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Chinese Growth, GDP, and Other Things the U.S. Should Doubt

Derek Scissors, PhD

The first question regarding China's newly released economic numbers is not how fast the People's Republic of China (PRC) grew last year. Rather, it is whether stars are aligned for the State Statistical Bureau (SSB) to provide accurate information about GDP and more useful measures, such as household consumption.

Answer: to some extent. The Chinese economy is undergoing a cyclical recovery and the SSB can honestly report a noticeable improvement.

There are two large qualifiers to this happy statement. First, the SSB never provides much valuable information due to political imperatives and flaws in GDP accounting itself. Second, the recovery is cyclical, not structural. The PRC's economy structurally weakened under Hu Jintao's outgoing government and, until market reform restarts, slow weakening will continue. Chinese data do not reflect this weakness and, therefore, incentives at work in Beijing. The U.S. needs its own measurements of China's economy as the first step toward better policymaking.

SSB + GDP = LOL. The Communist Party suppresses information it dislikes. How can anyone argue that quarterly economic reporting is exempt?

Beijing almost never reports a genuine unemployment number, because it is too sensitive. The PRC counts only a subset of those unemployed in cities and no one at all in rural areas. Including rural areas, official unemployment in the range of 4–4.5 percent may be off by a factor of five.[1] Housing prices, non-performing bank loans, and coal production are a few examples of the important figures that disappear from view when outcomes turn sour.

Is data quality improving? First, this suggests older data should not be used, which makes trends difficult to identify. Second, it is not clear quality is improving. Some improvements have been made, but other steps look manipulative. Data revisions typically find more of what the SSB wants to find: more consumption, more services, and so on. They are always left incomplete, so the end result is less comparability, less consistency, and effectively less transparency.

The problems come to a head over GDP and its constituent elements, such as investment and consumption. When China releases GDP figures, it releases indicators that look like investment and consumption—fixed asset investment and retail sales. But these numbers are virtually useless. More accurate components of GDP are released far later. How can GDP be available within two weeks of the quarter ending (compared to two months in far richer countries) while its principal components are not available for months afterward? Ensuing revisions always find more GDP.

Another fault is intrinsic. GDP is an accounting tool for annual expenditure or production. It is a poor way to describe economic performance over time. The PRC embraces short-term projects: For instance, buildings are built, torn down, and rebuilt. Each action adds to GDP, but together they add nothing to national wealth. China also runs the world's biggest trade surplus, each dollar of which adds to GDP. Does restricting competition from imported goods and services boost China's prosperity?

This paper, in its entirety, can be found at **http://report.heritage.org/ib3832**

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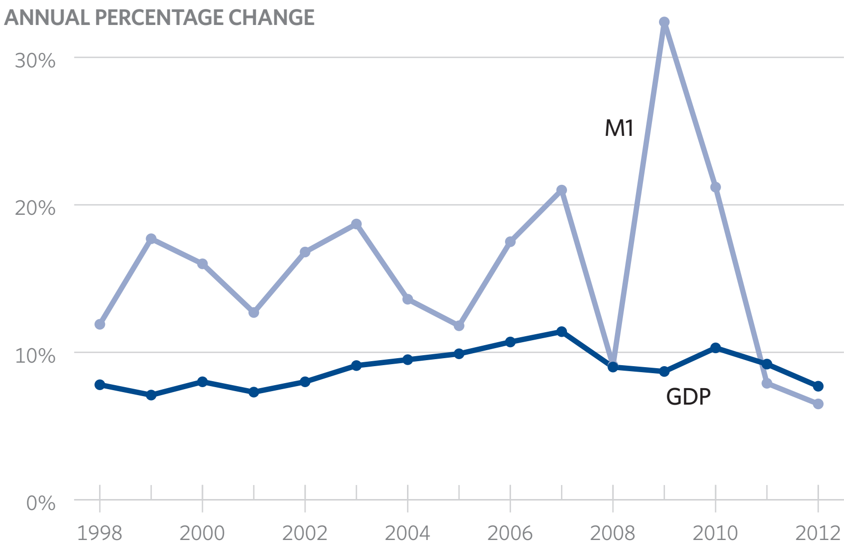
The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

CHART 1

China's GDP and Narrow Money (M1)



Source: China Monthly Statistics, National Bureau of Statistics, Beijing PRC, Volume 1, 1999–Volume 12, 2012.

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The scope of the problem makes it hard to grasp. Growth in narrow money supply (M_1) hit a 15-year low in 2011, then fell further in 2012. This is compatible with a major economic shift. Yet GDP growth remained within its historical range and is now rising. The relationship between M_1 and GDP has changed in a somewhat suspicious way. But where is the problem: with M_1, with GDP, with older data, with newer data? There is little foundation on which to proceed.

Surprise! Everything Is Fine Again. This is the context in which to report SSB claims. Fourth-quarter and 2012 GDP as a whole were going to outperform whatever expectations were set. GDP growth was thus reported at 7.9 percent for the quarter and 7.8 percent for the year, pushing annual output past $8 trillion (more than half of America's). Examining other measures suggest that annual growth was lower than this, but fourth-quarter growth is close to accurate.

More important, household income in both rural and urban areas outpaced GDP. Very strong output growth in the middle of the last decade contrasted with comparatively weak income growth, a problem that is no longer visible. Now the problem is income inequality, which is not reported.

Figures on components of GDP are again dubious. Fixed investment appears slower—which is welcome, because it is excessive. Consumption was said to generate more than half of GDP gains. But fixed investment still rose faster and is far larger than retail sales. The trade surplus grew three times faster than retail sales. One cannot see consumption-driven growth in numbers the SSB publishes. Trends in industrial production and the purchasing managers' index are also incompatible. GDP is not too far off, but more important indicators are more muddled.

A Weaker Chinese Economy. The typical observation is that China's economy has been weakening because reported GDP growth has slipped over time from 13 percent to below 8 percent. This is a symptom, not the disease, and a minor symptom at that—GDP is not a good measurement of health.

In fact, the economy began faltering while GDP was still accelerating. With the arrival of a new government in 2003, market reform faded, fixed investment spiked, and the imbalances now plaguing the economy first manifested. Growth in fixed investment jumped 10 percentage points in 2003 and has not returned to its 2002 level. Moreover, the gap between fixed investment and gross fixed capital formation—the world's investment measure—has widened. This suggests greater waste.

Genuine Chinese consumption is weaker than suggested by retail sales. The performance is not weak in absolute terms; it simply cannot keep pace with investment. Some observers claim that consumption has been underestimated. While possible, this tells us little without similar evaluation of other indicators and the distribution over time. For example,

1. People's Republic of China, "The Basic Situation of China's Human Resources," http://www.china.org.cn/government/whitepaper/2010-09/10/content_20906151.htm (accessed January 17, 2013). Many countries (including the U.S.) understate unemployment by excluding those who wanted jobs but gave up searching.

if consumption was heavily understated in the 1990s, growth since has been weaker than reported.

More investment than consumption leads to more supply than demand. For instance, more than one-third of domestic shipyards received no orders in 2012. Officially, auto sales weakened in 2012 (though these data are spotty), while auto capacity continues to expand.[2] And when demand is inadequate, high investment breeds debt rather than expansion.

Rising debt indicates that economic performance is unsustainable. China's trend is hard to establish because debt is often treated literally as a state secret. A Chinese Academy of Social Sciences corporate survey put the 2011 debt-to-asset ratio at 105 percent, the highest among 20 countries evaluated.[3] This bottom-of-the-list debt performance came after years of world-beating official GDP growth.

If expansion requires domestic debt, it will not last. Foreign demand is unreliable—and less important to China than a decade ago. The only solution is internal reform. The PRC must innovate, and it must become more efficient in use of its battered land, a labor force that will soon stop expanding, and capital. Sharper ownership rights (to both intellectual property and land) would accomplish the first two objectives, sharper competition the second two. If these improvements are not seen, the economy will stagnate. Then political imperatives will overwhelm any methods of improvement, pushing Chinese data further from reality.

If You Want Something Done Right. The PRC is ostensibly becoming an economic rival of the U.S. or, if public debt continues to drag America down, even a contender for the leading global economy. The U.S. cannot be viewed as taking that challenge seriously if it considers official Chinese economic data accurate rather than driven by politics or otherwise misleading (as with GDP).

It is past time for the U.S. to generate its own estimates of important Chinese economic statistics, to guide policy in the bilateral relationship and make clear the economic balance. This would both raise the quality of American policy and offer friends and allies a more accurate picture of the global economy.

Specifically, the Departments of Treasury and Commerce and the Central Intelligence Agency should compile independent economic series for the PRC for wealth, unemployment, and other vital information and publish these data on an annual basis.

Hope Is Not Enough. A cyclical economic recovery means official data are not too far off concerning Chinese economic aggregates for 2012. But structural weakening will continue, and the cyclical recovery will ebb by the end of this year without reform. If that happens, official statistics will become less useful again. For its part, the U.S. can and should do better than parroting the latest claim that GDP growth exceeded China's target.

*—**Derek Scissors, PhD,** is Senior Research Fellow in Asia Economic Policy in the Asian Studies Center at The Heritage Foundation.*

2. Michelle Wiese Bockmann, "Vessel Order Dearth Seen Spurring China Shipyard Closings," Bloomberg.com, December 27, 2012, http://www.bloomberg.com/news/2012-12-27/shipbuilding-order-dearth-seen-spurring-yard-closures-in-china.html (accessed January 17, 2013); and KPMG, "Overcapacity: A Potential 'Speed Bump' in the World's Largest Automotive Market," 2012, http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Documents/China-Automotive-Market-201206.pdf (accessed January 17, 2013).

3. Xinhua, "Corporate Debt Reaches 'Alarming Level,'" *China Daily*, May 18, 2012, http://www.chinadaily.com.cn/business/2012-05/18/content_15328186.htm (accessed January 17, 2013).