

WebMemo



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China Grows 10 Percent Again: Is This Believable?

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The man set to become China's prime minister in early 2013, Li Keqiang, became prematurely famous last month when he was reported as admitting that China's gross domestic product (GDP) figures were "for reference only." The comment from the future economic helmsman will be used to dismiss Chinese government data for years to come.

Li was also quoted as saying something more productive and valuable: He cited bank lending, rail cargo, and electricity consumption as signaling the true health of the Chinese economy. There are many ways to delve into what is truly happening underneath the official veneer,¹ and Li's method, in keeping with his background, places too much weight on industry.

But it also yields interesting and reasonable insights. In particular, the PRC's economic performance looks stronger than official numbers indicate for 2010. Following Li's guidance, though, it looks much weaker than official numbers indicate for 2008–2009. This greater instability, and the desire to hide it, shows China playing with a weaker hand than it appears. American policymakers should be mindful of periods of Chinese economic vulnerability in considering when to apply pressure and when to offer more cooperation.

The Official Version. According to China's State Statistical Bureau (SSB), 2010 GDP growth was 10.3 percent, bringing the economy to just over \$6 trillion, another milestone. Perhaps surprising, most other official figures imply that the SSB actually understates Chinese growth in 2010.

For instance, the consumer price index is reported to have climbed 3.3 percent. However, this is the smallest gain among the PRC's many price measurements. A better price measurement is the GDP deflator—the difference between arithmetic GDP growth and announced real growth—which for 2010 is 6.4 percent. Either true inflation is notably faster than the consumer index shows or the GDP deflator is too large and real GDP growth is higher than announced. Either way, the economy ran hotter than the SSB claims.

Components of GDP reveal another problem. Fixed asset investment and retail sales are benchmark measures for investment and consumption, respectively, but add up to more than China's GDP by themselves. Along with the trade surplus, which is the world's largest, the three main components of GDP add up to far more than GDP.

This is because fixed investment and retail sales do not correspond to investment and consumption as understood everywhere outside China. The SSB nonetheless insists on reporting them. Fixed investment is an absurd 70 percent of GDP, twice the proportion of just eight years ago. Perhaps when fixed investment exceeds 100 percent of GDP, Beijing will acknowledge that it is a useless measure.

This paper, in its entirety, can be found at:
<http://report.heritage.org/wm3098>

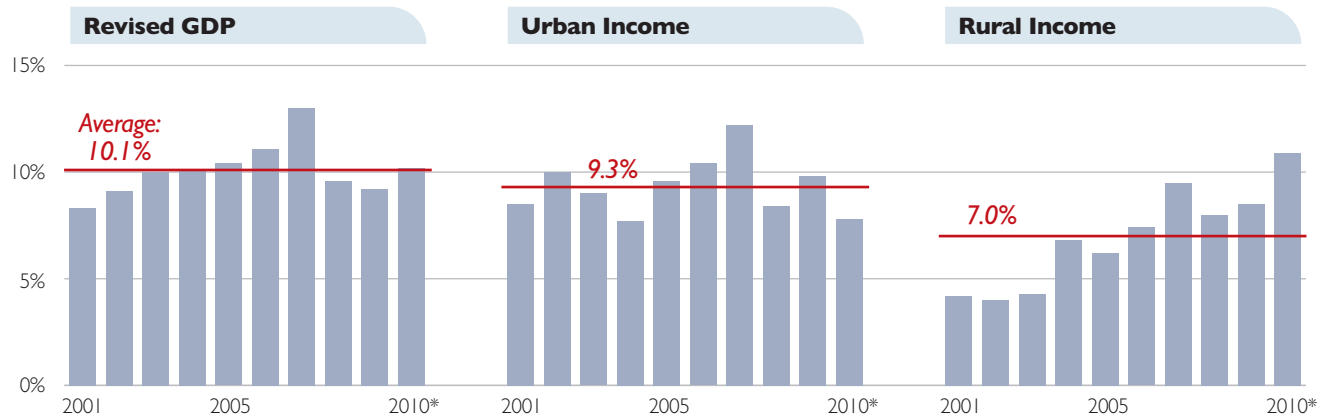
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China's Unproductive Growth

Annual Percentage Change



* Preliminary estimates.

Source: National Bureau of Statistics, *China Monthly Statistics*, Beijing, Vol. 1, 2001–Vol. 12, 2010.

Chart 1 • WM 3098 heritage.org

An economic weakness on the official tally is that GDP consistently outpaces personal income. In a rare event, rural incomes may have grown faster than GDP in 2010, depending on the price measure used. Urban incomes rose considerably more slowly.² The PRC's rapid official growth does not provide equally rapid gains for its people.

Finally, the official report on 2010 will be revised. Every Chinese GDP revision to this point has been the same in two crucial ways: (1) It is always higher, and (2) it is always incomplete. GDP growth is always said to be higher than initially estimated, but revisions for many figures are not published, so the numbers are rendered incomparable. China's revisions reduce transparency and credibility and make Li Keqiang seem wise.

Li Keqiang Theory. One view of Chinese economic figures is that they are all too high. A more nuanced view is that the Party is obsessed with stability, and this obsession leaks into data reporting

such that the highs and lows of China's economic performance are both dampened. This hypothesis is supported by examining, as Li suggested, rail and electricity.

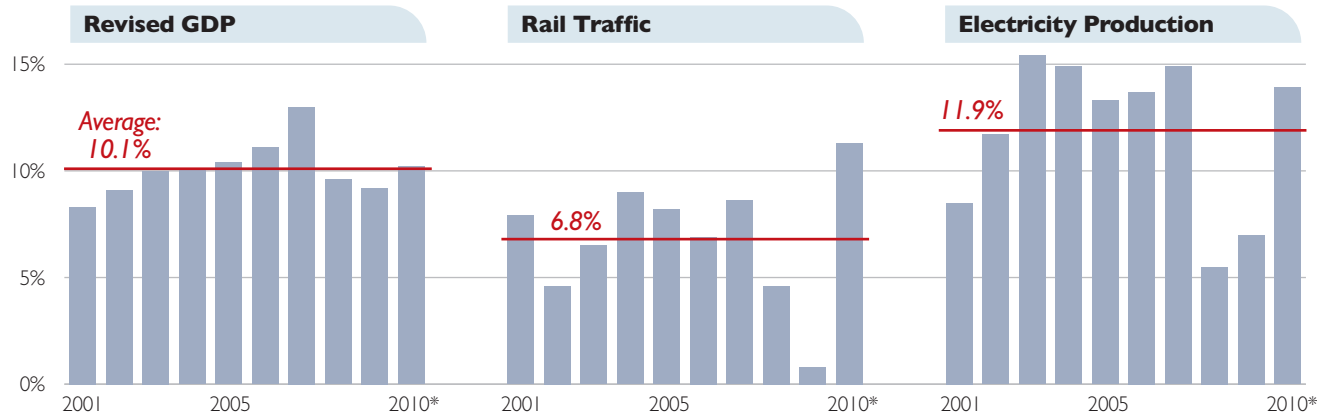
Rail growth is slower and bounces around more than GDP, but the size of the gap between them is a maximum of 4.4 percentage points from 2001 to 2007. In 2008, the gap reaches 5.0 points. In 2009, it is 8.4 points as rail traffic slowed a great deal but GDP was said to slow only slightly. This is simply not credible. In 2010, rail traffic seems to have leaped from far slower than GDP to faster than GDP for the first time in more than a decade. Li might find this implausible—and rightly so.

Electricity production is used so that all figures stem from a single source (electricity production is more stable than consumption, and bias results in China's favor). Electricity production growth is faster than GDP from 2001 to 2007. In 2008–2009, it is slower. Then, in 2010, it is faster again. This is

1. Simon Rabinovitch, "China's GDP Is 'Man-Made,' Unreliable: Top Leader," Reuters, December 6, 2010, at <http://www.reuters.com/article/idUSTRE6B527D20101206> (January 19, 2011); Derek Scissors, "The Truth About China's Growth," Heritage Foundation WebMemo No. 2238, January 22, 2009, at <http://www.heritage.org/Research/Reports/2009/01/The-Truth-About-Chinas-Growth>.
2. Ma Jiantang, "National Economy Showed Good Momentum of Development in 2010," National Bureau of Statistics of China, January 20, 2011, at http://www.stats.gov.cn/english/newsandcomingevents/t20110120_402699463.htm (January 20, 2011).

China's Unreliable Growth

Annual Percentage Change



* Preliminary estimates.

Source: National Bureau of Statistics, *China Monthly Statistics*, Beijing, Vol. 1, 2001–Vol. 12, 2010.

Chart 2 • WM 3098 heritage.org

a pattern that extends back further: In especially difficult years, electricity production is slower than GDP; in all other years, it is faster.

It is unlikely that the PRC rotates between splurging on electricity and appearing to be energy-efficient. It is also unlikely that rail freight growth can collapse while GDP growth barely budges. Li's guidance argues, in contrast, that Chinese GDP slowed far more than the SSB admitted for 2008–2009 and accelerated faster than it reported for 2010.

Bank Lending Discouraging. The last element of Li's triumvirate of indicators, bank lending, is more complex. It is difficult for large amounts of rail traffic or power production to escape Beijing's count. It is much easier for large amounts of lending and borrowing to occur outside formal banking, especially when cities and provinces are encouraged to borrow. In addition, commercial bank lending accelerates as the economy accelerates. Policy-driven bank lending, in contrast, rises to bolster a weak economy.

Bank lending, therefore, does not have a clear relation to the true speed of growth. Instead, it is linked tightly to central government objectives; it is the main tool for the Chinese government to encourage growth with conventional fiscal policy

involving far smaller sums of money. In that sense, Li was right, again, to consider bank loans as vital.

Over the past 10 years, if official figures are accurate, China averaged 17 percent loan growth and 10 percent GDP growth. This level of loan growth is unsustainable, but it is distorted by the panicked 2009 stimulus. The 2010 performance is more worrisome. Official 2010 GDP growth is average, but lending needed to achieve it is well above average. Compared to 2004–2007, unpleasantly faster lending is required for the same growth. This is an economy noticeably weaker than five years ago, notwithstanding talk of its greatness.

The obvious issue is that rail and electricity indicate that the GDP figures are not accurate. In particular, 2008 and 2009 were weaker than acknowledged, and 2010 was stronger. It is difficult to discern trends in this situation, but if the economy was very weak in 2008–2009, hyper-aggressive lending might have been appropriate. However, the continuation of rapid lending in a strong 2010 constitutes a major policy mistake.

From 1998 to 2007, the PRC worked to address problems in banking. The work has now been undone by forced policy lending. Officials estimate hidden local government debt at 10 trillion yuan

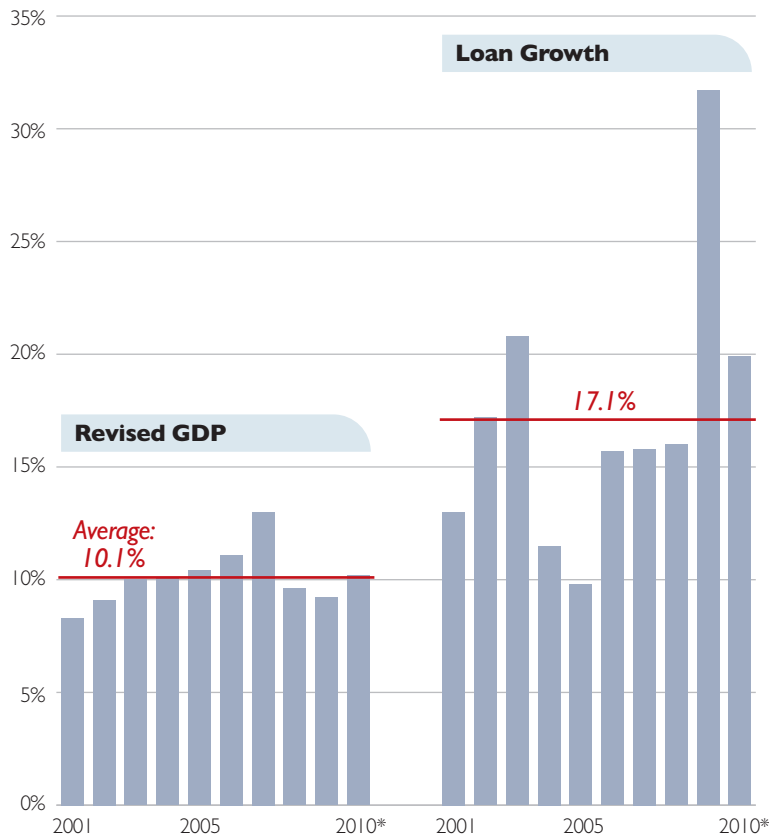
(\$1.5 trillion), a number that rises every time the government mentions it.³ Yet local borrowing continues, as do other errors—tightening to this point is a myth. Interest rate increases have not kept up with inflation, so real interest rates have actually fallen. If GDP growth is accurate, China’s economy is structurally weakening. If, as is more likely, GDP growth is artificially stable, a damaging policy error was made in 2010.

Better Informed American Policy. The Obama Administration and Congress should listen to Li Keqiang. More reliable figures suggest that China smoothes its GDP results, and its economic challenges are far more daunting than they appear in official renditions. A properly informed American policy will have a better sense of when the time is right to push China and when more aggressiveness would be harmful.

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China’s Unsustainable Growth

Annual Percentage Change



* Preliminary estimates.
 Source: National Bureau of Statistics, *China Monthly Statistics*, Beijing, Vol. 1, 2001–Vol. 12, 2010.
 Chart 3 • WM 3098 heritage.org

3. Moneynews.com, “Beijing Lawmaker: China Has \$1.5 Trillion ‘Hidden’ Debt,” January 14, 2011, at <http://www.moneynews.com/StreetTalk/BeijingLawmakerChinaHas1-5TrillionHiddenDebt/2011/01/14/id/382841> (January 19, 2011).