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Understanding China's Defense Budget: What it Means, and Why it Matters by Andrew S. Erickson and Adam P. Liff

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On March 4, China announced its 2011 defense budget of 601.1 billion RMB (approximately $91.5 billion). Importantly, many experts believe actual spending is significantly higher than the official figure suggests.

Although China's rapidly increasing defense budget is a development of considerable significance for the US and its allies, it remains poorly understood and is often analyzed out of context. There is a tendency to focus *exclusively* on quantitative trend lines rather than considering all available data. We provide comprehensive assessment of China's official defense budget and military transparency, as well as its expanding capabilities and strategic intentions. The PLA budget remains unclear in many respects, but it is not necessary to count every single RMB to know that the PLA can and will do a lot more in the foreseeable future. The greatest and highest-level activity will occur in China's homeland and near its borders, as well as in the three "Near Seas" and their immediate approaches.

Trends in Spending and Transparency

There are two trends in China's defense spending: the first regards increases to its official budget; the second relates to its (gradually) improving transparency. At 12.7 percent, the increase in the 2011 budget represents a return to double-digit spending increases after a one-year hiatus and continues a nearly 25-year trend of rapid growth. Annual defense budget increases averaged 15.9 percent from 1998-2007, 14.5 percent from 1988-1997, and 3.5 percent from 1978-1987. Over the past 10 years, the official budget has increased by roughly 3.6 times (from 166 billion RMB in 2002 to 601 billion RMB today).

Longitudinal comparisons of China's defense spending are complicated by a number of factors, however. First, prior to 1998 the only information publicly released about China's official defense budget was the single aggregate figure of total spending. Second, since 1998 the content of the official defense budget has changed as a result of various budget reforms, the major effect of which has been a substantial reduction in the gap between the PLA's official budget and its actual revenue.

Third, since 1998 China has published biannual national defense white papers and, since 2008, has submitted a Simplified Reporting Form containing basic information about military expenditures to the UN Secretary General annually, which includes previously unreleased information about the relative shares of China's defense budget allocated to its active forces, reserve forces, and militia. However, a) the PRC still does not publicly release an official breakdown of the PLA budget by service and b) the simplified form contains much less information than the Standardized Reporting Form submitted by most advanced Western states.

Western Criticisms

Some observers believe Beijing's opacity conceals nefarious intentions. Over the past decade, the Chinese government has been criticized for excluding major defense-related spending from its official defense budget, including funding for the 660,000-strong paramilitary People's Armed Police (PAP), some military R&D expenses, money spent on overseas purchases of major weapons and platforms, PLA revenue from certain kinds of weapons exports, state subsidies to China's defense industries, provincial defense-related spending, and the budget of China's space program. Recent analyses by the International Institute for Strategic Studies, a U.K.-based think tank, concluded that the inclusion of such spending would have increased the official PLA budget by 72 percent (FY2005) and 39 percent (FY2008).

However, given China's very lack of transparency about how its official defense budget is calculated, it is extremely difficult to judge the validity of these criticisms.

Chinese responses

To develop a more comprehensive understanding of China's defense budget, it is important to understand the manifold drivers behind recent increases. Although it is rare for Chinese defense experts and government officials to respond publicly to *specific* criticisms of China's (lack of) transparency and rising defense budget, our survey of available English- and Chinese-language open source data identifies a set of typical Chinese responses.

The most frequent Chinese rejoinder to criticisms of its relatively low level of military transparency is that transparency of *intentions* matters more than transparency of military capabilities or doctrine. Another typical refrain amounts to a palliative comparison of the current level of transparency to even lower transparency in the past; for example, the days before China first published a figure for annual defense spending (1981), white papers (1995), and voluntarily submitted information to the United Nations (2008). Finally, Chinese commentators will often – accurately – point out that there is no universal standard for military transparency.

Chinese justifications in state-run media for the rapid rise of China's defense spending can be roughly divided into seven notional categories. *Modernization-imperative arguments*, maintain that the current rapid rise in defense spending is merely compensating for the government's relative neglect of military modernization between 1978 and the early 1990s. Two rationales involve proportionality: 2) the *economic-growth-is-still-our-priority argument*, which stresses that defense spending as a percentage of China's rapidly increasing GDP has been fairly constant and as a percentage of total central government expenditures is actually shrinking; 3) and the *palliative comparison approach*, which argues that China's defense spending as a percentage of GDP is still significantly lower than that of other major powers.

Three rationales emphasize defensiveness: 4) the *domestic focus argument*, which maintains that societal well-being and "harmony," particularly in restive Tibet and Xinjiang, remain Beijing's foremost priority; 5) the *strategic insecurity argument*, which points to China's less-than-ideal geopolitical circumstances and geography as justifications for China's "purely defensive" military expansion; and 6) the *historical territories justification*, which emphasizes the imperative of recovering lost territorial and maritime claims, with Taiwan foremost among them. A final rationale highlights military trends: 7) the *new historic missions argument* emphasizes that the PLA must expand its nontraditional security capabilities.

Meanwhile, China's national defense white papers have listed further justifications for increased defense spending, including: structural and organizational reform of the PLA, the establishment and improvement of a social security system for servicemen, compensation for rising commodity prices, and rapid increases to standards-of-living, pensions, and pay in order to stay competitive with surging salaries throughout the public and private sectors.

Even if one remains skeptical of China's long-term strategic intentions, the drivers delineated above are undoubtedly *at least part of* the story behind the increases in China's defense spending in recent years.

An Estimate is an Estimate

There is little doubt that significant defense-related spending is excluded from China's official defense budget. However, many critics who cite estimates of China's "actual" defense spending by Western organizations often forget that these are in fact *estimates*, which, despite sharing many qualitative criticisms, are plagued by serious reliability issues. For example, the difference between SIPRI's estimate and the upper bound of DoD's estimate of China's "actual" FY2008 defense spending came out to $62.9 billion – more than the total official defense budget. There are three main reasons why estimating China's actual defense spending is so difficult.

First, defining "defense spending" is a fairly subjective exercise. As a recent report from The United States – China Policy Foundation points out, the definitions used by DoD, NATO, and SIPRI differ significantly. China may actually include a number of items in its official defense budget that are excluded from Western defense budgets, such as funds related to its missions of national economic and infrastructure development, social welfare, and crisis management and (domestic) disaster relief. Second, when converting China's defense spending into US dollars, the "appropriate" RMB-dollar exchange rate chosen will have a significant impact on the magnitude of the resulting dollar-denominated estimate. Additionally, no consensus exists on the question of whether it is appropriate to apply a straight-forward purchasing power parity (PPP) rate when converting China's aggregated defense budget into dollars. Third, China's lack of accounting transparency means that estimates of China's aggregate defense spending involves a fair amount of guesswork about both the actual costs of individual items and what specific spending is already captured by the official figures.

China's Expanding Capabilities and Strategic Direction

Whatever the exact size of China's actual defense budget, China is developing an increasingly capable military. For the foreseeable future, preparing to defend China's territorial and maritime claims by asymmetric means is likely to remain the PLA's focus, even as it pursues secondarily lower intensity missions further afield.

China is concentrating its most dynamic, high-intensity capabilities on its contested maritime periphery: the three "Near Seas" (Yellow, East, and South China Seas) and their immediate approaches. As part of its anti-access/area denial approach to deter outside military intervention in this sensitive area, China is developing ballistic and cruise missiles, submarines, sea mines, and other platforms and weapons systems that target specific vulnerabilities in foreign platforms. In a sign of impressive progress, within the past three months China's anti-ship ballistic missile is believed to have reached the equivalent of initial operational capability and China has flight-tested a prototype of the J-20, a stealth fighter.

Thanks to its rapid economic growth, China can also afford to develop increasing configurations of low-intensity capabilities to address its interests further afield, through the vital energy SLOCs of the Indian Ocean into the pirate-infested Gulf of Aden, and now even into the Mediterranean for its first operational mission there in February 2011.

Developing robust long-range capabilities to support high- or even medium-intensity conflict, however, would require new platforms, force structure, training, and operations and significant further budget increases. Even the most basic data on service budgets remain unavailable to foreign researchers, making it difficult to quantify the costs of potential developments in these areas.

China's military capabilities are clearly growing, but its intentions – at least beyond asserting control over its territorial and maritime claims, to include Taiwan – remain unclear.