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What Is behind the Changes in Chinas Military Expenditure

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United States Institute of Peace**International Network for Economics and Conflict****What Is behind the Changes in China's Military Expenditures?**

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The key to deciphering China's military strategy and intent is to analyze the patterns and trends in military expenditures. It is important to fathom whether the Chinese plan is to develop a military that is personnel centric or whether they will build a military that is technology centric and expect to see significant reductions or reduced accelerations in the number of personnel that are employed. Understanding changes in personnel expenditures is one element in understanding the dynamics of China's military decision making.

Despite its rapidly growing economy in the 1970s and 1980s, China's defense budget increased very slowly during this period. Starting in the late 1980s, specifically after the Tiananmen crises, China embarked on a bid to modernize and upgrade its military; with expenditures rising an average of 16 percent annually in the past decade, growing to about RMB480 in 2009. The Chinese maintain that the country's rising military budget reflects general economic growth and the recent massive increases in the defense budget are devoted to nonthreatening expenditures; like personnel costs due to rising salaries, increased training and education, and improving benefits and quality of life. However, Chinese government figures indicate that the average growth of its Gross Domestic Product over the same period was about 12.5 percent, far below the increase in military expenditures. It is worthwhile noting that even though the Chinese defense budget is the second largest after the United States, it remains only a small proportion of what the United States spends on its military. The United States is responsible for approximately 43 percent of all military spending worldwide, whereas China's expenditure represents a little over 7 percent.

It is crucial to understand personnel expenditures in order to investigate military intent since China argues that the growth in military expenditures is primarily the result of rising salaries and benefits of servicemen, which account for approximately a third of the military budget. As I outlined in my *previous INEC blog* on the subject, estimates of China defense expenditures usually start with the three categories: personnel pay, operations and maintenance, and equipment. Since the 1960s, the budget has been roughly evenly divided among these categories.

We will focus on wages and emoluments in China's military sector. Three points need to be addressed when analyzing the official Chinese numbers in relation to personnel costs: currency conversion for international comparison, quality of personnel, and service allocation. Purchasing Power Parity (PPP) conversions are used for non-traded categories in the defense budget such as personnel pay and benefits. PPP-based analysis must be used carefully and appropriately caveated, because it may skew the analysis. For example, Stockholm International Peace Research Institute estimates Chinese expenditures for 2010 at USD119b using market exchange rates and at USD210b for the same period using PPP conversions. The RAND Corporation, a nonprofit nonpartisan policy think tank, on the other hand estimates, China's expenditures using a combination of PPP and market exchange rates. RAND estimates a mid-range projection of USD91.2b and a high of USD145b in military expenditures for the same period. However, it could be argued that conversion issues will become less important with time, as competition with a burgeoning private sector should start to equalize the estimates. Increasingly, the level and growth of military expenditures can be ascertained by disaggregating the expenditure numbers and linking reported increases in personnel compensation to verifiable private sector benefit data to generate a defense

deflator.

Conventional wisdom holds that the quality of Chinese services, such as the effectiveness of individual soldiers, relative to the West is lower thus necessitating a larger military. However, this point is overplayed and will become less important with time. China produces globally competitive products with sophisticated technologies in many areas and actually outsources low skill, low pay work to other nations such as Cambodia and Vietnam. China military compensation is lower than the West but the argument can be made that the compensation in the West may be higher than it needs to be, artificially inflating the value of personnel. Western increases in compensation may not be commensurate with the increase in quality of services and several countries are reevaluating the military personnel compensation system. However, China will eventually have to contend with personnel compensation issues such as health care that will place upward pressure on the budget.

Finally, Xu Guangyu, a retired major general with the China Arms Control and Disarmament Association, alluding to the realignment of the military indicates that significant changes in the composition of the armed forces may be in the works to enhance naval and air power projection effort and engage in a process of rapid modernization. China's basic objective may be to transform its massive army, originally designed for wars of attrition in defense of its own territory, to one capable of fighting and winning against high-tech opponents. A key part of this effort is to downsize its army; the world's largest, while beefing up its air force and navy. This will enable China to project military force farther beyond its borders. This force transformation is expected to shift the personnel budgetary allocation from its current approximately 60 percent army, 20 percent navy and 20 percent air force to about 50 percent army, and 25 percent each for navy and air force. Although it is unclear how this force realignment will affect the bottom line defense budget over the medium term, it is clear that this shift signals the emergence of a different type of Chinese military. One that relies less on brawn and much more on technology and power projection.

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