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China's Economic Data Are (Still) Not Credible

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China today announced that gross domestic product (GDP) growth for 2011 slowed to 9.2 percent. Over the next days and weeks, there will be a stream of pontificating about what this means. There is a good chance that everyone involved will be pontificating about nonsense.

China's economic statistics are usually inconsistent—and occasionally wildly inconsistent—and do not seem to be improving in quality. For 2011 GDP in particular, Beijing is very likely exaggerating growth. (Some years it understates.) Rather than focusing on reported figures, the U.S. should prepare for a weak Chinese economy but one that may begin to rebalance in 2012. It should also engage in long-overdue independent estimation of China's performance.

Impeaching the Growth Result. There is a cottage industry that gains directly or indirectly from insisting that Chinese numbers are fairly accurate and far better than they were during the bad old days of 15 years ago. But reasons for skepticism abound.

On one side are 9.2 percent growth last year and 10.4 percent in 2010. On the other is evidence of a far sharper slowdown. Auto sales, for example, plunged to 2.5 percent growth last year from 32 percent growth in 2010. There are also figures that can be corroborated with foreign partners. More than four-fifths of China's shipbuilding tonnage is for export. New ship orders plummeted 52 percent outright in 2011. Growth in imports of crude oil slipped to 6 percent growth last year from 17.5 percent in 2010.[1]

There are indirect indicators of a much slower economy. Monetary policy has long been extremely loose, featuring negative real interest rates. Yet the central government began loosening further several months ago, a strange reaction to growth still over 9 percent. China still boasts the world's largest foreign trade surplus and net inward investment. Foreign exchange reserves fell in the fourth quarter, suggesting capital flight. That would translate to a sluggish world economy being more attractive than China's own.

Premier Skeptics. Problems go well beyond 2011 GDP. It has been over a decade since former Premier Zhu Rongji wondered how all provinces could grow faster than the country as a whole. The problem persists and, in fact, was worse in 2011 than in 2008. The trends in national and provincial growth clearly match, but provinces remain unwill-

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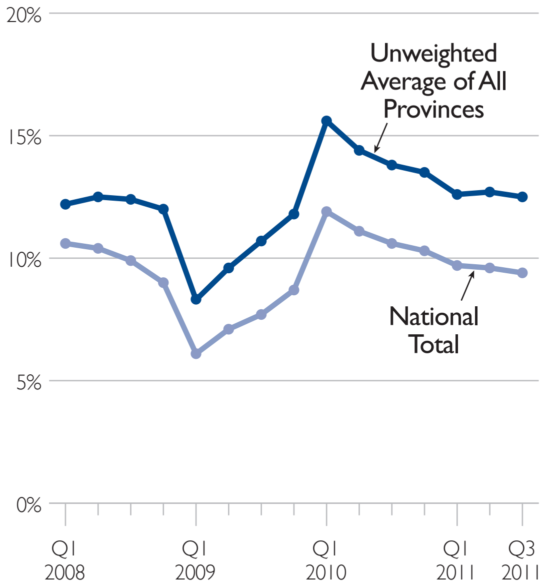
China's Peculiar GDP Growth

GDP Growth, Cumulative Year-on-Year Percentage Change



Source: National Bureau of Statistics, *China Monthly Statistics*, Beijing, Vol. 1, 1999–Vol. 12, 2011.

Chart 1 • WM 3458 heritage.org

ing to report accurate numbers. Such unwillingness extends deeply into Chinese statistics.

Li Keqiang, himself set to become premier in 2012, once dismissed GDP figures as "man-made." A serial revision process was intended to improve the quality of the data. There has never been a downward GDP revision, though, which indicates more unwillingness to report certain results. Further, only some data are revised, creating a mismatch between revised and unrevised elements. The revision process is indeed man-made and may have worsened data quality.

Some Chinese figures are so absurd that they do not require a premier to doubt them. There is no pretense of a true unemployment rate but instead only a figure for "registered urban unemployed," a number that is not allowed to exceed 5 percent.

It is considered too dangerous to announce true urban joblessness, much less the far higher rural number.

With GDP and unemployment, the third pillar of macroeconomics is inflation. The consumer price index rose 5.4 percent last year. The implicit GDP deflator—the gap between the arithmetic rise in GDP and announced real growth—was 8.3 percent. The GDP deflator fluctuates more widely than the consumer index, and the latter is acknowledged by the Chinese government to have flaws. But price instability is considered sensitive. If political imperatives prevent release of better inflation numbers, any reasonable unemployment figure, useful revisions, or sensible provincial series, why accept the smoothest growth profile for any developing economy in history?

It should be emphasized that many problems in the Chinese data are due to foreign observers. The Ministry of Commerce identifies Hong Kong as the source of 60 percent of incoming foreign direct investment (FDI) in 2011, soaring from an already substantial 35 percent in 2007. Calling investment from Hong Kong "foreign" strains credulity, especially with so many mainland subsidiaries that are listed in Hong Kong and sending money back to the mainland. Yet it is duly repeated that FDI is rising.

Not Rebalancing Yet. The flaws in Chinese data have serious consequences. The imbalance between consumption and investment has become a critical force in the world economy, but data issues cloud both the extent and the trend of the relevant data.

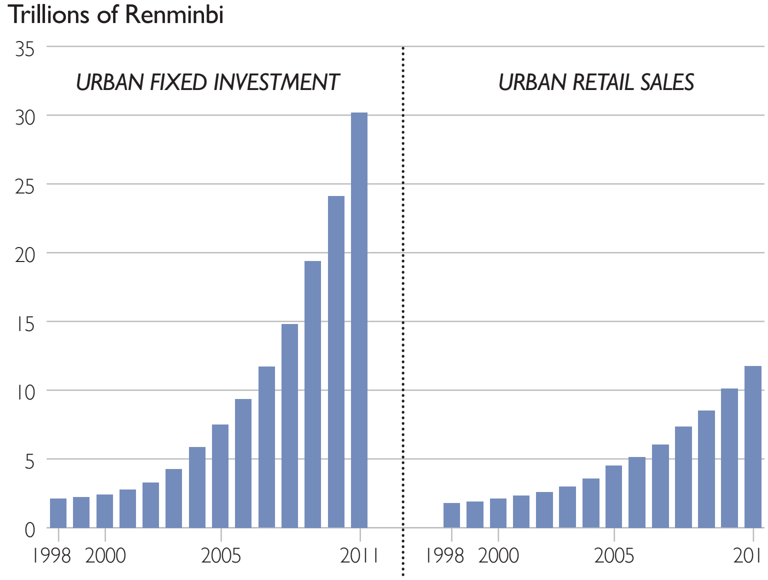
1. Xinhua, "China Auto Sales Posts Slowest Growth in 13 years," January 12, 2012, at *http://news.xinhuanet.com/english/china/2012-01/12/c_131356430.htm* (January 16, 2012); Xinhua, "China Built More Ships Last Year but New Orders Sank," January 13, 2012, at *http://news.xinhuanet.com/english/china/2012-01/13/c_131359059.htm* (January 16, 2012); Wayne Ma, "Oil Data: China December Crude-Oil Imports Rose to 21.92 Million Tons," SmartMoney.com, January 9, 2012, at *http://www.smartmoney.com/news/on/?story=ON-20120109-000542&cid=1259* (January 16, 2012).

Using national accounts measurements, consumption's share of GDP was below 48 percent in 2010. This is about 15 percentage points below the ideal level and continues a decline that began in 2002. Regarding investment, the Asian financial crisis of 1997–1998 occurred in large part as a result of unproductive outlays. The year before it erupted, Indonesia's investment share of GDP was below 36 percent. In 2010, China's share of investment in GDP approached 49 percent, surpassing consumption and a historically unprecedented level.[2]

Some claim that China is already rebalancing. They cite retail sales as growing faster than consumption as measured in national accounts. But retail sales are a poor economic indicator. This figure is incompatible with official GDP, so both cannot simultaneously be accurate.[3] And retail sales have been rising quickly precisely because they include elements that have nothing to do with consumption, such as building materials and government-to-government transactions.

Another tactic is to cite estimates that reveal official consumption as too low. Due to inadequate survey methods, however, official figures have underestimated the size of most of the Chinese economy. For the same reason, official numbers often overestimate annual growth, since the base is larger than acknowledged and some annual gains consist of "discovering" old activity. Isolating parts of the economy is a serious error. That consumption is larger than estimated does not establish its GDP share or growth trend.

Creating an Imbalance



Source: National Bureau of Statistics, *China Monthly Statistics*, Beijing, Vol. 1, 1999–Vol. 12, 2011.

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Restructuring by Default? Data and interpretation errors should not obscure the magnitude of the consumption-investment imbalance. It is true that consumption has been growing steadily. The problem is that investment always grows faster, as it did in 2011, so consumption's GDP share still falls. Moreover, financing rapid investment requires that consumption be suppressed through lack of competition, low returns on savings, and so on. For true rebalancing, investment growth must decline noticeably, something Beijing has been utterly unwilling to accept.

In 2012, it is possible that the central government may be persuaded to stand aside and let investment moderate, for two reasons. First, the explosion in

2. Aaron Beck, "Data Bolster China's Currency Case," *The Wall Street Journal*, November 16, 2011, at *http://online.wsj.com/article/SB10001424052970204323904577039592614894900.html* (January 11, 2012).

3. Derek Scissors, "Something Is Not Right in Beijing," Heritage Foundation *WebMemo* No. 2775, January 25, 2010, at *http://www.heritage.org/research/reports/2010/01/chinas-economy-something-is-not-right-in-beijing*; Derek Scissors, "China Refuses to Adjust Its Economy," Heritage Foundation *WebMemo* No. 2546, July 16, 2009, at *http://www.heritage.org/research/reports/2009/07/china-refuses-to-adjust-its-economy*.

lending triggered in 2009 in response to the global shock restricts both the quantity of stimulus in 2012 and its potential impact. Second, specific sectors reinforce the idea that the government might restrain itself.

For instance, real estate receives one-fourth of fixed investment. Real estate spending should stabilize, but explosive growth is unlikely. Dampening power consumption growth argues against heavy new spending on plant construction. Railways were to be a source of extremely high investment, but well-documented problems with rail expansion now make that unlikely.

Beijing can still find sectors through which to ensure another 25 percent rise in investment, but the task will be harder. How determined will the government be? The political transition in 2012 argues for high stimulus. There is a counterargument, though: Overcapacity is daunting. For example, nearly one-third of aluminum capacity could be unused in 2012. Overcapacity in autos may reach a similar level a few years later.[4]

Hence, most traditional industries could be harmed more than helped by further investment in 2012. This may finally cause investment to slow such that consumption can catch up. The central government does not need to act; it only needs *not* to act.

Challenges for the U.S. China's macroeconomic and data issues present varying challenges to the U.S. First, the U.S. should stop relying on numbers that are deemed absurd by the most senior officials of the government producing them. Second, it is possible that Chinese rebalancing may actually begin in 2012—if more by default than by some dramatic central government program.

The U.S. should therefore:

- Create a project, led by the Department of Commerce, to compile American estimates of important Chinese economic indicators: GDP, unemployment, inflation, investment, consumption, and so on. This project is long overdue.
- During Vice President Xi Jinping's anticipated February visit and the spring Strategic and Economic Dialogue, encourage the Chinese government not to fight rebalancing.

The U.S. Can Help. One way the U.S. could facilitate Chinese rebalancing is by its own rebalancing—cutting the budget deficit. Short of that, the U.S. can publicly tie progress in Chinese rebalancing to an American commitment to forgo trade sanctions. This would be especially helpful in the politically dangerous year ahead.

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4. Bloomberg, "China May Idle Most Aluminum Capacity Since 2009," January 11, 2012, at *http://www.bloomberg.com/news/2012-01-11/china-may-idle-most-aluminum-capacity-since-2009-commodities.html* (January 12, 2012); Xinhua, "Expanding Auto Production Triggers Overcapacity Concerns," July 17, 2011, at *http://www.china.org.cn/business/2010-07/17/content_20517491.htm* (January 12, 2012).