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# Is China a Developing Country?

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## Summary

China is the world's largest exporter of goods. It is also, by any plausible criterion, a developing country. China's dual status needs to be better reflected in Chinese policies - recognizing its global responsibilities -- and in those of the Western powers - recognizing China's limitations. Across three important agendas - macroeconomics, development assistance, and climate - important differences between China and the West remain, yet none of these issues appears intractable.

## INTRODUCTION

China designates itself as a developing country in the World Trade Organization and is classified as such by the World Bank based on the income per capita criterion. This enables China to avoid many of the responsibilities and disciplines applied to rich countries in international organizations, while qualifying for preferential treatment in some instances. Yet China is already the world's largest economy by some measures and is home to nearly as many companies as the United States in the Forbes list of the 500 largest companies. China is the largest producer of electric vehicles, has the global lead in important technologies such as 5G, and is among the leaders in artificial intelligence, facial recognition, electronic payment systems, and space exploration. It is the largest official **creditor** to developing countries. Understandably, China's continued self-designation as a developing country is a major source of tension between China and the United States and its allies.

What to make of this? Is China really a developing country? And does it matter whether it is or is not? This brief shows that—despite its many achievements—China remains a developing country by any plausible criterion. Yet China is exceptional since it is the first time in history that a relatively poor nation plays a dominant role in the global economy[2].

1. I thank PCNS colleagues, especially Hinh Din and Isabelle Tsakok, for detailed comments that improved the draft.

2. Arguably, the Soviet Union was both a developing country and a superpower, but it was on the margin of the global market economy. By the time the US emerged to play a leading role in the global economy, at the turn of the twentieth century, it was already a relatively rich country at that time.

China's exceptionalism has major implications. China should become more aware of the global repercussions of its policies, while the United States and its allies need to understand better China's limitations and moderate their expectations of China. I discuss what this means in three policy arenas: macroeconomics, development assistance, and climate. In a companion paper, I will tackle another issue where China's underdevelopment matters, and which is especially complex: trade policies.

## China's Development Status

The most widely used measure of development in the academic literature and in policy circles is income per capita (PCI) adjusted for purchasing power parity (PPP), intended as a direct measure of living standards. However, PPP calculations are based on many assumptions and suffer from measurement problems, especially for large countries such as China where the cost of living varies widely across its territory. Partly for this reason, the World Bank uses a simpler and more easily computed criterion, per capita income in current $, to classify countries according to stages of development. The exchange rate the Bank applies to the local currency is based on a weighted average of $ exchange rates over the previous three years adjusted for inflation, called the Atlas method.

Based on the Atlas method calculation, China is an upper-middle-income developing country, the category just below high-income countries including the United States and other G7 countries. To get a sense of how distant China's population is from achieving high-income living standards, in 2019 China's PCI PPP was $16,804[3] while the average for the high-income group as defined by the World Bank was three times higher, $52,785. The latest country to graduate into the high-income category, in January 2020, was Romania, whose PCI PPP in 2019 of $33,323 was twice China's.

Case closed? Not so, since questions are often raised about the quality of China's national accounts, i.e., the underlying income measure expressed in renminbi, and as mentioned, the accuracy of the PPP adjustment for China. If the cost of living in China is less than estimated by the PPP surveys, then China is richer than the headline numbers tell us. For this reason, it is worth probing a little further into China's development status using other data points that compare it with groups of rich and poor countries.

Consider China's exports of goods per capita, for example. Taken in isolation, this number is hardly an adequate measure of development status but provides a useful indication, since you would expect the residents of a rich country to export more than those of a poor country, and indeed exports per capita are strongly correlated with income per capita. Moreover, exports per capita are a particularly reliable statistic because exports from China can easily be verified by matching them with imports from China as reported by its trading partners. China is the world's largest exporter of goods, but, expressed per capita, in 2019 China's exports were $1716 compared to the OECD average of $7948. China's exports per capita are almost exactly in line with those of other upper-middle-income countries, $1876. Viewed this way, China is not quite the export juggernaut it appears.

Let us also consider other features common in developing countries and whether China conforms to them. As argued in landmark contributions by Nobel Prize winners Arthur Lewis and Simon Kuznets, developing countries tend to be characterized by greater **inequality** than high-income countries, both in terms of personal income and geography, i.e. across regions or the **urban-rural space**. In fact, on the broadest measure of inequality, the GINI index, China is far less equal (GINI of 38.5) than the median of the G7 countries, which is Canada (33.3), although China is more equal than the United States (41.4), which is an outlier among high-income countries. If instead we compare inequality in China to a sample of seven large middle-income countries—Brazil, Indonesia, India[4], Mexico, Russia, Thailand, and Turkey—we find that it is in line with the median, Indonesia, which has a GINI of 38.2.

Geographical or spatial inequality is more difficult to compare across countries since regions can be defined in many ways (urban/rural, states, provinces, cities, etc.). Still, it is clear that—as in other developing economies—spatial inequality is exceedingly high in China. The disposable incomes of Beijing and Shanghai (not adjusted for cost of living) are five times above those of the poorest provinces such as Xizang and Gansu. This is also the level of inequality found between the richest and poorest states in India and Mexico, for example. By

3. All data referred to in this brief is sourced from the World Bank's World Development Indicators, unless otherwise stated.

4. India is the outlier in this group as its PCI PPP is far lower but is included because it is often compared to China as a poor country with a huge population.

contrast, the income differences between the richest U.S. states such as Connecticut, and the poorest, such as Alabama, is no more than two to one. This is also the order of magnitude difference found among members of the European Union, with exception made for rich outliers such as Luxembourg.

Related to their high inequality, developing countries have many poor people. China has made enormous progress in eliminating absolute poverty. However, 24% of China's population still lives on below $5.50 a day PPP-adjusted, which is the poverty line the World Bank has set in middle-income countries. This compares with other upper-middle income countries, where the share of people living under $5.50 is 20%, and with high-income countries where the share is near zero. About one quarter of China's employment is in agriculture, where productivity is a fraction of the Chinese average. This share is about 8 times larger than that of high-income countries and is in line with that of upper middle-income countries.

An alternative and widely used measure of development to PCI PPP is the United Nation's **Human Development Index** (HDI), which includes the income measure but, additionally, gives a high weight to human achievement in education and health. The HDI index includes life expectancy at birth, expected years of education[5] and the population's mean years of education. Chinese life expectancy at birth is 76.9 years, over three years less than the OECD average. Its expected years of education are 14 compared to 16.3 in the OECD. Its mean years of education are 8.1 compared to 12 in the OECD. Although China typically does slightly better on these measures than the other large middle-income countries in the sample, the gap with the OECD is large. In fact, China's global rank out of 189 countries using the HDI is only two positions better than its PCI PPP rank.

China has a relatively young population, with only 11% of its population over 65, in line with other upper-middle-income countries, and much lower than high-income countries (18%). However, reflecting in part the one-child policy, China's population is **aging much faster** than either of these groups.

In summary, whether one uses income measures or proxies such as exports per capita, the GINI index, spatial inequality ratios, the incidence of poverty, prevalence of agricultural employment, health and education indicators, or age structure, China is like other middle-income developing countries and is different from high-income nations.

Though China is fast becoming the world's largest economy even in current $ terms, it is not about to catch up to the living standards of high-income countries. Assuming China continues to grow its PCI PPP at near 4% per year in real terms (an optimistic long-term forecast), it would take 36 years for China to catch up with the income of the most recently promoted high-income country, Romania, assuming the latter's PCI PPP grows at 2% a year.

Indeed, the gap in individual income between China and the richest countries, such as the United States, is so large that it will continue to widen in absolute terms unless China grows several times faster. For example, between 2010 and 2019, the absolute difference between per-capita income in the U.S. and in China increased from $7551 to $16,830 despite China's faster growth rate. China's per capita income is advancing vis-à-vis the United States in relative terms but falling behind in absolute terms. China's total GDP – whether expressed in current $ or PPP- adjusted is, on the other hand, close to that of the United States and China appears set to overtake the US as the world's largest economy even in current $.

## China's Institutional Weaknesses

Many in the West see China as directed by an all-powerful superstate led by the Chinese Communist Party. The concern that a small group of individuals wields too much power in China compounds tensions in many arenas of international relations. But the ability of China's regime to marshal resources and deliver impressive results—including in a time of crisis as shown in the COVID-19 pandemic—conceals a more complicated reality. China has a population of 1.4 billion dispersed over a large and diverse territory. It is a complex dual economy, combining pockets of high income and technological achievement with vast areas of rural poverty. As **David Dollar** of Brookings—a former World Bank Country Director in China—has written:

5. Expected years of education is the number of years of schooling that a child of school entrance age can expect to receive if prevailing patterns of age-specific enrolment rates persist throughout the child's life.

*"Outsiders often make the mistake of seeing a 'China, Inc.'—that is, a centralized, authoritarian state executing careful plans. With such a view of Chinese decision-making, Chinese inconsistency is hard to explain. In reality, China has many different stakeholders and complicated domestic politics."*

China's decision-making is poorly understood abroad, but so is the country's capacity – or rather, lack of capacity -- to operate a rules-based system consistently. Like other developing countries, China's institutions are not nearly as robust as those of advanced countries, and this is especially evident in the ability to enforce rules and regulations in a uniform and predictable fashion. Perhaps the most comprehensive assessment of the quality of institutions is found in the World Economic Forum Global Competitiveness Report (GCR). The assessment draws on a global survey of some 18,000 executives in 140 countries, including 400 in China. The GCR evaluates the quality of institutions through 26 indicators grouped into 8 categories: security, social capital, checks and balances, public-sector performance, transparency, property rights, corporate governance, and future orientation of government. Table 1 shows that China is ranked about half-way between the OECD average, near India and Indonesia in our sample of middle-income countries. On the prevalence of corruption, China ranks much closer to the average of developing country comparators than to the OECD average.

### Table 1 - China's institutions rankings compared

| | China | OECD average | MIC Average |
|---|---|---|---|
| **Institutions** | 58 | 31 | 74 |
| **Corruption** | 75 | 28 | 88 |

Note: the MIC (middle-income country) average includes the rankings of Brazil, India, Indonesia, Mexico, Russia, Thailand, and Turkey.

Source: World Economic Forum, Global Competitiveness Report 2019

The data from Table 1 could be extended to cover many other international comparison indicators drawn from international organizations that convey a similar message: China's institutions, its business practices, and even many of its policies (for example its trade and investment restrictions) are ranked somewhere between those of other middle-income countries and advanced countries and are often closer to the former than the latter.

Although China has seen one of the most rapid economic transformations in history and continues to progress rapidly, the fact remains that institutions are not built overnight. In China as elsewhere they change slowly. For example, under Xi Jinping China has embarked on a massive campaign to root out corruption, applying the death sentence in some cases. Yet, according to executive surveys, corruption remains rampant. There are many other areas in which China's laws and regulations have changed to become more business friendly. Except in politically sensitive areas, such as media and education, the rules are not dissimilar to those of advanced countries. However, the observance and application of the law in the real world continue to lag.

The inconsistent application of rules is, not surprisingly, a concern of Western firms in China. **As Pauline Weil** and I wrote in a recent Bruegel brief: *"A big grievance flagged by U.S. and EU firms operating in China is uncertainty and inconsistency surrounding laws, their interpretation and enforcement. U.S. firms rank this as their top concern. EU firms also complain about red tape and market access restrictions ... a recurring theme is the discrepancy between de-facto and de-jure restrictions. Only about 15% of EU firms report overt impediments to their operations but twice as many reported less transparent barriers such as lengthy, complicated, and opaque licensing and administrative approval processes".*

China's vast spatial and social inequalities are themselves a sign of weak institutions and inadequate capacity. Inequality also makes reform more hazardous. The 350 million poor Chinese living under $5.50 a day are found not only in the country's less-developed western regions but also on the fringes of China's relatively prosperous coastal cities. The vulnerability of this population to any kind of external shock makes policymakers more cautious about embarking on potentially disruptive reforms, such as market opening and reduced state involvement in the economy. Despite the concentration of power in one

party in China, legitimacy must be preserved, and, as in any other country, domestic political constraints play a major role in determining the speed and extent of reform in China.

## Policy Divide, and Areas of Convergence

China is a world power, wielding great influence over the global economy. In an average year, China accounts for some 20% of the growth of world GDP. With power comes responsibility in areas ranging from the stability of China's financial sector to the management of its exchange rate, the credit policy towards small and vulnerable economies, carbon emissions, exploitation of deep-sea fisheries, and many other areas in which China's policies can have major effects on the rest of the world. But China is also a developing country with young and relatively weak institutions and large vulnerable populations. Even when laws are agreed and take effect in China, implementation takes a long time and is uneven across territories and groups.

Contending with this reality has profound implications for China's policies and the policies of the United States and its allies. In considering the implications, I focus here solely on the economic dimension of relations with China, despite the importance that geopolitics, security, and human rights play. Moreover, to keep the subject matter manageable, I will refer mainly to the economic relationship between China and the United States, which plays a central role, and which shares many concerns about China with its allies.

Here, I will briefly describe the state of play on three major issues of contention in the economic relationship between China and the United States: macroeconomic policy, development assistance, and climate change mitigation.

### Macroeconomics

Macroeconomic policy has long been a major bone of contention but is also the area where progress has been greatest. Although China still runs a large bilateral trade surplus with the United States, it is no longer suspected of undervaluing its currency. As it has become more reliant on domestic demand, China's global current account has moved from a huge surplus relative to its GDP to a surplus in line with that of the European Union and Japan, and far smaller than Germany's.

China is now a large supporter of and contributor to various International Monetary Fund lending facilities and the renminbi is now one of five currencies that form the Special Drawing Rights (SDR). However, China's voting share in the IMF—while higher than before following a recent reform—remains far lower than its weight in the global economy because of U.S. and European opposition. China continues to apply various forms of capital controls and its financial system continues to be heavily dependent on state-owned banks. Although there has been significant liberalization of the Chinese financial sector in recent years, many obstacles impede Western financial firms and Chinese and foreign portfolio investors. At the same time, in the wake of the Asian financial crisis (1997-1998) and the Great Financial Crisis (2007-2009), the academic and policy consensus has shifted in favor of capital controls in developing countries on precautionary grounds. This cautious approach to capital-account liberalization has become part of mainstream thinking, including at the IMF, giving China and other developing countries more space to undertake financial and balance-of-payments reforms at their own pace.

### Development Assistance

One of the surprising features of China as a developing country is that it has itself become a large foreign investor, as well as a creditor and provider of development assistance. According to an **analysis** by Carmen Reinhart, now Chief Economist at the World Bank, and co-authors, about 150 countries have received Chinese loans and investments amounting to $1.5 trillion.

Major tensions over China's development and lending policies are a relatively new aspect, due especially to the increase in China's lending for transport and power infrastructure to poor countries under its **Belt and Road initiative**, launched in 2013. China's engagement and omnipresence in developing countries was bound to be disruptive of established zones of influence and controversial in any circumstance. In this case, however, concerns have been aggravated by what Western donors see as non-transparent lending, which is carried out mainly on commercial terms, is financed and executed by Chinese firms, and which carries various conditions

that limit the borrower's flexibility. This is possible because China is not a member of the OECD Development Assistance Committee (DAC), which establishes standards for development lending, including, for example, concessional terms and competitive procurement rules.
China participates in the Paris Club restructuring and forgiveness process for official debt in poor countries. However, it also claims that much of its lending to poor countries is not official, even when the creditor is typically a large Chinese state-owned enterprise. In times of distress, as in the wake of the pandemic, this gives Chinese lenders the freedom to restructure debts on their own terms.

There is no question, however, that China makes a big contribution to the development agenda by enabling investment in much needed infrastructure in poor countries, meeting a demand that has gone largely unfulfilled in recent years because of many constraints and slowness in the traditional development agencies, and unwillingness on the part of the private sector to take the risk. China has also become a big contributor to the International Development Association concessional lending arm of the World Bank, with which it has a long-standing and productive relationship, nowadays mainly based on the bank's advisory services. As in the IMF, China continues to be underrepresented relative to its size in its shareholding and voting power in the World Bank.

### Climate

In no domain is the combination of China's global heft and its relative underdevelopment drawn in starker contrast than in climate policy. China is the largest emitter of carbon dioxide, with the U.S. a distant second. However, China's $CO_2$ emissions per capita are less than half those of the United States. Both countries must reduce carbon emissions, but how should the burden be shared? Naturally, China insists on the Paris Accord's principle of common but differentiated responsibility, which is code for all countries contributing but with developing countries—including China—allowed greater leeway in reducing emissions.

With the US returning to the Paris Agreement under the Biden administration, cooperation on climate with China stands out as the area where a certain rapprochement between the two superpowers has already taken place. At the virtual Climate Summit organized by President Biden in April 2021 and attended by Xi Jinping, China made no new explicit commitments but—in the flurry of diplomacy that preceded the summit—signaled its awareness of the need to reduce the use of coal, including by limiting its support for building coal-fired plants through the Belt and Road Initiative. As things stand, China aims to be carbon-neutral by 2060 and to reach peak emissions in 2030. The intent is also to reduce carbon emissions per unit of output by 18% over the next five years. Biden has pledged that the U.S. will reach carbon neutrality by 2050, 10 years ahead of China, and will achieve zero emissions in the power sector by 2035. Ambitious as these goals are, environmentalists say that both countries must do more if the Paris Accord goal of limiting the global temperature rise to 1.5 degrees centigrade relative to pre-industrial level is to be met.

## Conclusion and Recommendations

As it becomes increasingly integrated into the global economy, China's dual status as a world power and developing country is a great source of friction and complications. If the large global gains in welfare from China's integration are to be realized in full, China and the United States and its allies need to adapt mindsets and policies to deal with a situation that—while no longer new—is historically unprecedented.

Reciprocal concessions will be essential for successful integration to happen. Our review of differences and convergence in macroeconomics, development assistance, and climate, suggests that much convergence between China and the U.S. and its allies has already happened. This is most evident in macroeconomic policy, where global imbalances have been vastly reduced, and in climate where China and the United States are once more aligned in both overall objectives and approach. Development assistance, a relatively new sparring arena, is an area in which objectives are (or should be) broadly aligned—everyone wants development to happen after all—but where the distance between the parties on modalities remains greatest. Still, in all these areas and against the vast canvas of international diplomacy, the remaining differences appear bridgeable. Deals can be done.

The U.S. and its allies should allow China to play a greater role in the IMF and World Bank—shareholding and voting power corresponding to its size—in exchange for China increasing its contribution to both organizations. The contribution required of China is not mainly monetary, although that would help. It is principally about adopting standards and disciplines that high-income countries already adhere to, for example in lending to developing countries under the DAC, and about reform of the financial sector as a prelude to capital account liberalization and a less-managed exchange rate regime. In recognition of China's status and genuine constraints as a developing country, the U.S. and its allies should allow these reforms to be implemented over an extended period, even as they insist on a defined framework and timetable to do so.

On climate there are numerous areas of potential collaboration. A good start would be to toughen the targets on carbon emission reductions in a coordinated way. Such a step would create strong incentives for cooperation on the development of technologies to reduce emissions, provision of technical assistance to poor countries, and establishment of incentive frameworks that facilitate the achievement of targets. The latter could include a framework for the establishment of a carbon tax together with a carbon border adjustment mechanism that allows differential treatment for developing countries. Also possible is a WTO-sponsored plurilateral free trade agreement in environmental goods that would include China. This takes us into the field of trade policy, which is an especially thorny issue, and the subject of a forthcoming companion brief.

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