

WebMemo



Published by The Heritage Foundation

No. 1597
August 31, 2007

Questioning the CIA's Claim of a Drop in China's Military Spending

John J. Tkacik, Jr.

While everyone else in the world, including the Chinese government, says China's spending on its People's Liberation Army (PLA) is growing by double-digit percentages annually, the U.S. Central Intelligence Agency has quietly cut its estimate of Chinese defense spending from 4.3 percent of GDP down to 3.8 percent—a drop of about 12 percent. The timing and methodology behind the revision suggest that the CIA may be under political pressure to downplay the “China threat.”

The China Threat. With the 1991 collapse of the Soviet Union—China's only existential threat—China's military spending immediately began to increase while the United States and virtually all U.S. allies set about reaping a “peace dividend.” The United States cut defense expenditures by more than 10 percent (from \$298 billion in fiscal year 1992 to \$268 billion in fiscal year 1997).¹ Meanwhile, the Chinese government announced an annual succession of double-digit increases in its declared defense spending,² and that pace persists today.

On March 4, 2007, China announced its largest-ever annual increase in military spending—17.8 percent, raising defense spending to about \$45 billion.³ While \$45 billion is a fairly small fraction of the United States' non-Iraq defense budget of about \$530 billion, there is no question that China's military outlays are indeed expanding at a rapid rate. Moreover, it has been an article of faith for China-watchers in the U.S. intelligence community for decades that China's “announced” budget was only a fraction—perhaps one-half or one-third—of what the PLA actually spends each year.

Methodology and Timing. On December 19, 2006, the CIA updated its public estimate of Chinese military spending to about 4.3 percent of China's GDP—the figure used in its 2006 *World Factbook*. The *Factbook* calculated China's 2005 GDP at about “\$8.883 trillion” in “purchasing power parity” (ppp) terms. Economists commonly use ppp as an inflator factor to compare the sizes of different economies rather than using the deeply distorting method of simply converting GDP using the currency exchange rate. The World Bank calculates China's ppp factor at 3.94,⁴ which is the figure used by the CIA.

The ppp factor gives a more accurate picture of China's defense spending in U.S. dollar terms. The methodology is as follows: Convert China's announced 2006 GDP into U.S. dollars (Y20.94 trillion renminbi = \$2.68 trillion based on the prevailing exchange rate of Y7.82 rmb = \$1.00); multiply by the ppp ratio of 3.94 to get about \$10.5 trillion for China's GDP; and calculate 4.3 percent of GDP to get about \$452 billion for China's military spending. Without the ppp factor, China's military spending comes to only \$115 billion (4.3 percent of \$2.68 trillion).

This paper, in its entirety, can be found at:
www.heritage.org/Research/AsiaandthePacific/wm1597.cfm

Produced by the Asian Studies Center

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002-4999
(202) 546-4400 • heritage.org

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With an estimate in the range of \$85–\$125 billion for China's defense spending,⁵ the editors of the Pentagon's annual "military power report" on China seem to like the straight exchange-rate calculation. But needless to say, China's army gets far more for each Y7.56 it spends than the Pentagon gets for its buck—probably about four times as much, given China's lower costs for troop pay, education and training, equipment procurement, land, facilities, and rights of way. The \$452 billion figure gives a better indication of China's military spending compared with its neighbors in Asia—or with the United States, for that matter.

On June 14, 2007, the CIA cut its estimate of China's military spending from the previous December's 4.3 percent of GDP to the new figure of 3.8 percent of GDP (a difference of \$53 billion using the ppp method outlined above). One has to wonder why the *Factbook* editors issued the new figures after only six months. The *Factbook* is an annual publication, so one would expect the CIA to wait until December 2007 before feeling any urgency to revise figures.

The move is suspect because certainly no one in the U.S. intelligence community would explicitly state that the PLA's rate of spending has fallen since December 19, 2006. Anyone who suggested such a thing would be laughed out of the interagency coordinating sessions. If the CIA changed its economic methodology to take into account the contributions of China's service sector to GDP, the editors should have mentioned it in the economic overview in the *Factbook's* China chapter.

Conclusion. One is left with the sneaking suspicion that the downward revision of China's military spending is not based on data or methodologies at all. Rather, the overhasty anxiety to revise a "year-book" entry after less than six months suggests someone was subject to political pressures to ease up on any rhetoric that might hint at a "China threat." The last thing America needs is an intelligence community that allows its analyses to be swayed by political considerations. This is particularly so of its with regard to its China analyses.

—John J. Tkacik, Jr., is Senior Research Fellow in China, Taiwan, and Mongolia Policy in the Asian Studies Center at The Heritage Foundation.

1. U.S. Office of Management and Budget, "The Budget for Fiscal Year 2005: Historical Tables," pp. 49–51, at www.gpoaccess.gov/usbudget/fy05/browse.html. Ed. note: The U.S. State Department lists China's annual military expenditures as second only to the United States. See "World Military Expenditures and Arms Transfers 1999-2000," June 2002, p. 38, at www.fas.org/asmp/profiles/wmeat/WMEAT99-00/WMEAT99-00.pdf and www.state.gov/documents/organization/18738.pdf.
2. China has announced the following annual percentage increases: 1.5 percent in 1987, 2.6 percent in 1988, 12.6 percent in 1989, 15.4 percent in 1990, 12.0 percent in 1991, 12.0 percent in 1992, 12.5 percent in 1993, 20.3 percent in 1994 (the yuan was revalued from \$6.10 to \$8.28), 14.6 percent in 1995, 11.3 percent in 1996, 12.7 percent in 1997, 12.8 percent in 1998, 12.7 percent in 1999, 12.7 percent in 2000, 18 percent in 2001, 17.7 percent in 2002, 9.6 percent in 2003, 11.6 percent in 2004, 12.6 in 2005 percent, 14.7 percent in 2006, and 17.8 percent in 2007. China also increased military spending by 20 percent in 1979 to pay for its February incursion into Vietnam. Data compiled by June Teufel Dreyer, Ph.D., University of Miami.
3. Audra Ang, "China to Increase Military Spending," The Associated Press, March 4, 2007.
4. See "World Development Indicators." The latest published World Bank "ppp" figures for China are for 2004. The World Bank calculated a \$7.634 trillion "ppp" GDP in with nominal exchange rate GDP as \$1.938 trillion, for a "ppp" ratio of 3.94. See devdata.worldbank.org/wdi2006/contents/Table1_1.htm. Other "ppp" figures are a bit lower. The *Penn World Tables* at the University of Pennsylvania calculate China's 2004 "ppp" ratio at 2.14. See pwt.econ.upenn.edu/php_site/pwt62/pwt62_retrieve.php.)
5. *The Military Power of the People's Republic of China*, Office of the Secretary of Defense, May 23, 2007, p. 25. The current and all previous reports are available at www.defenselink.mil/pubs/china.html.