes foreigners even more loathe to borrow in RMB—while stimulating perverse *inflows* of hot money to China.

The upshot is that China's central government steps in to intermediate and control the country's saving surplus in several different ways.

1. The accumulation of huge liquid official reserves of foreign exchange, currently about \$2.5 trillion, in the State Administration of Foreign exchange (SAFE).
2. The creation of sovereign wealth funds, like the China Investment Corporation (CIC) which invests overseas in bonds, equities, or real estate.
3. Encouraging China's large state-owned enterprises such as SINOPEC to invest in, or partner with, foreign oil companies in exploration and production.
4. Quasi-barter aid programs (the central theme of this paper) in developing countries which generate a return flow of industrial materials.

Each of these techniques generates claims on foreigners that are in "safe" government hands. That is, they won't be suddenly liquidated if, say, there is suddenly a new scare that the RMB will be appreciated. This minimizes, but does not eliminate, the possibility of hot money inflows back into China that could destabilize the exchange rate and make monetary control more difficult.

Tiny Singapore is also an immature creditor whose own currency is not used for international lending and whose government, like China's, tightly controls overseas financial intermediation. Singapore's net saving (current account) surpluses have been persistently the world's largest at about 15 to 20 percent of its GNP. To prevent hot money flows, it essentially nationalizes the internal flow of saving by requiring all Singaporeans to deposit what had been as much as 30 percent of their personal incomes into the Singapore Provident Fund—a state-run defined-contribution pension scheme. Then, beyond financing internal investments within Singapore, the proceeds from the Provident Fund are lent to two giant sovereign wealth funds: the Government Overseas Investment Corporation (GIC), which invests in fairly liquid overseas assets, and Temasek, which is more of a risk taker in foreign equities and real estate.

Both the GIC and Temasek are Singapore's answer to minimizing currency risk from international investing. Although their domestic liabilities to the Provident Fund are all in Singapore dollars, and their large foreign assets are in various foreign currencies—mainly U.S. dollars—both agencies are government owned with (implicitly) large capital reserves so that they can disregard the currency risk. Because the country's large overseas assets are in safe government hands, hot money flows are minimal. The Monetary Authority of Singapore (MAS) controls a gentle “float” of the Singapore dollar against U.S. dollar while holding little overt official exchange reserves. (The country's unofficial international reserves are the huge assets held by the GIC and Temasek.) The stable exchange rate then anchors Singapore's national price level.

This “Singapore Solution” to international financial intermediation by an immature creditor country, while preserving monetary control, was described in McKinnon (2005, ch. 8). Singapore is too small for Americans and Europeans to complain about its disproportionately large trade (saving) surplus, and demand that the Singapore dollar be appreciated. China (and Japan before it) are not so lucky. Although China's trade surpluses are proportionately much smaller than Singapore's, their large absolute size draws the ire of American mercantilists in the form of “China bashing” for the RMB to be appreciated. Although the common theory that exchange rate appreciation will reduce a saving surplus of a creditor country is wrong (Qiao 2005, McKinnon 2010), the fear of appreciation still induces large hot money inflows into China despite the immunization of its overseas investments—as described by points 1 to 4 above

Surplus-saving Japan is also an immature international creditor because the yen is not much used to denominate claims on foreigners. But, unlike China's or Singapore's, the Japanese government does not dominate the international intermediation of its saving surplus as much. How then is Japan's saving (current account) surplus financed internationally?

Large Japanese corporations make heavy overseas direct investments in autos, steel, electronics, and so on. But, in addition, Japanese banks, insurance companies, and pension funds, have become big holders of liquid assets, at different terms to maturity, denominated in many foreign currencies such as Australian, New Zealand, as well as U.S. dollars—which until fairly recently had much higher yields than yen assets.

This part of the Japanese system for overseas investment is vulnerable to hot money flows. Over the last 20 years, carry trades out of low yield yen assets have been commonplace with a weakening yen. But they can suddenly reverse. The Japanese economy is then vulnerable to sudden runs from dollars (largely owned by private Japanese financial institutions) into yen that create damaging sharp appreciations in the “floating” yen/dollar exchange rate. Investment within Japan is inhibited while making it more difficult for the stagnant economy to escape from its zero-interest liquidity trap (McKinnon 2007).

China, through measures 1. through 4. above, has mitigated— although not fully escaped from—the immature creditor dilemma.

China in Africa

“Chinese finance often goes to large-scale infrastructure projects with a particular focus on hydropower generation and railways. At least 35 African countries are engaging with China on infrastructure finance deals, with biggest recipients being Nigeria, Angola, Ethiopia, and Sudan. The finance is channeled primarily through the China Export-Import Bank on terms that are marginally concessional, though significantly less so than traditional official development assistance. A large share has gone to countries that are not beneficiaries of recent debt relief initiatives. ...Chinese financial commitments to African infrastructure projects rose from around US\$.5 billion in 2001-03 to around US\$1.5 billion in 2004-05, reached at least US\$7 billion in 2006—China’s official “Year of Africa”—then trailed back US\$4.5 billion in 2007.” (Foster et al, 2010, xi-xii).

In one of her chapters “How Much Aid Does China Give?”, Deborah Brautigam makes a heroic statistical effort to compare China’s with the collectivity of Western bilateral “aid” to Africa. A large part of China’s development assistance is in nonconcessional loans and export credits, which don’t count as “aid” by the Development Assistance Committee (DAC) of the OECD. The DAC counts just the gift component of international transfers as aid and excludes export credits. So taking this narrow definition of aid, China’s aid to Africa is smaller than that of other large industrial countries. By this definition, in 2007 U.S. aid to Africa was \$7.6 billion while China’s was \$1.4 billion—although China’s aid is growing much faster. China seems to deliver more aid than it commits to, while the DAC countries continually fall short of their pledges.

However, these narrow “aid” aggregates fail to take into account the huge impact of a complete Chinese package of an infrastructure investment, complementary direct investments (sometime with a domestic partner) in mining or power facilities, export credits, all with some “aid” as icing on the cake.

“Between 2007 and 2009, negotiations for a truly massive project that *would* be financed entirely by China Eximbank emerged out of the war-ravaged Congo, the former Zaire. China Railway Engineering Corporation (CREC) along with the Chinese hydropower company Sinohydro, and China Eximbank concluded an astounding package deal. Eximbank would provide a loan of \$6 billion in two installments. Sinohydro would be paid by these loans to build power plants and repair Congo’s water supply across the country. It would also build 32 hospitals, 145 health centers, two hydroelectric dams, two large universities, two vocational training centers, and thousands of low-cost homes. CREC built Shanghai’s high speed Maglev train, would renovate Congo’s colonial-era railway lines and build thousands of kilometers of

roads. CREC and Sinohydro would establish a joint venture with Gécamines, Congo's state-owned mining company, to reopen a disused copper and cobalt mine owned by a Belgian company and develop two new mining concessions. These investments, about \$3.25 billion would be financed by the two firms in a mix of shareholder credits and bank loans. The revenues from the mines would then be used over fifteen years to re-pay the initial loans." (Brautigam 2009).

Using another metric for measuring loans to Africa, Brautigam calculates that China's Eximbank is about the same size as the World Bank. In 2007, the lending of each bank to Africa as a whole was close to \$6 billion dollars. But there is an apples and oranges problem. Much more of the World Bank's loans were concessional, whereas the Eximbank loans and export credits were accompanied by a much broader array of direct investments—as with the Congo case described above.

The Beijing Consensus versus the Washington Consensus

In promoting growth in developing countries through foreign aid and investment, does the Beijing approach conflict with "Washington" guidelines used by the World Bank, International Monetary Fund, the OECD, and the United States itself?

The Beijing Consensus is hard to write down as a precise set of rules because of its pragmatism involving "a commitment to innovation and constant experimentation" (Ramo 2004)—as per the old Chinese saying "crossing a river by feeling the stones". It is also associated with China's specific commercial interests in, say, investing for extracting minerals on favorable terms—which enhances sustainability on both sides. In contrast, the Washington agencies in principle are more selfless (at least since the end of the Cold War) in aiming to raise per capita incomes and welfare in the recipient countries—but run the risk that aid recipients become permanent supplicants.

John Williamson (1990) did all a great favor by writing down the rules for what he called "The Washington Consensus" for developing countries to follow to absorb aid efficiently:

1. Fiscal policy discipline.
2. Redirection of public spending from subsidies ("especially in discriminate subsidies") toward broad-based provision of key pro-growth, pro-poor services like primary education, primary health care, and infrastructure;
3. Tax Reform—broadening the tax base and adopting moderate marginal tax rates;
4. Interest rates that are market determined and positive (but moderate) in real terms;
5. Competitive exchange rates;
6. Trade liberalization—with particular emphasis on the elimination of quantitative restrictions; any trade protection to be provided by low and relatively uniform tariffs;

7. Liberalization of inward foreign direct investment;
8. Privatization of state enterprises;
9. Deregulation—abolish regulations that impede market entry or restrict competition, except for those justified on safety, environmental and consumer protection grounds, and prudent oversight of financial institutions.
10. Legal security for property rights.

To provide perspective on these ten rules, the year 1990, when Williamson wrote, is important. It was just after the fall of the Berlin Wall and the complete collapse of confidence in Soviet-style socialism. The rules reflect the hegemonic confidence that most people then had in liberal market-oriented capitalism—think Ronald Reagan and Margaret Thatcher. But, 20 years later, should the meteoric rise of socialist China—both in its own remarkable growth in living standards, and in the effectiveness of its foreign “aid” to developing countries, undermine our confidence in Williamson’s Washington Consensus?

Surprisingly, no. The Chinese economy itself has evolved step-by-step (feeling the stones) into one that can be reasonably described by Williamson’s 10 rules! Chinese gradualism avoided the “big bang” approach to liberal capitalism, with the financial breakdowns that were so disastrous for Russia and some smaller Eastern European economies in the early 1990s, while retaining financial control in a model textbook sense (McKinnon 1993). So let us look again at Williamson’s 10 rules to see how well they fit China today in comparison to the United States.

Rules 1 to 3 on fiscal probity are more than satisfied by China: robust and growing revenue as a share of GDP has allowed massive investments in infrastructure both at home and abroad—and are increasingly directed toward health care, education and pension funding. Income taxes have been rationalized with marginal rates lowered, while a uniform VAT (17%) is a robust source of revenue shared between the central and provincial governments. In contrast, the American income tax has become riddled with exemptions and exclusions (think nonprofits), and the sales tax base of state and local governments has been eroded. The upshot is uncovered deficits at each level of government in the U.S. federal system.

On Rule 4, China has fixed its bank deposit rate at about 2 percent and loan rate at 5 percent, retail bank credit expanded strongly in 2009-10 to offset the global downturn. Its price level remains quite stable. Meanwhile the U.S. has fallen into a liquidity trap with short term deposit and interbank lending rates of interest near zero. Since 2008, retail bank credit has been contracting thus jeopardizing American recovery from the global crisis.

Exchange rate policies, Rule 5, are hard to compare because China fixes the yuan/dollar rate. Although the dollar fluctuates a lot against other currencies, it is not obviously persistently out of alignment in the sense of purchasing power parity.

On Rules 6 and 7, both countries follow fairly liberal policies for trade and investment.

On Rule 8, China has gradually privatized many enterprises. But there is still a large state-owned sector. However, most state-owned enterprises have been corporatized with strong incentives to operate profitably. Indeed corporate profitability is at an all time high.

On Rule 9, China has still some over regulated sectors—including some price controls on energy inputs. But its financial system—particularly the banks—has been regulated much more prudently than the American.

On Rule 10, private property rights remain much less secure in China than in the U.S., but not so much as to inhibit the efficient decentralization of economic decision making within the economy and in foreign trade.

“Although China is considered a market economy in general terms, its two most important trading partners—the United States and the European Union—refuse to afford it official market economy status (MES) at the WTO on the grounds that China still exhibits significant state involvement in the economy and has an ineffective framework for dealing with critical problems such as the abuse of intellectual property rights (Halper 2010, p 117).

Not being accorded MES status by some, but not all, members of the WTO makes it much easier for firms in the U.S. and EU to file and win antidumping suits against Chinese imports because they don't have to take Chinese domestic prices as a reference point for the alleged dumping of China's exports. However, Halper emphasizes that this restraint on total Chinese exports is being largely relaxed because high-growth emerging markets, such as Brazil (and others in Africa) are quite happy to grant China MES status in return for heavy Chinese aid-investment in Brazil's extraction of primary products. In effect, China is becoming an agent for freer trade in the world economy.

Halper worries that U.S. influence in the world economy is waning. Major countries can project “soft” (nonmilitary) power depending on how they organize their domestic economies. For more than two decades after World War II, the U.S. economic model was so successful that others want to emulate it—particularly in Europe with help of the Marshall plan, but also in developing countries outside the communist bloc. The strength of the U.S. economic and political model is now ebbing as China rises. However, U.S. influence in this soft dimension can be largely recouped if its government returns to a hard version of its own “Washington Consensus”— as China has done.

Aid-granting international agencies such as the World Bank, and crisis lenders such as the International Monetary Fund, have also changed. In the immediate postwar, the World Bank was formally known as the International Bank for Reconstruction and Development (IBRD). The focus then was to invest long term in infrastructure development—big dams and power plants—much as the Chinese do now. The IBRD, however, did not try to tie (succeed in tying?) repayments for these projects to a return flow of natural resources—unlike China's current quasi-barter deals. Rather it depended more on the host government's generating cash elsewhere to

repay interest and principal. With benefit of hindsight, this approach failed because host governments in Africa and elsewhere were fiscally weak, with rapid turnover, so that default rates were high.

Beginning in the 1970s, Stage II for the IBRD—now the World Bank—was to focus more on program lending to encourage governments to reform important parts of their weak economies by giving them cash. For example they would be given cash to liberalize foreign trade, or to strengthen bank regulation, or to strengthen public health facilities. But the World Bank would only disburse money in the context of so-called structural adjustment programs (SAPs). As the reforming host country successfully passed certain markers on the road to reform, the World Bank or the IMF would then release more money in parallel stages.

Occasionally SAPs worked, and perhaps still work—for example, Ireland and maybe Greece. But this program lending had, and has, an important downside. The international agency providing the money necessarily gets deeply involved in the monetary and fiscal affairs of the recipient country with an inevitable political backlash, perhaps made worse by attempts to change the political structure, e.g. introduce more democracy.

“Between 1980 and 1995, SAPs were applied to roughly 80 percent of the world’s population. Some of the more notable examples of adjustment stress include Mexico, Argentina, Bolivia, Peru, Ecuador, Venezuela, Trinidad, Jamaica, Sudan, Zaire (now Congo), Nigeria, Zambia, Uganda, Benin, Niger, Algeria, Jordan, Russia, and Indonesia. Each of these countries saw violent protests, in many cases deadly, against specific SAP stipulations, from sharp increases in fuel prices to steep currency devaluation and subsequent price hikes, and from food-price riots to university sit ins over the IMF mandating doubling the cost of bread or transport” (Halper p. 60)

No doubt that many, if not most of these SAPs, were in the long run interests of the recipient country if they had been politically sustainable.

Since 2000, now enter China. Its largely apolitical concern is to build infrastructure sufficient to sustain payment in the form of minerals or other natural resources—a mutually beneficial exchange. China’s Eximbank or Department of Foreign Aid would not dream of imposing structural adjustment programs on a new potential trading partner—much less get directly involved in nudging its politics in one direction or another, unlike the earlier Maoist adventures in Africa in the 1950s into the 1970s. True, the large scale of these projects will inevitably affect the economy, and perhaps the politics of the recipient country. But any such changes will be a natural outcome from the project itself—rather than the result of outside mandates, such as SAPs.

The least we can say about the “Beijing Consensus” in aid giving is that it fills niches that international agencies such as the World Bank don’t cover, but still complements what they do. The most we can say is that more and more developing countries will respond to China’s soft

power by trying to emulate its economic regime. Perhaps as they mature economically, these emulators will converge to the rules of the “Washington Consensus” much like China itself has.

In learning about China in Africa, Deborah Brautigam is hard to beat. She uses more than thirty years of experience from personal contacts on both the Chinese and African sides to develop great institutional insights into their economic interactions. Stephan Halper develops the most trenchant criticisms of the Western approach to aid giving, and the decline of American “soft” power. But he seems too pessimistic about “How China’s authoritarian model will rule the world”.

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