China Perspectives

2011/3 | 2011
Chinese Medicine: The Global Influence of an Evolving Heritage

Chinese local authority debt: The makings of a crisis?

Thomas Vendryes

Translator: Elizabeth Guill

Electronic version
URL: http://journals.openedition.org/chinaperspectives/5668
ISSN: 1996-4617

Publisher
Centre d'étude français sur la Chine contemporaine

Printed version
Date of publication: 1 October 2011
Number of pages: 84-85
ISSN: 2070-3449

Electronic reference
Thomas Vendryes, « Chinese local authority debt: The makings of a crisis? », *China Perspectives* [Online], 2011/3 | 2011, Online since 30 September 2014, connection on 28 October 2019. URL : http://journals.openedition.org/chinaperspectives/5668

This section, prepared by the Asia Centre (www.centreasia.org), draws mainly on the press in Chinese, aiming to reflect the point of view of the People's Republic of China on international questions and issues related to Greater China.

China Analysis
Les Nouvelles de Chine

Chinese local authority debt: The makings of a crisis?

Analysis by Thomas Vendryes based on:

– Huo Kan [1] and Wang Changyong [2], "Enquiry into the black hole of local debt," a special report by the magazine *Xin shiji* – New Century, no. 440, 7 March 2011:
– article 1: "Enquiry into the black hole of local debt";
– article 2: " The emergence of national debt";
– article 3: "The many heads of the statistical institutions";
– article 4: "Seeds of crisis";
– article 5: "In search of debt-reducing policies";
– article 6: "What direction for local funding?"

Against the background of the subprime crisis, and in the face of recent fears over the debt levels of Western governments, China appears to be a pole of stability, and the general state of its public finances a source of envy rather than fear. And yet, problems of local authority debt are now on the political agenda of the Chinese central authorities, since they are beginning to give rise to a certain anxiety. For example, on 23 June 2010, following an enquiry by the National Audit Office (审计署 – *shenji shu*), Auditor-General Liu Jiayi declared to the Standing Committee of the National People's Congress that local authority debt had reached significant proportions, that repaying it could already, in a certain number of cases, pose a problem, and that it was therefore creating a real risk (article 4). According to different – partial and vague – forecasts and estimates, the debt of Chinese local authorities has now risen to more than 10,000 billion *yuan* – that is to say, 150 percent of their annual budgetary revenue.

This increase has been gradual (article 1). Still very low in 2000, local debt increased significantly until the mid-2000s, reaching 4,000 billion *yuan* in 2007. The policy of budgetary support that was decided in the face of the international economic crisis then caused it to increase very rapidly, rising to the current figure of 10,000 billion *yuan*. This debt holds a Sword of Damocles over the Chinese economy in the shape of a debt crisis of the kind that hit Southeast Asia in the late 1990s and that has affected Western countries over the last two years (article 1).

Over and above the sums involved, the essential problem of this debt is that it is at the limits of legality and therefore largely out of the control of central government. Indeed, the Budget Bill (预算法 – *yusuan fa*) currently in force does not allow local governments to be in a position of deficit and therefore to get into debt (article 6). A relaxation of this rule has taken place in the last two years: as part of the plan for the support of the economy set up to tackle the international crisis, the state has authorised local authorities to borrow 400 billion *yuan* through the Ministry of Finance (财政部 – *caizheng bu*); that is to say, the Ministry has been authorised to issue debt obligations for funds intended for local authorities.

If these 400 billion *yuan* constitute only a minimal proportion of the real debt of local governments, it is because the latter have found roundabout ways of financing their deficits (article 2). "Local investment platforms" (地方融资平台 – *difang rongzi pingtai*) in particular have mushroomed. These investment companies issue debt obligations used by local governments. These obligations are, to a greater or lesser degree, guaranteed by the local authorities and are therefore known under the name of "quasi-municipal bonds" (城投债 – *chengtouzhai*). [3] According to a survey carried out by the Banking Regulatory Commission (银监会 – *yinjianhui*), Chinese banks loaned these platforms nearly 8,000 billion *yuan* in mid-2010 (article 3).

However, these finance platforms are beginning to arouse certain suspicions (article 4). The financial rating agency Lianhe recently placed the obligations issued by two of them on the list of ratings under surveillance (信用评级观察名单 – *xinyong pingji guancha mingdan*), a very rare decision.

A growing number of authorities seem, in fact, to be facing repayment difficulties (article 4). The county of Shache (莎车县) in the Province of Xinjiang was the first example of default, in late 2009. A survey of 18 provincial governments, 16 municipalities, and 36 counties carried out during the first six months of 2010 by the National Audit Office showed that for seven, ten, and 14 of them, respectively, the amount of debt exceeded their annual tax revenues (article 2), and almost half of the local authorities examined in the survey had to repay their debts by obtaining new loans (借新还旧 – *jiexin huanjiu*). All these symptoms point to a difficult situation.

1. Journalist.
2. Economist, Director of the Kunming Steel Company.
3. 城投债 (*chengtouzhai*) is the abbreviation of 城市投资债券 (*chengshi touzi zhaiquan*), literally "obligatory municipal investment loans." These are debt obligations that are issued unofficially rather than officially, and they are guaranteed by the municipal authorities to enable them to contract a debt. They are therefore now translated into English as *quasi-municipal bonds*.

Conscious of the danger of a major credit crisis erupting, the Chinese government decided to first of all implement a vast campaign to audit local debt (article 1). The enquiry was formally launched by a circular from the general office of the State Council (国务院办公厅 – *guowuyuan bangongting*) on 13 February 2011, and its objectives were stated in a work plan published on the same date. It began on 1 March 2011 and will cover all local governments at the provincial, municipal, and county level. Although such campaigns have existed since 1997, this one stands out by virtue of its scope. All governments down to the county level must be inspected, and all types of financial commitments, notably those contracted through the intermediary of the "local investment platforms," must be taken into account. Both the amount and structure of these debts must be stated, and means of containing and reducing them must be identified. The aim of the central government is to clarify (清理 – *qingli*) this debt – that is, to obtain a complete and exhaustive vision of it in order to be able to reduce it (化解 – *huajie*).

Although the wish of the central government to clarify the local debt situation is welcome, since its extent and precise structure remain unclear, the means of remedying the situation have not yet been clearly defined.

A first measure, already accepted by the National People's Congress and currently under discussion by the State Council (article 6), would be to review the Budget Bill with a view to authorising local authorities to borrow directly without having to go through the Ministry of Finance as is currently the case. It would therefore be useless to turn to indirect forms of borrowing such as "local investment platforms," which are now making the identification, and therefore the evaluation, of local financial conditions particularly difficult. Details of this amendment to the Budget Bill authorising the issue of local debt have not yet been determined, notably with regard to the role of the central government, the constraints on local finances, and the conditions of indebtedness. However, according to an expert participating in discussions on the reform of the Budget Bill (article 6), preliminary experiments could take place in the near-term. Certain developed localities in the coastal provinces might therefore find themselves authorised to issue their own debt obligations directly, thereby initiating the process of gradually extending this new freedom.

However, this first measure, although welcome, does not solve the basic problem, that is to say, the causes of this exponential growth in local debt. Briefly mentioned in the articles that make up the report in *Xin Shiji*, the debts are not the subject of a thorough study or of any particular attention on the part of the central government. However, as Ni Hongri from the State Council's Development Research Centre notes, this local debt crisis is merely the manifestation of a crisis in local finance (article 4). Indeed, it was when the central government asked local authorities, particularly in rural areas, to set up a compulsory, nine-year education system for all (普九 – *pujiu*) that the first local debts appeared (article 1). Since the 1990s, moreover, the Chinese government has been committed to a policy of recentralising its tax revenues and imposing strict control over local budgetary revenue, whilst delegating much of the provision of public and social services to local authorities. The transfer of power from central to local authorities has not been sufficient to cover the deficits that have gradually appeared. The Chinese government seems reluctant to tackle this problem for the time being, and although the heralded review of the Budget Bill will be beneficial, it is to be feared that it will attack consequences rather than causes.

Translated by Elizabeth Guill