

Local Government Debt Issue: The Case in China

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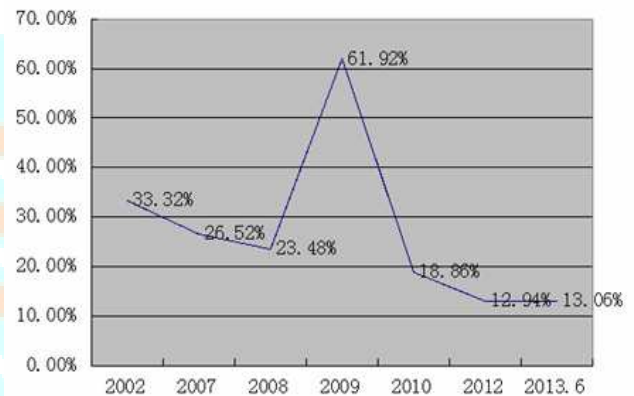
Abstract—Local government debt issue has troubled China’s economy and become a major issue for policy makers. Currently, China is facing downstream in both economy and gross revenue growth. It is acknowledged that preventing local government debt crisis and financial risks is crucial. Relevant suggestions will be proposed at the end of this article by analyzing the status of China’s local government debt with reference of international experience.

Keywords-local government debt; status; impacts; causes; suggestions.

I. INTRODUCTION

On December 30, 2013, the “National Government Debt Auditing Results Report” was published by the China National Audit Office. According to the report, by June 2013, the total amount of national government debt is about ¥ 30.27 trillion, in which the amount of repaying debt is ¥ 20.70 trillion, guarantee liabilities is ¥ 2.93 trillion and salvage obligations is ¥ 6.65 trillion. The total amount of local government debt is about ¥ 17.89 trillion, in which the repaying debt grows fast. By the end of 2012, the amount is ¥ 9.63 trillion; while by June 2013, the amount is ¥ 10.89 trillion, with an increasing amount of ¥ 1.26 trillion and rate of 13.06%. (Table I, Figure1)

Figure 1. Local government debt increasing rate



The deepening of China’s reform and opening up and the growing powers of local government lead to rapid expansion of local government debt. From the perspective of government level, borrowers and lenders, the debt amount of finance platforms is about ¥ 7 trillion; the amount of bank loans is about ¥ 10.1 trillion. (Table II, Table III, Table IV)

Table II. LOCAL GOVERNMENT DEBT BY GOVERNMENT LEVEL

TABLE I. STATUS OF NATIONAL GOVERNMENT DEBT

Year	Government Level	Repaying Debts	Contingent Liabilities	
			Guarantee liabilities	Salvage obligations
2012	Central	94376.72	2835.71	21621.16
	Local	96281.87	24871.29	37705.16
	Total	190658.59	27707.00	59326.32
June 2013	Central	98129.48	2600.72	23110.84
	Local	108859.17	26655.77	43393.72
	Total	206988.65	29256.49	66504.56

Unit: trillion ¥, Source: China National Audit Office

Government Level	Repaying Debts		Contingent Liabilities			
	Amount	%	Guarantee liabilities		Salvage obligations	
			Amount	%	Amount	%
Provincial	17780.84	16.33	15627.58	58.63	18531.33	42.71
City	48434.61	44.49	7424.13	27.85	17043.70	39.28
County	39573.60	36.36	3488.04	13.09	7357.54	16.96
Town	3070.12	2.82	116.02	0.43	461.15	1.06
Total	108859.17	100	26655.77	100	43393.72	100

Unit: trillion ¥, Source: China National Audit Office

Table III. LOCAL GOVERNMENT DEBT BY BORROWERS

Borrower	Repaying Debts		Contingent Liabilities			
	Amount	%	Guarantee liabilities		Salvage obligation	
			Amount	%	Amount	%
Finance Platforms	40755.54	37.44	8832.51	33.13	20116.37	46.36
Government and organizations	30913.38	28.40	9684.20	36.33	0.00	0.00
NPO	17761.87	16.32	1031.71	3.87	5157.10	11.88
State owned/controlling enterprises	11562.54	10.62	5754.14	21.59	14039.26	32.35
Self-supporting institutions	3462.91	3.18	377.92	1.42	2184.63	5.04
public service units	1240.29	1.14	143.87	0.54	1896.36	4.37
Other units	3162.64	2.90	831.42	3.12	0.00	0.00
Total	108859.17	100	26655.77	100	43393.72	100.

Unit: trillion ¥, Source: China National Audit Office

Other financing institutions	2000.29	1.84	309.93	1.16	1055.91	2.43
National bonds, external debts etc.	1326.21	1.22	1707.52	6.41	0.00	0.00
Financial leasing	751.17	0.69	193.05	0.72	1374.72	3.17
Raising funds	373.23	0.34	37.65	0.14	393.89	0.91
Total	108859.17	100	26655.77	100	43393.72	100

Unit: trillion ¥, Source: China National Audit Office

II. IMPACTS AND CAUSES

From a macro perspective, it is unlikely that the local government debt issue would lead to debt crisis and financial risks. But it still has major impacts on China's economy by limiting the implementation of fiscal and monetary policies; pushing up interest rate; crowding out business investments and household consumptions; aggravate tax on business and households. Moreover, the local government investment is not conducive to economic growth and multi-level capital market development.

The characteristics of government debt problems in China are: the expansion of government investment promoting economic overheating and rising debts. With the expansion of powers, local governments become financially inadequate, which leads to over liabilities. The capitals of local government debt are mainly from bank loans with finance platforms as major borrowers. The local governments will face greater pressure of debt payments in the next 3 years, and rely highly on land revenue. (Table V, Table VI, Table VII)

Table IV. LOCAL GOVERNMENT DEBT BY LENDERS

Lender	Repaying Debts		Contingent Liabilities			
	Amount	%	Guarantee liabilities		Salvage obligation	
			Amount	%	Amount	%
Bank Loans	55252.45	50.76	19085.18	71.60	26849.76	61.87
BT	12146.30	11.16	465.05	1.75	2152.16	4.96
Bonds	11658.67	10.71	1673.58	6.28	5124.66	11.81
-L-term government bonds	6146.28	5.65	489.74	1.84	0.00	0.00
-Corporate bonds	4590.09	4.22	808.62	3.03	3428.66	7.90
-M-term notes	575.44	0.53	344.82	1.29	1019.88	2.35
-S-term bonds	123.53	0.11	9.13	0.03	222.64	0.51
Payables	7781.90	7.15	90.98	0.34	701.89	1.62
Trusts	7620.33	7.00	2527.33	9.48	4104.67	9.46
Private loans	6679.41	6.14	552.79	2.07	1159.39	2.67
Underwritten/deferred payments	3269.21	3.00	12.71	0.05	476.67	1.10

Table V. STATUS OF LOCAL GOVERNMENT DEBT PAYMENT

Year	Repaying Debts		Contingent Liabilities	
	Amount	%	Guarantee liabilities	Salvage obligation
Jul-Dec 2013	24949.06	22.92	2472.69	5522.67
2014	23826.39	21.89	4373.05	7481.69
2015	18577.91	17.06	3198.42	5994.78
2016	12608.53	11.58	2606.26	4206.51
2017	8477.55	7.79	2298.60	3519.02
After 2018	20419.73	18.16	11706.75	16669.05
Total	108859.17	100	26655.77	43393.72

Unit: trillion ¥, Source: China National Audit Office

Table VI. STATUS OF LOCAL GOVERNMENT DEBT INVESTMENT

Investment	Total Debts		Repaying Debts	Contingent Liabilities	
	Amount	%		Contingent liabilities	Salvage obligation
constructions	58030.64	34.64	37935.06	5265.29	14830.29
Land reserve	18792.06	11.21	16892.67	1078.08	821.31
Transportations	40926.47	24.43	13943.06	13188.09	13795.32
indemnificatory housing	10947.83	6.54	6851.71	1420.38	2675.74
Education, Science, culture, public health	9725.57	5.81	4878.77	752.55	4094.25
Agriculture, forestry, Public irrigation	5434.39	3.24	4085.97	580.17	768.25
Environment protection	4539.92	2.71	3218.89	434.60	886.43
Industry and energy resources	2292.56	1.37	1227.07	805.04	260.45
Others	16818.13	10.14	12155.57	2110.29	2552.27
Total	167508.47	100	101188.77	25635.39	40684.31

Unit: trillion ¥, Source: China National Audit Office

Table VII. LOCAL GOVERNMENT INCOME IN 2012

Item	Amount	%
General budgetary revenue	57680.00	42.02
transfer payment and Tax return	45383.47	33.06
Fund revenue	34204.00	24.92
- land revenue	28517.00	20.77
Total	137267.47	100

Unit: trillion ¥, Source: China China Ministry of Finance

The excessive borrowing of local government has deep political and economic causes. Firstly, the soft budget constraints lead to supervision deficiency; secondly, the current GDP target oriented assessment system for local officials leads to competing for limited public resources and excessive investment impulse; thirdly, the “Four Trillion” project in 2008 created monetary and credit environment for over liabilities; fourthly, the external QE leads to low interest rate and ample liquidity.

III. SUGGESTIONS

Many Western countries have more experience in local government debt management. For instance, the core of the U.S. local government debt management is the fiscal discipline of hard budget constraints: the federal government does not pay unlimitedly for local government obligations; while private capital investment in local government bond is encouraged in Japan.

Upon the analysis and reference above, suggestions for China’s current local government debt issue could be proposed as follows:

1. In short-term

The local government debt issue in China stems from excessive investment and spending impulse. Currently, a large number of non-performing loans are supposed to be prevented, in order to avoiding debt crisis or even financial risks. In specific: control inflation; regulate local government financing; lower debt growing; clear finance platforms; control real estate growing; encourage direct financing and develop the bond market; encourage the development of the over-the-counter market for growing enterprises (the “New 3rd Board”).

2. In long-term

The local government debt issue in China involves complicated game of benefits with opaque information and the strong externalities of bank loans, therefore, it is difficult to improve significantly in short-term. Long-term suggestions are as below:

1) System supply perspective: Central government is supposed to strengthen the management of local government debt; confirm property rights and powers of local governments at all levels; cut down unlimited assistance gradually; establish hard budget constraints; change the GDP target oriented local officials assessment system and enhance government efficiency.

2) Management perspective: enhance the management and supervision of local government budget; strengthen information disclosure and improve security rating system; establish debt risk warning mechanisms and reserve fund; prevent illegal use of debt capital; improve relevant laws and regulations.

3) Market perspective: revitalize state-owned assets and improve solvency; promote municipal bond pilot issue and local government bond issuance authority; promote interest rate liberalization and reduce the dependence on bank loans; encourage regional financial innovation and private investment in public infrastructures; develop the multi-level capital market.

IV. CONCLUSION

To sum up, the central and local government working together with strict system constraints, developed capital market and competent legal system, is the guarantee to prevent and resolve the fundamental problems of local government debt issue.

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