

BACKGROUND

No. 2839 | SEPTEMBER 4, 2013

How to Make China More Honest

Derek Scissors, PhD

Abstract

Official Chinese economic statistics, from unemployment to arable land, are controlled by the Communist Party and therefore cannot be trusted. The prevailing American and global view of China as a rising, if presently troubled, economic superpower is based on this unreliable data. Evaluation of selected economic, financial, and sociopolitical indicators shows them to be inconsistent and most likely inaccurate, so that American and global decision making is badly informed. A sustained effort to compile more accurate data on China would clarify China's global economic role and improve the basis for U.S. policymaking and limit taxpayer exposure.

China is far more economically open today than the Soviet Union was when its collapse surprised the U.S. policy community in 1991. Still, the Chinese Communist Party controls and manipulates the information it releases. The prevailing American view of the People's Republic of China (PRC) as a rising economic superpower, even if struggling a bit, is based on this poor information. American decision making requires considerably better data, so that policy can be based on actual conditions in the PRC.

There are indicators, concerning unemployment, inflation, non-performing financial assets, debt, public health, and inequality, that would illuminate the true state of the Chinese economy, and to some extent its societal well-being. These specific indicators are chosen for their nature and their salience. They are quantifiable in nature, requiring less judgment and suffering from less bias. They are numbers the PRC itself presents, though inaccurately, because they lie

KEY POINTS

- The U.S. understanding of China's economy is flawed. Chinese government data are manipulated for political reasons, making them a faulty basis for policymaking and commercial decisions.
- The key indicators of the real economy—unemployment and inflation—are misrepresented by official figures. Unemployment is much higher than Beijing claims; inflation has been higher than claimed, as well.
- The most sensitive financial indicators, measuring various kinds of debt, are often altered to hide the extent of problems. China's financial system cannot be understood by loose comparisons to America's financial system.
- Sociopolitical indicators, such as income and life expectancy, also appear altered. The reasons behind stark income inequality and uneven life expectancy, which show bias in government policies, are heavily suppressed.
- It is past time for the U.S. to make a concerted effort to gather better data on the Chinese economy—to improve American policymaking, and to clarify China's global role.

This paper, in its entirety, can be found at <http://report.heritage.org/bg2839>

Produced by the Asian Studies Center

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

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

at the core of Chinese prosperity and economic and political stability. And they are often used as constitutive elements in outside assessments of China, or simply repeated as the only data available.

The easy conclusion when examining these indicators is the party is attempting to hide areas of considerable economic vulnerability. Information about this vulnerability may offer the U.S. government leverage on both economic and political issues, a topic which others can explore.¹ What can be demonstrated now is that the continuation of China's positive role in the global economy requires far greater transparency, closer to that of the Organisation for Economic Co-operation and Development (OECD) economies. The PRC's transparency failures are a considerable problem, for both itself and its partners.

In response, the U.S. government should encourage the PRC to be more transparent. More important, it should initiate its own programs and support existing private efforts to gather better data on key Chinese indicators. An element of the U.S. government action should be strict limitations on U.S. taxpayer support—direct or indirect—for projects in China and ventures with Chinese entities.

Macroeconomic Transparency

There is a worldwide obsession with Chinese gross domestic product (GDP). GDP is a poor measure of national wealth and economic performance. This is especially true in China where so many transactions are “empty”: China's official benchmark of fixed asset investment for 2012, for instance, was about \$1.75 trillion higher than the State Statistical Bureau's (SSB) number for gross fixed capital formation, the standard international measure.² Land

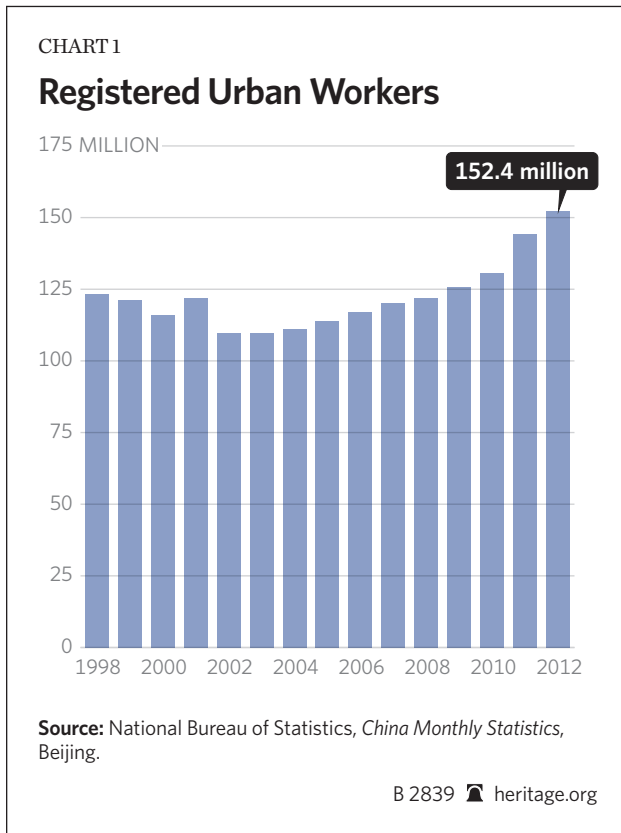
or used machinery changes hands but creates no additional value. Funds are said to be spent, with no identified benefit. Fixed asset investment is dutifully reported every month, while gross fixed capital formation appears only once a year.

What the party cares about in economic terms is not GDP or fixed investment, but inflation and unemployment. The former led to massive protests for democratic reform, and ultimately violence, from 1987 to 1989. Fear of the latter has driven Chinese economic policy for 15 years, in particular the panicked response to the global financial crisis that ensured the current economic stagnation.³

Unemployment. The crucial nature of unemployment is straightforward: The jobless are more prone to mass protest. High unemployment is a threat to political stability in the PRC, as it is everywhere else. This is why the only regularly published unemployment rate is “urban registered unemployed” (read: whom the Ministry of Human Resources and Social Security is willing to count). These are exclusively urban workers in the jurisdiction where they are officially registered, and who have worked for certain periods for surveyed employers (most of which are state entities).

This definition accounts for the trend over time. When the global financial crisis struck, China faced the possibility of mass unemployment and responded with unprecedented bank lending.⁴ Yet official employment actually rose sharply, because workers fled a shrinking private sector for the state sector. This also helps explain the perception that the state sector has advanced at the expense of the private sector. Because the Ministry of Human Resources counts as it likes, the unemployment rate never exceeds 5 percent, with the number of urban jobless

1. The Claremont Institute, “The Coming China Nexus of the Global Markets and U.S. Security Community,” April 2012, http://www.pssi.cz/download/docs/166_the-coming-china-nexus-of-the-global-markets-and-u-s-security-community.pdf (accessed August 12, 2013).
2. Derek Scissors, “GDP: I Do Not Think It Means What You Think It Means,” The Heritage Foundation, The Foundry, June 13, 2013, <http://blog.heritage.org/2013/06/13/gdp-i-do-not-think-it-means-what-you-think-it-means/>. In 2012, the State Statistical Bureau estimated gross capital formation contributed 46 percent of GDP yet reported fixed investment equivalent to 70 percent of GDP. For an explanation of the gap between investment measures, see Shen Minggao, “Macroreview: Deconstructing China's Investment,” *Caijing*, July 16, 2013, <http://english.caijing.com.cn/2009-07-16/110198793.html> (accessed August 9, 2013).
3. “China's Urban Unemployment Rate Rises to 4.2%,” *China Daily*, January 20, 2009, http://www.chinadaily.com.cn/business/2009-01/20/content_7412656.htm (accessed August 9, 2013), and “China Reports Record 9.59 Trln Yuan in Loans in 2009,” *China View*, January 15, 2010, http://news.xinhuanet.com/english/2010-01/15/content_12816059.htm (accessed August 9, 2013).
4. Tan Yingzi and Xin Dingding, “20 Million Migrants Lost Jobs: Survey,” *China Daily*, March 2, 2009, http://www.chinadaily.com.cn/china/2009-02/03/content_7440106.htm (accessed August 9, 2013), and Derek Scissors, “China's Economy: Something Is Not Right in Beijing,” Heritage Foundation *WebMemo* No. 2775, January 25, 2010, <http://www.heritage.org/research/reports/2010/01/chinas-economy-something-is-not-right-in-beijing>.



presently between 9 million and 10 million.

At the other end of the spectrum in terms of the jobs challenge is a September 2010 government white paper on human resources that puts the total labor force at 1.07 billion, and the number of employed at 780 million. The 290 million who are not reported as employed are mostly registered in rural areas.⁵ Many are farmers and therefore self-employed (and perhaps also underemployed).

Between this and registered urban unemployed are a host of unofficial estimates. One recently developed estimation technique is to compare the number of job seekers to urban jobs available, using data from government job centers. Unlike the official measure, this technique revealed a surge in joblessness when the global financial crisis struck. At present, however, the number of job seekers used is not even as large as the ministry's partial figure for annual urban labor-market entrants. It thus gives a

wildly optimistic picture of overall unemployment.⁶

It is hardly just China where published unemployment rates are misleading; even much richer economies struggle. But no other country offers an ostensible range of 10 million to 300 million idle or partly idle laborers. If, say, 175 million people are unhappy because they cannot find adequate work, the PRC is extremely vulnerable to events that threaten employment.

Consumer Purchasing Power. Casual observations about how much richer the PRC has become, in terms of GDP per capita or foreign reserves, neglect that the economy consists of people. What matters is their wealth. This wealth has to be controlled for inflation, and official inflation estimates are inadequate.

The GDP deflator is the price change implied by the difference between the on-year nominal increase in GDP and announced "real" GDP growth. When the Chinese economy is expanding rapidly, the deflator rises far faster than the consumer price index (CPI), making growth look slower. The main reason for this is that the deflator includes housing. (Unlike the CPI, it also includes producer goods, which see sharper price shifts in both directions.) A separate index of housing prices ceased publication at the end of 2010, because reported inflation hit double figures in 2009 and 2010, and even that was low compared to the values implied by space sold and revenue. While none of the indicators is anywhere close to ideal, implications of changes in the GDP deflator are often neglected. Closer examination and accounting for its makeup offers a different perspective on some of the reported numbers.

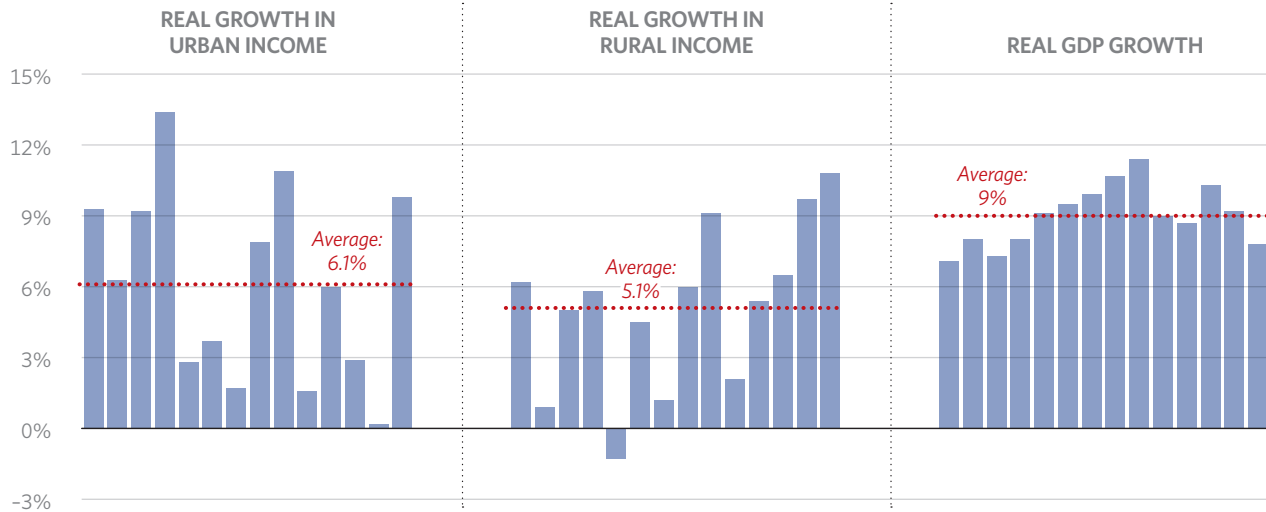
The other side of purchasing power, of course, is income. In rural areas, Chinese personal income previously lagged GDP growth, as more gains accrue to state enterprises and their employees than everyone else. In urban areas, weaker income growth and soaring housing prices have recently cut into gains in purchasing power, even while GDP growth remained solid. To correctly measure purchasing power requires adjusting personal income by a proper measure of prices.

5. "The Basic Situation of China's Human Resources," China.org, 2010, http://www.china.org.cn/government/whitepaper/2010-09/10/content_20906151.htm (accessed August 12, 2013).

6. Simon Rabinovitch, "Chinese Workers Find Jobs Still Plentiful Despite Slowing Growth," *The Financial Times*, July 15, 2013, <http://www.ft.com/intl/cms/s/0/6e9e7582-ed38-11e2-ad6e-00144feabdc0.html#axzz2ZF38VWIZ> (accessed August 9, 2013), and "Job Market Grim for New Graduates," China.org, June 7, 2012, http://www.china.org.cn/china/2012-06/07/content_25593348.htm (accessed August 9, 2013).

CHART 2

Income Gains Using the GDP Deflator



Source: National Bureau of Statistics, *China Monthly Statistics*, Beijing.

B 2839 heritage.org

Using the GDP deflator to represent prices, instead of the various deflators the statistics authority purports to use, real rural income growth averaged 4 percent annually for a decade (1999–2008) before improving the past few years. On the flip side, real urban income growth has averaged barely 4 percent from 2008 to 2012. These are substantial gains but they are far from spectacular. Large portions of the population are not as happy with China’s economic performance as top-line figures suggest, not because of high aspirations but because they have not seen particularly strong gains in the first place.

Regional Disparities

In both its foreign and domestic policies, the party demonstrates concern about China’s territorial integrity. The concerns are primarily political, such as the ethnic violence in the west, but there is also an economic challenge. The PRC faces clear and very large development gaps between its solid middle-income east coast and its still largely lower-income interior.

The nature and extent of these gaps is obscured by Chinese and foreign data. Because the east coast is economically larger, richer, and more integrated,

it is far more important to foreign partners, both corporate and national, than the rest of the country. Corporate headquarters, research houses, and visiting official delegations are therefore heavily concentrated in Beijing and Shanghai. The information gathered by most foreign entities is about the China that matters most to them, not necessarily the China that matters most to the party.

The party may not have much better information. It is by now well known that provincial GDP series do not match national series.⁷ What is less well known is that problems are even worse with other data. The SSB now collects national data independently of the provinces; the provinces generate their own data. The latter are essentially useless.

The party did not choose economic reform for the interior, it chose state-directed spending. As a result, inland provinces claim rapid GDP growth based on even more rapid investment growth. Reporting has become absurd: There are now multiple provinces whose fixed investment is larger than their GDP—which would be impossible if fixed asset investment was anything close to a legitimate measure. GDP, and thus GDP *per capita*, is being heavily exaggerated, so that the gaps with the coast are understated.

7. “Local Exaggeration in GDP: 5.8 Trl Higher than Central Data,” *Caijing*, February 4, 2013, <http://english.caijing.com.cn/2013-02-04/112486637.html> (accessed August 9, 2013).

Fabrication is even worse in foreign investment statistics; here, provincial totals can exceed the reported national figure by 50 percent.⁸

This undercuts the common view that inland provinces have been catching up to the coast. They may have, but only temporarily, on the basis of increasingly useless state spending. (Or they may have only in the form of imaginary numbers.) The party is certainly aware that the public statistics are false⁹ and likely has a good sense of which regions are potential sources of unrest. Political assignments are made accordingly and key economic programs, such as permitting labor movement, may be shaped by awareness of regional disparities. To better evaluate the calculations behind Chinese policy decisions, far better provincial-level data are needed.

Financial Transparency

GDP and inflation statistics are issued and pored over every quarter. A long-term economic crisis would most likely be due to unemployment. But what wins attention on a weekly basis is Chinese finance. Whenever signs of stress are perceived, most recently the June 2013 interest-rate spike, speculation begins on whether a domestic financial crisis is imminent. In principle, a short-term crisis could occur due to a default by a bank, major firm, or local government arm.

However, a mistake continually made by foreign observers is to treat the PRC's financial system as more or less equivalent to America's financial system. Ninety-seven percent of Chinese banks' assets are held by state-owned institutions. (Fewer than 2

percent are held by foreign-owned banks, fewer than 1 percent by domestic private banks.)¹⁰ Even the much-discussed non-bank finance—"shadow banking"—stems largely from state banks taking assets and liabilities off their books, plus the investment activities of state-owned insurers.

So there is far less counterparty risk than in the U.S., and little meaningful competition. Benchmark interest rates are irrelevant both to troubled state firms, which enjoy costless borrowing through endless loan rollovers, and private firms, which pay far more.¹¹ Understanding Chinese finance requires data, not severely strained comparisons to Lehman Brothers.

Bank Debt. Non-performing bank assets are the repository of economic failure. An unwise loan funds an overly optimistic investment. The ensuing increase in production is unwanted by the market and an economic imbalance is created. Closing the loop, the banks' probability of repayment is lower. So a rising amount of distressed assets signifies a failing economic model. And a high level of distressed assets implies a systemic threat.

Small wonder that the party treats the system-wide level of non-performing loans as a state secret. Estimating the total amount of bad loans used to be a cottage industry in international finance. Then, the government decided that as many state banks as possible should seek multibillion-dollar initial public offerings (IPOs), and independent assessments of asset quality were harshly suppressed. Bad loans were offloaded to other entities prior to IPOs, and massive amounts of cash were continuously injected

-
8. "China to Collect More Accurate Investment Data," China.org, March 6, 2013, http://news.xinhuanet.com/english/china/2013-06/03/c_132427804.htm (accessed August 9, 2013), and Kelly Liu, Kevin Daly, and Maria Estela Varua, "Determinants of Regional Distribution of FDI Inflows Across China's Four Regions," *International Business Research*, Vol. 5, No. 12 (2012), <http://www.ccsenet.org/journal/index.php/ibr/article/view/22162> (accessed August 12, 2013).
 9. Cheng Yunjie and Wang Zichen, "Xinhua Insight: China Advance Reforms For Data Accuracy," China.org, December 27, 2012, http://news.xinhuanet.com/english/china/2012-12/27/c_132067664.htm (accessed August 9, 2013), and John Wong and Ding Lu, *China's Economy into the New Century: Structural Issues and Problems*, (Hackensack, NJ: World Scientific, 2002).
 10. Grant Turner, Nicholas Tan, and Dena Sadeghian, "The Chinese Banking System," *Reserve Bank of Australia*, September 2012, <http://www.rba.gov.au/publications/bulletin/2012/sep/pdf/bu-0912-7.pdf> (accessed August 9, 2013), and "Is China Finally Ready for Private Banks?" *The Economic Observer*, July, 18, 2013, <http://www.eeo.com.cn/ens/2013/0718/246768.shtml> (accessed August 9, 2013). An oft-cited figure of 70 percent state ownership refers to urban banks; in different fashion, rural banks are also all state-owned.
 11. Sanjay Jain and Daisy Wu, "China Banks Sector—Debt Threats: Downgrading the Bank Sector on Asset Quality Concerns," Credit Suisse, June 20, 2011, <http://arg.credit-suisse.com/doc/BK1273.pdf> (accessed August 9, 2013), and Shang-Jin Wei, "Das (Wasted) Kapital: Is China Investing Too Much?" *VOX*, June 16, 2007, <http://www.voxeu.org/article/china-investing-too-much> (accessed August 12, 2013).

TABLE 1

Deteriorating Setting for Lending

Year	Urban Fixed Investment Growth	Domestic and Foreign Sales Growth*	Pressure on Loan Quality
2004	27.6%	28.9%	Falling
2005	27.2	21.8	Rising
2006	24.5	17.4	Rising
2007	25.8	19.1	Rising
2008	26.1	20.4	Rising
2009	30.5	3.7	Rising sharply
2010	24.5	26.9	Falling
2011	23.8	20.5	Rising
2012	20.6	10.4	Rising

* A weighted average of urban retail sales and exports.
Source: National Bureau of Statistics, *China Monthly Statistics*, Beijing.

B 2839  heritage.org

by government financial arm Central Huijin,¹² implying that distressed assets steadily accumulated over time. All the while, official data on bad loans have bordered on the absurd. Despite well over \$1 trillion in new loans in 2009 in an acknowledged downturn, bad loans were said to fall. Nor did they rise later on.¹³

The trend for bad assets is easy to identify, in principle: If investment is rising clearly faster than domestic and overseas sales, bad loans will

eventually rise no matter how strong demand is and no matter what Beijing claims. On this view, pressure on loan quality began to accumulate in 2006, though slowly enough that improvements in practices may have protected bank portfolios. That was not true in 2009, when loan quality plummeted. A 2010 recovery was followed by a mediocre 2011 and poor 2012. The quality of official investment and sales figures is an obvious problem but non-performing assets are almost surely far larger in 2013 than 2006.

An exact figure is harder to come by. There are likely closely held estimates, including within the Chinese government. It may be useful for the U.S. intelligence community to seek them out and make them publicly available. These should be combined with assessments of the thresholds where a non-commercial banking system is progressively impaired.

Corporate Debt. The obvious counterpart to bank debt is corporate debt. Chinese corporate accounting has long been a farce. In 2000, the national audit office accused two-thirds of almost 1,300 state enterprises of cooking the books. Chinese guidelines at the time were so minimal as to be useless by international standards, yet state firms still could not meet them.¹⁴ Since then, domestic reports of accounting problems have become politicized, but American regulators have identified fraud at Chinese companies and their foreign accountants.¹⁵ This fraud has affected U.S.–China commercial relations, reason enough for the U.S. government to gather better information.

Another reason is to undercut the “Beijing consensus.” Though the PRC has never officially

- Richard McGregor, “E&Y Withdraws China NPL Report,” *Financial Times*, May 15, 2006, <http://www.ft.com/intl/cms/s/0/11e4d368-e3c7-11da-a015-0000779e2340.html#axzz2ZnsKOOEI> (accessed August 12, 2013), and Central Huijin Investment, Ltd., “Currently, Central Huijin Holds Shares in the Institutions Listed Below,” December 31, 2012, http://www.huijin-inv.cn/hjen/investments/investments_2008.html?var1=Investments (accessed August 12, 2013).
- “China’s Non-Performing Loans Down in 2009,” Wall Street Pit, January 15, 2010, <http://wallstreetpit.com/14073-chinas-non-performing-loans-down-in-2009/> (accessed August 12, 2013), and “China’s Banks’ Non-Performing Loan Ratio About 1%,” *The Wall Street Journal Market Watch*, July 15, 2013, <http://www.marketwatch.com/story/china-banks-non-performing-loan-ratio-about-1-2013-07-15> (accessed August 12, 2013).
- U.N. Economic and Social Commission for Asia and the Pacific, “Rejuvenating Bank Finance for Development in Asia and the Pacific,” October 28, 2002, http://www.unescap.org/drrpad/publication/toc/fin_2206con.htm (accessed August 12, 2013), and Ray Ball, Ashok Robin, and Joanna Shuang Wu, “Accounting Standards, The Institutional Environment and Issuer Incentives: Effect on Timely Loss Recognition in China,” *Asia-Pacific Journal of Accounting and Economics*, Vol. 7, No. 2 (2000), pp. 71–96, <http://www.tandfonline.com/doi/abs/10.1080/16081625.2000.010510579#.UfBIG421F8E> (accessed August 12, 2013).
- U.S. Securities and Exchange Commission, “SEC Charges China Affiliates of Big Four Accounting Firms with Violating U.S. Securities Laws in Refusing to Produce Documents,” 2012, <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171486452#.UfBnLY21F8E> (accessed August 12, 2013).

embraced the concept, the Beijing consensus is the claim that state-led development is superior to market-led development—the “Washington consensus.” The crux of the evidence cited is the PRC’s impressive GDP growth, presumably a result of its mix of planning and market implementation of government plans, and the dominance of its very large state-owned enterprises (SOEs).¹⁶

It is therefore important economically and diplomatically to analyze SOEs beyond their size and the foreign currency provided to them by the government. Not coincidentally, such analysis is inhibited not only by bad accounting practices but by protection of the corporate information of large SOEs as state secrets, with severe associated penalties for disclosure.¹⁷

While the evidence is limited, the size and expansion of SOEs could mask debts that would be unsustainable in a competitive system, and require transfers from the rest of society. Chinese firms are indeed large, with the second most appearances on the Fortune 500 list (after U.S. firms). But these firms show far more leveraging than their American counterparts.¹⁸ Indeed, a state think tank indicated Chinese firms had the worst debt-asset ratios in the major economies, at over 100 percent.¹⁹ Further investigation would almost surely find more, hidden weakness, discrediting the Beijing consensus and reducing the appeal of working with Chinese state investors.

Local Government Debt. The third main component of financial worries is local government

borrowing. Direct accumulation of debt by local governments is formally limited, but most long ago set up investment vehicles to circumvent the restrictions. Local government debt is a component of the evaluation of the Chinese economy in terms of policy trends, aggregate economic vulnerability, and comparative regional performance.

After encouraging local governments to spend in response to the 2008 financial shock, Beijing began to fret and ordered an audit of local borrowing. The result was reminiscent of that for firms: dozens of cities and counties with debt-to-asset ratios over 100 percent and total debt of \$1.61 trillion in 2010. The total figure has certainly risen, the number of distressed local governments probably has, too, and there have been a series of official statements to the effect that the problem has worsened.²⁰ But there has been no official update yet.

This may be due to fear of the future. Most foreign observers focus on the possibility of an urban housing market collapse, which would harm employment and bank assets and ultimately the wealth of ordinary people. A larger problem, at least regarding the amount of money involved, is the value of land. In addition to soaring real estate taxes, revenue from land sales stood at a total of 5.3 trillion yuan from 1999 to 2008. In 2010 and 2011 alone, it was almost 5.9 trillion yuan. This rate of increase cannot possibly last and, indeed, there was a mild decline in 2012.²¹

More declines are coming, so local government ability to service debt will also decline. A complete

-
16. Derek Scissors, “The China Models,” The Heritage Foundation, The Foundry, September 6, 2011, <http://blog.heritage.org/2011/09/06/the-china-models/>.
 17. Michael W. Vella and Jerry Ling, “Traps for the Unwary in Disputes Involving China,” Jones Day, August 2012, http://www.jonesday.com/traps_for_unwary/ (accessed August 12, 2013), and Keith B. Richburg, “China Sentences American Geologist to 8 Years for Stealing State Secrets,” *The Washington Post*, July 5, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/07/05/AR2010070500859.html> (accessed August 12, 2013).
 18. Wu Ying, “Financial Repression Greatest Risk to China’s Economy,” China.org, December 24, 2011, http://www.china.org.cn/opinion/2011-12/24/content_24233313.htm (accessed August 12, 2013).
 19. “Warning Issued About High Debt,” *China Daily*, August 7, 2012, http://www.china.org.cn/business/2012-08/07/content_26154420.htm (accessed August 12, 2013), and “Fortune 500 List Reveals Need for Structural Reform,” *People’s Daily Online*, July 12, 2013, <http://english.peopledaily.com.cn/90778/8324216.html> (accessed August 12, 2013).
 20. “China’s Own Account of Local Government Debts,” Reuters, June 7, 2011, <http://www.reuters.com/article/2011/06/27/china-debt-highlights-idUSL3E7HROCX20110627> (accessed August 12, 2013), and Josh Chin and Dinny McMahon, “China Real Time Report: China’s Local Debt Mystery,” *The Wall Street Journal*, July 5, 2013, <http://blogs.wsj.com/chinarealtime/2013/07/05/chinas-local-debt-mystery/> (accessed August 12, 2013).
 21. Wang Changyong and Xing Yun, “Revenue from Five Major Real Estate Taxes Has Soared,” *Caixin Online*, March 20, 2013, <http://english.caixin.com/2013-03-20/100504151.html> (accessed August 12, 2013), and “China’s Land Sales Hit 2.69 Trillion Yuan in 2012,” *China Daily*, January 13, 2013, http://www.chinadaily.com.cn/china/2013-01/13/content_16109855.htm (accessed August 16, 2013).

picture of the financial system, including true local government debt and the likely trajectory of land sales revenue, would answer vital questions. How far will the central government be constrained by the need to support local outlays? Is expanded public spending even possible on a net basis? Will some local governments be forced to shrink outright, perhaps in poorer counties and provinces where this would provoke discontent?

Sociopolitical Transparency

Economic data are published regularly; the problems with them stem from internal inconsistencies that leave analysts endorsing one official Chinese figure over another. Figures with more obvious sociopolitical implications, such as those concerning income distribution or mortality, are typically suppressed.

The party believes that the top threat to its rule is internal corruption. Individual cases of corruption have proven manageable, but evidence of increasing wealth concentration correlated with party membership and rank might not be manageable. Given state dominance of the economy, income inequality is a proxy for perception of corruption. Perhaps even more inflammatory than inequality of income is inequality of health, both in terms of how long people live and their causes of death. This is the kind of information that can trigger political change.

Income Inequality. The party has acknowledged, and begun to address, urban-rural income disparities. The SSB's income statistics show urban income 2.48 times larger than rural income in 1997, with the absolute gap at a bit over RMB 3,000 (\$365). By 2009, the ratio was 3.33:1 and the absolute gap was RMB 12,000 (\$1,750). Either policy steps, statistical falsification, or both, partly stemmed the tide, and the 2012 ratio was 3.10:1. However, the absolute

annual income gap still passed RMB 16,000 (over \$2,500).²²

Rural areas remain somewhat isolated. What promotes dissatisfaction among hundreds of millions of urban residents is seeing huge wealth disparities right in front of them, most prominently expressed in housing. After years of surprisingly focused social complaints, the SSB published an overarching inequality measurement, in this case 10 years of the gini coefficient. From 2003 to 2012, the term of the Hu Jintao government, the reported gini never fell below 0.47, where 0.4 starts to indicate considerable inequality.²³

The numbers were released because the 2012 result was said to fall below the 2008 peak, and even the 2003 figure. But it is highly doubtful that the general population accepts anything like this. In spring 2007, it was alleged²⁴ that nearly all of the wealthiest were family members of high-ranking party cadres. As the term of the Hu government neared an end in 2012, a set of reports in the Western media documented the extreme concentration of wealth at the top of the party leadership.²⁵ The responsible outlets saw retaliation from Chinese censors but the stories all corresponded with what ordinary urban Chinese could see for themselves.

The percentage of national wealth held by the top 1 percent or 5 percent can be incendiary in any country, but much more so in the PRC. There, the wealth of the top 5 percent is almost all due to the party's control of the economy, and heavily influenced by systemic corruption. Figures on how much of the Chinese "miracle" has not been shared will change the perception of that miracle both outside and inside China.

Public Health and Environment. Public health is reported on constantly, but reliable numbers are again conspicuously lacking. The World Bank has done a series of reports over the past 20 years

22. *China Monthly Statistics*. The equivalent dollar values are a bit confusing due to the 30 percent appreciation of the RMB over this period.

23. Yang Lina, "Gini Coefficient Release Highlights China's Resolve to Bridge Wealth Gap," *People's Daily Online*, January 21, 2013, <http://english.peopledaily.com.cn/90778/8101041.html> (accessed August 12, 2013).

24. Carsten A. Holz, "Have China Scholars All Been Bought?" *Far Eastern Economic Review*, Vol. 170, No. 3 (April 2007), pp. 36-40, <http://ihome.ust.hk/~socholz/HaveChinaScholarsAllBeenBought-FEER30April07.pdf> (accessed August 12, 2013).

25. Michael Forsythe, "China's Billionaire People's Congress Makes Capitol Hill Look Like Pauper," *Bloomberg*, February 27, 2012, <http://www.bloomberg.com/news/2012-02-26/china-s-billionaire-lawmakers-make-u-s-peers-look-like-paupers.html> (accessed August 12, 2013); "The Family Fortunes of Beijing's New Few," *The Financial Times*, July 10, 2012, <http://www.ft.com/intl/cms/s/0/86a82f3e-bc69-11e1-a470-00144feabd0.html#axzz2a4KVp89Y> (accessed August 12, 2013); and David Barboza, "Billions in Hidden Riches for Family of Chinese Leader," *The New York Times*, October 25, 2012, <http://www.nytimes.com/2012/10/26/business/global/family-of-wen-jiabao-holds-a-hidden-fortune-in-china.html?pagewanted=all> (accessed August 12, 2013).

documenting the economic costs of environmental degradation. Initially suppressed, these have been accepted, even repeated, by the party because they always paled against reported economic performance. The pollution pattern is similar. China accepts reporting about bad air and water pollution when it can no longer be avoided, and quickly promises massive clean-up efforts.²⁶

While such issues cause local protests and general disgruntlement, they are not directly life and death issues. But birth defects and cancer rates are, and domestic reporting has been suppressed in these areas. Reliable national data on the trend in cancer rates and birth defects, especially if broken down geographically, would be a critical indicator of the true level of “social stability.”

Life expectancy combines these health and environmental factors. It is possibly the single most important indicator of societal welfare and strongly correlated with economic expansion. Declining life expectancy is tied to the collapse of Soviet Communism, an event which the PRC continues to evaluate.²⁷ China reports increasing life expectancy. This was certainly credible at the outset of reform and for some years after, but it is not clear that recent figures should be accepted as reliable.

One main reason they might be inaccurate: The way China exploits its coal resources is known to be bad for public health. The PRC has long had

lax regulation of mining, production, and thermal power generation.²⁸ It now also accounts for half the world’s coal output—on less than 7 percent of the world’s land and fresh water. Coal mining is land-intensive and even more water-intensive. This combinations of factors has the obvious effect on life expectancy at the local level—sharp reductions.²⁹ Even if the national average life expectancy has managed to continue to increase, it can only have done so with widening regional gaps. A large and expanding difference in life expectancy is perhaps the starkest inequality imaginable. Detailed, trustworthy data on life expectancy would reveal the extent of the PRC’s social and, ultimately, political cohesion.

Arable Land. A final issue combines the macroeconomic and social dimensions. For the sake of revenue, land can be seized by the government without due process, to be sold to infrastructure projects or property developers. It can be lost to pollution. Loss of land means unemployment for farmers, it means food-inflation pressure, it adds to income inequality, it threatens public health through food quality, and it ultimately undermines local government finances.

The problem here is not false Chinese figures; arable land can be evaluated by satellite. The problem is failure by the PRC and independent observers to fully evaluate the multiple implications of land loss.³⁰

-
26. Edward Wong, “China Lets Media Report on Air Pollution Crisis,” *The New York Times*, January 14, 2013, http://www.nytimes.com/2013/01/15/world/asia/china-allows-media-to-report-alarming-air-pollution-crisis.html?_r=0 (accessed August 12, 2013); “China to Invest \$277 Billion to Curb Air Pollution: State Media,” Reuters, July 24, 2013, <http://www.reuters.com/article/2013/07/25/us-china-pollution-idUSBRE96O01Z20130725> (accessed August 16, 2013); Keith Bradsher, “China Report Shows More Pollution in Waterways,” *The New York Times*, February 9, 2010, <http://www.nytimes.com/2010/02/10/world/asia/10pollute.html> (accessed August 12, 2013); and Sui-Lee Wee, “China to Spend \$301 Billion on Water Projects,” Reuters, January 20, 2011, <http://www.reuters.com/article/2011/01/20/us-china-water-investment-idUSTRE70J2DL20110120> (accessed August 12, 2013).
 27. R. H. Dinkel, “The Seeming Paradox of Increasing Mortality in a Highly Industrialized Nation: The Example of the Soviet Union,” *Population Studies: A Journal of Demography*, Vol. 39, No. 1 (1985), <http://www.tandfonline.com/doi/abs/10.1080/0032472031000141296#.UfL-GI21F8E> (accessed August 12, 2013), and A. Greer Meisels, “Lessons Learned in China from the Collapse of the Soviet Union,” *China Studies Centre Policy Paper* No. 3, January 2013, http://sydney.edu.au/china_studies_centre/images/content/ccpublications/policy_paper_series/2013/Lessons-learned-in-China-from-the-collapse-of-the-Soviet-Union.shtml.pdf (accessed August 12, 2013).
 28. Xin Qiu and Honglin Li, “Energy Regulation and Legislation in China,” Environmental Law Institute, July 2012, <http://www.epa.gov/ogc/china/Qiu.pdf> (accessed August 12, 2013).
 29. Yuyu Chen, Avraham Ebenstein, Michael Greenstone, and Hongbin Li, “Evidence on the Impact of Sustained Exposure to Air Pollution on Life Expectancy from China’s Huai River Policy,” National Academy of Sciences of the United States of America, May 28, 2013, <http://www.pnas.org/content/early/2013/07/03/1300018110> (accessed August 12, 2013).
 30. Guilin Li, Ying Zhao, and Shenghui Cui, “Effects of Urbanization on Arable Land Requirements in China, Based on Food Consumption Patterns,” *Food Security*, Vol. 5, No. 3 (June 2013), pp. 439–449, <http://link.springer.com/article/10.1007/s12571-013-0265-9> (accessed August 12, 2013), and Australian Government, Department of Foreign Affairs and Trade, “Feeding the Future: A Joint Australia–China Report on Strengthening Investment and Technological Cooperation in Agriculture to Enhance Food Security,” December 2012, <http://www.dfat.gov.au/publications/feeding-the-future/feeding-the-future.html> (accessed August 12, 2013).

TABLE 2

Life Expectancy and Coal

Year	Coal Production, in Billions of Tons	Life Expectancy
2000	0.99	71.4
2001	1.06	-
2002	1.18	-
2003	1.33	-
2004	1.61	-
2005	1.82	-
2006	2.07	-
2007	2.19	-
2008	2.48	-
2009	2.96	-
2010	3.24	74.8

Source: National Bureau of Statistics, *China Monthly Statistics*, Beijing.

B 2839  heritage.org

Urbanization is at the heart of current development plans. At the micro level, not just farmers but urban poor are harmed disproportionately by land loss, the former due to loss of livelihood and the latter due to the harsher impact of (correctly calculated) food inflation. At the macro level, urbanization impinge upon protecting arable land, forcing even more resources to be diverted to protect food supply. The party's long-standing fear of dependence on imported food is already frayed by \$30 billion in soybean imports annually. Without far better protection of arable land, more large-scale food imports should be expected.

Recommendations for the U.S.

Recommendations that the U.S. government, the private sector, international institutions, and China itself improve the quality of the data provided are old hat.³¹ Of course, if they had been heeded 10, or even five, years ago, American policymaking would have been much improved.

A fresh reason for urgency in gathering better information is greater awareness of the PRC's economic difficulties. There is increasing likelihood of financial losses from current and previous China-related transactions, losses that could drive speculative attacks on the stocks of the companies involved and even be transmitted to American taxpayers in various forms. Private entities should not be inhibited in any way by the U.S. government but should proceed entirely at their own risk.

- The U.S. government, through the relevant Cabinet departments and the intelligence community, should devote additional resources over an extended period to compile independent data on select Chinese macroeconomic, financial, and sociopolitical indicators.
- The U.S. government should press international institutions, such as the World Bank, to adopt a two-tier statistical classification system for publicizing economic data, where Tier 1 countries provide high-quality national statistics and Tier 2 countries do not.
- The U.S. government should not offer loans, financial guarantees, insurance, or other support through financial institutions, such as the Export-Import Bank or the Overseas Private Investment Corporation, to projects where transparency is low, such as those involving Chinese state entities.
- Similarly, to be eligible to participate in federal deposit insurance or any other government assistance, American financial institutions should be required to fully and properly disclose all transactions with counterparties in low-transparency environments.

Conclusion: Hard Thing, Worth Doing

Claims that Americans have adequate information on the Chinese economy are false. The same line has been used for years: Old numbers were faulty but

31. Derek Scissors, "China Grows 10 Percent Again: Is this Believable?" Heritage Foundation *WebMemo* No. 3098, January 20, 2011, <http://www.heritage.org/research/reports/2011/01/china-grows-10-percent-again-is-this-believable>.

current numbers are satisfactory.³² This was said in 2004 about data from 1994, it is said now about 2004 data, and it will be said a decade from now about today's data.

It is certainly true that the SSB's methods have improved over time, for example, by relying less on provincial reporting, and further improvement is possible. It is equally true that the Communist Party still controls and alters the flow of information, and some important indicators, such as for unemployment and investment, have actually become more misleading over time.

Whether the PRC's economy rises, falls, or stag-
nates, it is big enough to be important to know why

ordinary people, local cadres, and the top leadership are behaving the way they are and how the U.S. can better exert global influence. To gather better numbers on any one of the indicators listed here would be valuable, but would still offer an incomplete picture. To gather better numbers on all of them will likely require sustained U.S. government assistance over time, and be well worth it. Until then, American taxpayers should not have to support commercial activities in a low-transparency environment.

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

32. For example, Tom Orlik, "Lies, Damned Lies, and China's Economic Statistics," *The Wall Street Journal*, July 25, 2012, <http://online.wsj.com/article/SB10000872396390444840104577548932454533806.html> (accessed August 12, 2013) vs. Carsten A. Holz, "The Institutional Arrangements for the Production of Statistics," Organisation for Economic Co-operation and Development, China Governance Project, January 19, 2005, [http://search.oecd.org/officialdocuments/displaydocumentpdf/?doclanguage=en&cote=std/doc\(2005\)1](http://search.oecd.org/officialdocuments/displaydocumentpdf/?doclanguage=en&cote=std/doc(2005)1) (accessed August 12, 2013).