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Credit ratings and financialized political capitalism in a Chinese development zone

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Abstract

China's state driven urbanization and the revenues earned through conversion of land from rural (legally non-commodified) to urban (legally commodified) status have been studied intensively. What makes this new urban land valuable is less discussed in the context of financializaton. Through a study of bond financing in one of China's "national level new areas", Tianfu New Area, on the outskirts of Chengdu, south-western China, this paper argues that financialization is not only created through conversion of land, but also through the capitalization of perceived political favour. The link between state and market is frequently conceptualized as consisting of non-transparent vested semi-corrupt networks between the state and well-connected state owned or private enterprises. We argue that an additional link exists between state and market through financialized political capitalism. This is a system where certain narratives and interpretations of policy suggest an implicit guarantee of bailouts of those debtors who are perceived to be politically important. These narratives and perceptions of political ranking become factors in determining credit ratings and issuing bonds both on the Chinese and the global market and thus the creation of capital based on real estate in China.

1. Introduction

In the broader literature on the Chinese political economy, the Chinese economy is often conceptualized as "state capitalist" with focus on the sustained and reformed role of state-owned corporations in the economy (Tsai and Naughton, 2015). In a recent working paper, Pearson et al. (2020) argue, however, that state capitalism in its classic formulation is not a useful framework for understanding the post-financial crisis political economy of China. According to them, China under Xi Jinping has developed into a new system – a distinctly Chinese model of capitalism. In this model the state no longer simply engages in the state capitalist system to create growth. It engages in it with the purpose of maintaining political control. Formal party networks thus increasingly extend into both private and state-owned enterprises. Pearson et al. (2020) propose the concept "party-state capitalism" to emphasize the particularities of this system and specifically focus on the role of financialization as a tool for governance.

Study of financialization in the West from the 1970s onwards is a major field of research within political economy (Erturk and Solari, 2007, van der Zwan, 2014). Financialization is commonly understood as the expansion of financial activity as a share of the economy and the effects this has on the organization, functioning of, and effects on, that economy. It includes the increasing use of financial instruments and the increasing centrality of financial markets in corporate governance facilitating shareholder dominance, short termism, more leveraged corporate structures etc. (van der Zwan, 2014) and the centrality of financial markets for citizens (ex. housing as a financial asset).

In the Chinese context, land-based finance is often described as the core of the financialization process. The use of debt for development of land and the development of non-bank debt operations have been a central part of Chinese economic development especially since the 2008 financial crisis and Chinese economic policy of stimulus through finance in response to it (Rithmire, 2015, Lauridsen, 2018). The connection between land and finance is not a unique Chinese feature. As financialization and land scholars (Schwartz and Seabrooke, 2009, Hofman and Aalbers, 2019) have pointed out, land – especially urbanized or sub-urban developed land – and the buildings on it form the most common form of collateral in both highly developed and emerging financial systems – especially through variations of the mortgage. In China, however, the model of land ownership with the state as the sole formal owner of land leaves various levels of government in an extremely central position in the land based financialization process.

The unclear boundaries between state and market have led to the development of a number of different ways of profiting from conversion of rural land to urban land. This ranges from individuals doing illegal conversion with hope of post-hoc forgiveness over local governments exploiting various grey zones to fully fledged conversion approved in China's rigid planning system (Hsing, 2010). The mixture of state and market has raised debates about corruption (Rithmire and Chen, 2021) and abuse of government power (Ong, 2014, Pils, 2016, Pils, 2020). It is also well described how informal and usually technically illegal forms of land transfer often work more efficiently and in ways providing cheaper housing to those in need than the formal institutions sanctioned through city governments' monopoly on transferring land that is fully commodified (Ho, 2015). The literature, however, agrees that the state, especially city governments, are placed in a unique position with a monopoly of deciding who can profit from land conversion and themselves taking a substantial part of this profit. Lin (2014) argues that Chinese city governments are among the chief capitalist actors in a neoliberal system of state capitalism. In this system, measured economic growth and the physical display of urban construction plays a much larger role than state ideology. In newer literature on Chinese urban development, the link to political ideologies, or at least political discourses, appears to become more central. Both Lim, 2019, Wu, 2015, in their work on zoned development, show how making urban development within a specific area addressing specific development goals set through policy (green cities etc.) becomes more and more important in attracting both public and private spending.

In this paper, we use a case study of what these officially stated intentions for urban development in a highly prioritized urban development project mean for financialization in China. We do this by studying how Chinese credit ratings for projects in Tianfu are assessed, and how these credit ratings are translated into global credit ratings. The article thereby studies how narratives of political commitment are created, and how they are translated into real value through credit ratings.

In the article we first discuss the concept of financialized political capitalism as a supplemental mechanism within party-state capitalism and the role of narrative with in. After a section on methods, we then introduce Tianfu as a case of politically prioritized development with an important narrative of central political support. After this, we focus on two larger companies engaged in the development of Tianfu and analyse the impact of the narratives on credit availability and credit ratings. Based on this, we then finally make a rough estimate of the value of Chinese political capital and thus the impact of narratives.

2. Financialized Political Capitalism: Political narratives as capital

In China, the financialization of the political economy involves the increased use of market for securities and imported financial techniques and institutions such as derivatives, credit ratings and so forth – especially after the impact of the global financial crisis in 2009 (Gabor, 2018, Livingston et al., 2018). Financialization in China is not fundamentally different from the same phenomenon in the Western world in so far as it involves increased use of credit and financial sophistication (Wijburg 2019). However, due to the involvement of the state in the financial system it takes a different form. Where in the West, the hands-off regulatory regime leads to financial innovation and complexity, in China state actors actively cultivate and support financialization while trying to govern it to develop and restructure the state-owned sector and the wider political economy (Wu, 2018).

The traditional framework for understanding the connection between financialization and urban space in a Western context is neoliberalism (Hofman and Aalbers 2019). Wu (2018), however, argues that the concept of neoliberalism creates more confusion than clarity when applied to the process of financialization and commodification of land in China. He argues that unlike under neoliberalism the underlying motive is not to use state power to replace state power with market power, but to enhance state power through governance through markets. He proposes "state entrepreneurialism" as a concept to capture the role of the state as exercising governance of and not for the market in China.

This state entrepreneurial approach aligns with Pearson et al. (2020) concept of party-state capitalism. Both rightly focus on the expansion of the power of the Party-state through financialization. However, they also both still adopt a focus on how political power shapes economic power. This form of governance from the top down, we argue, also creates a change in the bottom-up logic - political capitalism. To capture this bottom-up logic, we adopt the term "financialized political capitalism".

The term "political capitalism" is taken from Max Weber ́s taxonomy of forms of capitalisms in "general economic history" and "Economy and Society" (Weber, 1978, Weber, 2017: 164, for an extensive discussion see Lauridsen, 2018). Weber defines politically oriented capitalism as a form of capitalism where capitalist profits derive from political power. This can be in the form of profits derived from 'predatory profits' from political connections, profits from politically enforced monopolies or from what Weber terms 'unusual deals with political authority.' (Weber, 1978, 2017:165). In the Chinese context, such 'unusual deals' may be so usual and predictable, that the political connections offer more credibility than traditional capitalist forms of credibility, such as deeds, a cadastral, etc. In the case of China, we may thus not be looking for "unusual deals with political authority", but for "usual" accumulation based on political authority.

The political capitalism concept is distinct from the concept of "state-capitalism" since it focuses on the source of profit/rents for the enterprises and not of the ownership structure of the enterprises. Plenty of state-owned enterprises without political capitalist power to extract profit from political connections exist and plenty of private enterprises are intimately connected to the party-state. In both cases, ability to make profit depends on the perception of political support. Thus, political capitalism is not a question of ownership, but the source of power (political) and orientation of action (capitalist).

It is important to note that political capitalism as it is used here is something different from the kind of more or less corrupt patrimonial networks that exist in all societies and certainly to a great extent in China (Sardan, 1999, Weber, 1978). Political capitalism in this conceptualization is a system that creates financial returns and thus financial assets held on the balance sheets of capitalist enterprises, rather than a system for extracting rents for personal use by beneficiaries of these enterprises or by actors within the state. In principle, one can imagine a perfectly non-corrupt and rationally-bureaucratically organized system of political capitalism that creates assets backed by "usual deals with political authority." It is important to note that this act of analytical imagination certainly does not imply that corruption, rent-seeking, fraud and opportunism are unimportant elements of the actually existing capitalist system in China in general or in land financing in particular. What we are arguing here is an analytical point – that we can distinguish conceptually between rent-seeking and corruption and the mechanism we call financialized political capitalism. Nor do we imply that the mechanism described here cannot cause corruption and rent seeking, but in this paper that potential connection is not examined.

The distinctiveness of "financialized political capitalism" as a concept can be seen through comparing it to Yuen Yuen Ang's (2020) concept of "access corruption" and Pearson et al. (2020) concept of "party-state capitalism" as discussed above. The mechanism proposed by Ang involves collusion with government actors to secure favours which create a positive sum game between business interests and government officials. She argues that this kind of corruption can promote economic growth, but at the cost of equality in and sustainability of that growth. Pearson et al. (2020) propose a different mechanism as discussed above, but which still focuses on the party. In both mechanisms, the party-state is pushed to take actions - either by trade or threat. What we propose is a different mechanism: that the perception of political support amongst market participants is sufficient to create a basis for rents. The party-state does not need to do any concrete action – rather either through persuasion or veiled threat, it just needs to exist and send signals through policy or symbolic gestures - these do not have to have any particular intent behind them as long as they are interpreted as signals by the relevant actors. In this way the party-state does not work like an actor or set of actors, but an institution - an idea that exists among actors in a market which drives their actions.

The institution, we argue, also works through a narrative – through the idea that the Chinese Communist Party stands ready to ensure specific outcomes including creating profits and repaying debts through use of political power and the ability to reorganize enterprises, markets or the physical world.

This narrative can be thought of as an institution in the way it is understood in discursive institutionalism –not as a formal rule or an informal norm, but as an institution as an idea or narrative (Schmidt, 2008). The importance of "state support" is under normal operation not that it is "real" in the sense of explicit guarantees from local government or informal norms or connection to local government, but rather the idea that risk relates to a more ephemeral expectation of support from the economically powerful central government – that a bailout will probably be arranged. Once this idea exists it becomes real through the financial system - it exists as formal contracts, credit ratings, accounts. The power being capitalized is the story of support, not a norm nor informal connection.

As we shall argue, the perception of political favour from the centre and connection to official policy goals becomes clearer when we are not dealing with places in Eastern and Southern China hosting headquarters of large private enterprises like Alibaba or Evergrande. By studying Tianfu, on the outskirts of Western China's most populous city, Chengdu (European Commission, 2018), this is what we do in the case study in this paper. This difference in geographical focus matters. Existing studies on urban finance *chengtou* (Feng et al., 2021) focus on eastern China, where the local and provincial governments are themselves centers of economic power and the local model of capitalism is more driven by private actors. In the Western Chinese context, the state (both the local and the central) is even more dominating. This makes narratives of political priority a source of financial power.

3. Methods and data

In this article, we study the financialization of some of the largest companies engaged in the development of Chengdu's new prestigious satellite city, Tianfu. Below, we discuss why Tianfu is potentially an exemplary case of financialized political capitalism, and how we apply credit rating reports and other financial and political documents as material.

3.1. Tianfu

In the autumn of 2018, news about Chinese plans to launch a "second moon" hit the world press. This grand plan was in fact put forward by a company in the space industry based in Chengdu. At a convention it had claimed that it would be able to launch a satellite that could elucidate the 100 most central square kilometers of Tianfu (Weisberger, 2018). The plan was probably a state-owned enterprise's failed attempt to get state investors. However, the idea of launching a second moon illustrates how wild, politically prestigious plans in China re-enforce themselves. Because there is trust in the political commitment in the area even the most wildly implausible plans seem plausible.

The development of Tianfu as a national development zone is unquestionably the highest prioritized development project in Sichuan province, and investments in a new international airport for Tianfu and visits by president Xi Jinping show that there is political backing for it from Beijing. Most investments in Tianfu (like in most other cities, particularly in inland China (Wu, 2015)) are related to real estate and infrastructure, industries which are traditionally described as state capitalist (Lin, 2009). Tianfu thus has all the elements of a case where all the grandiosity of Chinese political capitalism is on full display. By studying a critical case, we are only testing the plausibility of the role of political support and commitment. If political commitment is not relevant for the financialization of Tianfu, it is not likely to be so elsewhere.

3.2. Global Credit Ratings and Chinese Credit Ratings as data

One of the most concrete ways of measuring perceptions of credit quality is through credit ratings. Since the companies studied both issue bonds in China and internationally, they have a global as well as a Chinese rating.

Credit ratings are not only a tool for investors who lack the ability or willingness to carry out independent risk assessment of debt securities – they also serve as an element of financial regulation. In China, a credit rating is a regulatory precondition for being able to issue a bond in the Chinese bond markets. A credit rating is an evaluation of risk and it is communicated through a grading system. Globally there are three major credit ratings agencies: S&P, Fitch, and Moody's. These three agencies are also present in China but have been required to enter into joint ventures with Chinese credit ratings agencies. Globally each of these agencies have their own rating scales that use numbers and letters as a shorthand for judgments of the risk of securities. These credit ratings are assigned to both public and private sector debt securities and to specific issuers. In the West, the highest rating – collectively known as the triple-A rating – is typically given to sovereign issuers, who borrow in their own currency and have a central position in the global financial system – that is to issuers of debt whose failure to repay would basically spell the end of global financial capitalism. While the evaluation of sovereign debts is controversial and is based on the judgement of the behaviour of political actors such as central banks and governments, the evaluation of debt issued by corporate entities is seemingly simple: will a corporate entity be able to service and repay its debt over the period of borrowing and what is the likelihood that it will have to default?

The credit ratings agency as an institution in China was created by fiats as a part of the financial reform push in the late 1990s to support the creation of tradable bond markets for non-financial enterprises. While these markets did not develop much before the global financial crisis after the effects of the crisis hit China it led to the growth of the Chinese shadow banking sector and bond financing became a growing part of financing for real estate development (Walter and Howie, 2012). Inside China, both local and joint venture ratings agencies use different sets of grades than those used internationally, so Chinese ratings are not directly translatable to international ratings (Luo and Chen, 2019).

3.3. Data collection

Data for this article was collected during intensive fieldwork in Tianfu in August 2018, and through analysis of data from Chinese and Western documents on company finances and credit assessments. Interviews were mainly with local cadres and experts acting as consultants for both companies and the local bureaucracy, and frequently took the form of more informal conversations during visits to some of the many construction sites. These visits were accompanied by assistants from the Chinese host university, and it was declared that conversations were part of a research project, and that information would be used anonymously in publications emerging from the project. Direct access to the leadership of the large enterprises was not possible. Since most of the companies are fully state-owned enterprises, they do not publish annual reports, but we have collected information on enterprises through a database of credit information of Chinese state owned enterprises (State Administration for Market Regulation n.d.), and through credit rating reports in Chinese and English for the companies that have issued bonds.

4. Analysis: The Financial and political development of capital in Tianfu, Chengdu

Chengdu has a history of special zones. Most of these have been linked with approval from the central government to transfer land from rural to urban status, and hence add profit opportunities to the city government (Zeuthen, 2020; Zhang and Wu, 2017). In 2007, Chengdu became one of two special zones for Urban-Rural Integration, and as such could experiment with new ways of changing status of land from rural to urban status while China was in a process of tightening land use regulations. Chengdu thus had special opportunities to develop land. These opportunities all required political framing. Some counties hit by the 2008 Wenchuan earthquake got privileged access to profiting from creating new arable land by demolishing villages. They could then sell the building rights created by the reduced built-up area to counties and districts with a more attractive location. Using schemes like these more than 900,000 peasants around Chengdu were resettled between 2006 and 2016 (Zeuthen, 2018: 942). Other areas, such as Tianfu, were situated in locations where urban planners with the blessing of Beijing were planning more urban development and thus assigned quotas allowing local governments to convert land. Opportunities for transferring land from rural to urban status were decisive for the finances of local state authorities (Zeuthen, 2020). These opportunities relied on zoning. The zoning reflected the zone's rank on the current policy agenda.

The zoning limited the supply of urban land and maintained scarcity. Being allowed to transfer land or sell land alone, however, did not make land valuable. There needed to be buyers of the land, and these buyers would need financing for their investment – usually debt financing.

4.1. Companies Operating in Tianfu

The name of Tianfu directly translates into Sichuan Tianfu New Area (四川天府新区). The name alone tells something about the way the zone was created. Chengdu already had one high-tech zone. The revenues from developing the high-tech zone went directly to the city government. People engaged in local politics explained that the making of Tianfu had mainly been a priority of Sichuan province (the administrative level above Chengdu), because it wanted a share of these revenues, and because it wanted a zone similar to what the neighbouring province-level city, Chongqing, had under its jurisdiction. The establishment of Tianfu as a so-called national new area was approved by Beijing in 2010, and the new area was established in 2014. Its administrative structure reflected its origin as a compromise between Chengdu and Sichuan. Its core consisted of around a third of the former very prosperous county, Shuangliu, which was placed directly under the administration under Chengdu as Sichuan Tianfu New Area Directly under Chengdu (四川天府新区成都直管区). This area covered around a third of the total area of the designated zone. The rest of the zone was under the jurisdiction of several other counties under the jurisdiction of Chengdu with small sections in the neighbouring prefecture, Meishan.

But Tianfu was more than a place – it was a brand. In several of the areas not formally designated as part of the new area, local governments promoted new development zones through the Tianfu brand. For instance, a bank founded by Nanchong, a relatively poor city a few hundred kilometres away changed its name, so it was now named after Tianfu rather than Nanchong and expanded its activities in Chengdu. This brand name effect was even visible in the rating of its bonds. Bonds issued under the name Tianfu were rated as AA+ while the Nanchong bonds were AA.

Direct public investments in infrastructure in Tianfu were massive. In the core zone, a branch of the extremely prestigious Peking University was established. In a more peripheral part of the zone (under the jurisdiction of Meishan), a campus of vocational schools designed for more than 20,000 students was established. In all parts of the new area, signs revealed ongoing work by several different entrepreneurs with a subdivision of the national railways as one of the larger actors within real estate construction.

The largest investment from the central level was, however, the building of a new airport for Chengdu, the second largest planned infrastructure investment in China after Beijing's second airport. While the airport would technically be outside the special area, its name would be Tianfu airport, and several metro lines would link it to Tianfu. Chengdu city government despite also wanting to develop its own high-tech zone was also an important actor. One of its leading development/financial vehicle companies Chengdu Xingcheng Investment Group (CXCIG) will be discussed in depth in the following section.

Administratively, Tianfu was also unusual. Normally, there would be a county or a district at the level below the city-prefecture, but in the case of the core area of Tianfu, it was governed by a steering committee directly under the city and some of the leading staff in the department governing the area was appointed by the provincial government. Tianfu core district owned a development company, Chengdu Tianfu New Area Investment Group (CDTTJT) with reported total assets of 104 billion RMB in 2018. The equity capital of approximately 13bln RMB was all invested by the District Committee's Financial Department (Chengdu Tianfu New Area Investment Group, 2019a, Chengdu Tianfu New Area Invetment Group, 2019b).

The official policy goal for the development of Tianfu was to develop it from a semi-rural area with a population of two million into a satellite city of five million by 2030. Achieving this goal required a high number of planned investments in motorways, metro lines and other infrastructure as well as investment in building residential housing, and various public buildings. The companies involved in highly prioritized projects had a fairly safe source of income. However, not all plans for the development of the zone were set in stone. There were elements that were too prestigious to fail, but there were other elements that might or might not be built as proposed in plans or by companies or local governments wanting to become part of the attractive zone.

The satellite city worked as a model for urban planning and as show-case for bus after bus of cadres on study trips. Companies playing a core role in developing it could feel fairly safe about the projects that they worked on would be carried out. In more distant parts of the zone and in areas around the zone wanting to become part of it, commitment for investments was much more questionable. In most of the local governments in these areas, plans for metro lines extensions were presented, but were later scrapped or postponed indefinitely. A smaller privately owned company specialized in speculating in applying rural property rights in creative ways that would get as close as possible to commodify rural land was aware that it was engaged in a risky business. According to its director, it had networks with centrally placed scholars and politicians wanting to experiment with property rights as an important element of its business strategy. The director was a former county bureaucrat, and presented the framing provided by these centrally placed scholars as important for his business model.

4.2. The Tianfu brand and credit ratings

These differences between centre and periphery and between well and poorly connected companies were reflected in credit assessments of the companies involved. While both Western and Chinese credit assessments recognized the relatively high risk associated with investments in real estate and also recognized the risk that sudden policy changes might cause, the political priority of the projects in which the companies were involved along with the level of state to which the company belonged played an important role. The assessment of CDTTJT was thus closely linked to the perceived role of Tianfu:

‘Tianfu New Area Chengdu Section is a territory under the direct rule of Chengdu City, and as such attracts considerable support. The past few years, Tianfu New Area Chengdu Section has maintained quite fast growth. The very good prospects for the local development give CDTTJT a good environment for growth.’ (Shanghai Brilliance Credit Rating and Inversts Service co. ltd. 2018: 1, author’s translation)

The prospects for CDTTJT were particularly good, because it was part of all investments:

‘As the main body of local development as well as management of state assets and state capital transfers in Tianfu New Area Chengdu Section, CDTTJT has an outstanding business position.’ (Shanghai Brilliance Credit Rating and Investment Service co. ltd 2018: 1, author’s translation))

The fact that a number of central government regulations restricted its operations was not regarded as major issues, because it was assessed that the company though owned by a relatively low level of government was sufficiently highly prioritized. The credit assessment report assessed that these and other initiatives:

‘in the short run will challenge urban investment companies but will help the sector to become more ordered’ (Shanghai Brilliance Credit Rating and Investment Service co. ltd 2018: 9, author’s translation).

This Chinese assessment of the situation was also reflected in the international rating of the company. Moody’s in 2019 used their estimate of high likelihood of political support to raise the credit rating by three notches from Ba3 (a non-investment grade) to Baa3 (the lowest investable grade) (Moody’s, 2019). In 2020, Moody’s changed the methodology to an even closer reflection of the Chinese assessment. They simply took Chengdu’s very high A3 rating as the starting point, and deducted a fixed number from Chengdu’s own rating reflecting the high prestige of Tianfu as a national new area lead to a one notch higher rating than other similar local government vehicles (Baa2) (Moody’s, 2020).

If we compare CDTTJT to the situation of another company, Sichuan Longyang Tianfu New Area Construction Investment Group, with a similar function in a neighbouring county the difference is clear. It was assessed as less credit-worthy with a lower credit rating. With its peripheral location on the outskirts of Tianfu the rating agency assessed that a bail-out was much less likely than in Tianfu’s core area (Sichuan Longyang Tianfu New Area Construction Investment Group, 2019). It was clear that the political commitment and prestige of the project in which the two companies owned by county level entities were involved affected their credit ratings. CDTTJT had subsidiaries co-owned with two of the largest national banks, Bank of China and China Development Bank (CDB), and it had a foreign credit rating that allowed it for raise capital on foreign markets. The company in the physical periphery of Tianfu and in the periphery of political focus was in a very different situation, because 1) the degree of commitment to the development of the periphery was less of a priority and 2) because the periphery government was regarded as lower ranked than the satellite provincial administration governing Tianfu’s core. This despite the fact that the distance to the actual economic centre, Chengdu, was slightly shorter from Longyang.

4.3. From Land Rents to Financial Rents: Chengdu Xingcheng Investment Group

To further examine how much political support affects credit ratings, we narrow down our focus to one of the companies engaged in the development of Tianfu, CXCIG. CXCIG was through its subsidiaries among the largest developers engaged in Tianfu. Like the other developers, it was state-owned – specifically by Chengdu's SASAC[1], which held 100% of paid-in equity in the company.

As always when studying financial operations in China, the data is impartial and limited. The main reason why CXCIG was chosen as a case is the availability of detailed data about their finances. The main source for data on the company is a prospectus from 2018, where CXCIG raised 135.000.000€ through issuance of a 5-year bond in Frankfurt. This prospectus includes financial statements for 2015, 2016 and 2017(first half) for the group. After this period several changes were made in the regulations surrounding financing of these types of companies (often called local government financing vehicles (Chen et al., 2020, Wu, 2015)), which prohibited some of the practices described below. However, the main aspects of the business model were quite clear.

The company was the holding company of a conglomerate. The main business of the company was development – the physical transformation of land into urban land in Chengdu. Once prepared with public buildings and infrastructure, the land could be sold off to other real estate developers. CXCIG did not claim title on the land, but acted as a contractor for the city government. The company was compensated for its efforts from the proceeds of land-auctions. Therefor it did at no point own land to use at collateral for borrowing. While smaller in Tianfu than Tianfu's own CDTTJT, CXCIG's Tianfu Greenway's project was carried out by one of its subsidiaries with total investments of 41.5 billion RMB from 2017 to 2020 (Chengdu Xingcheng, 2018: 74).

To examine this example, we first focus on how the company's equity capital was created. Then we shift to the debt funding arrangement and see how CXICIG funded their investment. Finally, we are going to focus on the role of political support through an examination of the role of credit ratings in creating what we call a "political AAA".

4.4. Creating equity: ownership and political support in CXICIG:

To be able to borrow, a company needs equity to be able to assure creditors that repayment is likely even under adverse outcomes. Maintaining an equity capital buffer lowers risk for lenders and consequently financing costs. For certain centrally situated financial institutions such as the big four state banks (Industrial and Commercial Bank of China, China Construction Bank, Bank of China, and Agricultural Bank of China) or policy banks (primarily China Development Bank), equity capital provides little benefit, since their credit worthiness depends on their perceived political backing rather than actual financial health,[2] but for other companies in China, equity matters.

CXCIG was created in 2009 through a merger of two other development companies. In 2012, the local SASAC paid in 5.5 bln. RMB as equity capital. Following its founding in 2012 a number of capital injections from different city department which did not change the ownership of CXCIG expanded the equity capital with around 50% (Chengdu Xingcheng (2018) – appendix "2016 financial statement" p 183). However, capital was also "created" through transformation of assets from less to more valuable types – for examples from fixed assets to government debt. This process is best illustrated by an example. When conducting development projects, the company did not take over the land it developed. Rather it carried out politically mandated projects – such as the construction of segments of a new ring road. While the road was finished in 2013, it seems to not have been handed over to the city government until 2015. The prospectus implies that the toll road segment was held as such an asset on the balancesheet of CXCIG – which could be quite problematic in terms of trying to raise money for new projects – since the value of a road is hard to discern. This asset quality problem was solved by making a retrospective "build to lease" agreement. By leasing the road from the company, the local government transformed an asset of uncertain value into an asset of predicable value without incurring the upfront fiscal cost of buying the road of the company. The price for the lease was set at 10.8 bln RMB repayable over 15 years. It created a predicable cash flow of 720 million per year. Functionally, the city government took a loan from CXCIG to finance the purchase of the road from CXCIG – basically allowing the government to buy it in instalments. A toll road had now been transformed into a local government loan, creating equity and thus removed barrier for further borrowing by the company without creating official local government debt.

These "usual deals" to transform or inject assets depending direct on the ownership status of the company, since it was local government and Chengdu SASAC just rearranging their assets to create a basis for borrowing by increasing equity and lowering leverage – a practice well understood in Chinese finance (Lauridsen, 2018, Walter and Howie, 2012). This close relationship to the local government and the ability to move and rearrange assets on the balance sheet show the importance of political embeddedness to help developers create the foundation for continued expansion: a strong, if slight arbitrary, capital base. The purpose of this base is of course primarily providing access to borrow funds for land development. It is this funding to which we now turn.

4.5. Borrowing: Sources of funding and political connection

We now turn to the sources of funding for investments. We again use the funding structure of CXCIG as an example, as it is the best available source of the funding structures of this type of company in Tianfu. These sources of funding show the ability of CXCIG to access funding from sources that are not only based on local connections but perceptions of likelihood of repayment by central actors – or the perceptions of the likelihood of bailout.

The Chinese financial system can be understood as a hierarchy of financial institutions. The degree of liquidity and security depends on the closeness to the People's bank of China and the central interbank markets (Allen et al., 2005, Gabor, 2018).

In the core are the largest banks owned by the central governments. These financial institutions are of such size, prestige and importance, that they will not under any circumstance be allowed to fail or have their ability to pay questioned. In the first circle, there are a number of smaller national banks and a variety of large non-bank financial institutions – these are usually understood to have backing from either provincial or centrally owned SOEs. They are unlikely to be allowed to fail, as their failure would raise questions, but restructuring and disciplinary action through the party is common – leaders of these organizations are not core players in the party, while heads of the core banks are (Walter and Howie, 2012).

The second circle are the local banks and non-bank financial institutions, which have a variety of owners – usually provincial government or financial conglomerates. While bailouts might and do happen, the failure of these institutions would be more a question of social unrest or local prestige rather than questions about the overall stability of the Chinese financial system. In the outer rim lies the world of shadowbanking of various sorts. From informal finance to entrusted loans through banks, this is supposed to be outside the guarantee of the party, but in some cases, bailouts of even informal credit has happened when there is a threat of civil unrest (as in 2011 in Wenzhou (Financial Times, 2012)).

So, a way to look at the political position of a company, is to look at what kind of funding it can raise and from whom. The more central the funding source and the more prestigious the project, the stronger the narrative of support will be. As can be seen in the figure below, the main sources of funding are bank loans, which are mainly from the big four or other national level banks (such as Minsheng Bank) (Allen et al., 2005, Tsai and Naughton, 2015).

If we for a moment appreciate the actual business model of CXCIG, it is wholly undiversified, since it is dependent on the housing and land market in Chengdu almost exclusively for its income and it is financed by debts with relatively short maturities which exposes it to liquidity risk, then it would not seem like a particularly solid debtor (Chengdu Xingcheng, 2018). However, it is still able to access quite high-quality funding in the form of bank loans from the big four banks and enterprise bonds. The structure of debt is also telling as seen in Fig. 1.

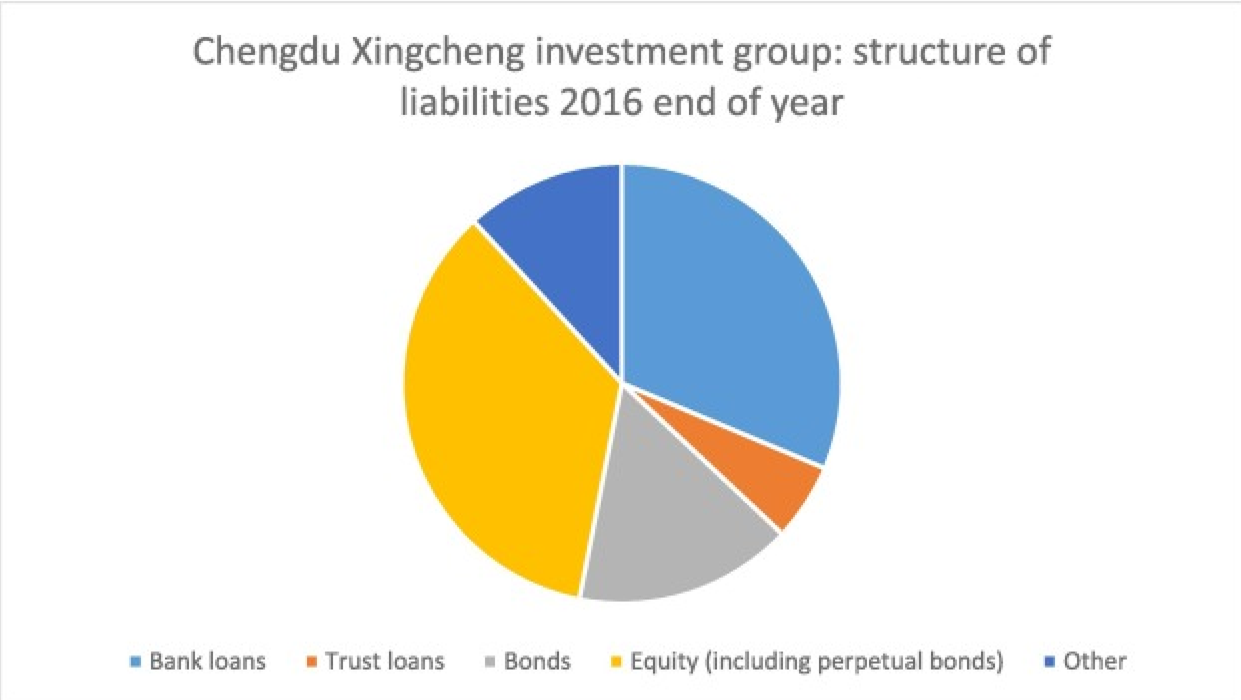

Fig. 1. Chengdu Xingcheng investment group: structure of liabilities 2016.

The structure of debt shows how Chengdu Xingcheng is accessing markets and types of lending which are not available to just any enterprise in China. Access to mainland bond markets is rationed and requires regulatory approval for each issue – approval that requires political backing. Access to foreign markets to fund domestic investment requires even more clout. Since access is limited and issuers are perceived at safer, interest rates in these markets are lower than for unsecured bank loans, trust loans or shadow finance.

Overall, CXCIGs balancesheet shows that its ability to access forms of financing and credit depends on its connections to politically embedded organization on various levels, such as large state-owned banks and national level financial regulators such as the National Development and Reform Commission (NDRC). But it is not just in the type of credit perceptions of political support is crucial, but also in the perception of risk and pricing of that credit. This effect is most clearly visible in the institutionalization of the political "AAA" through credit ratings and its effect on cost of funding.

4.6. The political AAA: Credit ratings, bond financing and the effect of political trust

The bond markets have played a significant role in the long-term development of the Chinese financial system towards a more securities based financial system (Gabor, 2018). However, the adoption of credit ratings precedes the current drive towards such a system.

The non-financial non-government bond markets are dominated by bonds issued from the local SOEs, which make up 65% of the total number of bond issues and 48% of the total value of bonds issued. To get access to domestic bond financing, a bond issue must be approved by the relevant authority and to be approved, the bond must have a credit rating issued by a licensed credit rating agency (CRA) (for an overview of the credit rating industry see Livingston et al. (2018)). China has several different bond markets, to each of which access is controlled by a key regulator and where different types of companies typically issue bonds and which have quite different secondary markets. The enterprises bond market is regulated by the NDRC. Crucially, enterprises bonds can be used as collateral for repo transactions in one of the interbank markets (footnote on the Chinese interbank market). This means that for financial institutions purchasing these bonds, they are very liquid since they can be turned into liquidity overnight in a market that accounts for 95% of all bond market secondary trades in China. Non-SOE companies are confined to the corporate bond market, which has a traditional secondary bond market and which cannot be used for repos in the interbank markets and thus are much more illiquid. For a local SOE access to enterprise bond market is in a valuable alternative to borrowing from banks or accessing even more expensive shadow banking lending such as trust company credit or informal sources of finance (Gabor, 2018, Tsai and Naughton, 2015).

4.7. Estimating the importance of a good credit rating

Credit ratings make the expectation explicit that politically connected companies will be bailed out in some fashion if they come into financial difficulties. This is a quite rational belief given that before 2014, no bond had defaulted in China (Livingston et al., 2018), unlike bank loans, where non-performing loans and loan restructuring have been a part of Chinese finance since the 1990s (Lardy, 1998, Lauridsen, 2018). From 2010 onwards some Chinese authorities have been struggling to impose market discipline through strategically allowing the failure of locally embedded state owned companies or financial institutions (Lauridsen, 2018), but this has not stopped the focus on the companies' place in the political narrative. Fundamentally, the reason for the "political credit rating boost" is trust in the capacity and willingness of the Chinese party-state to maintain its economic power through the state-sector and its financial system. Failure of marginal companies and the bailout of connected ones does not devalue political connections – rather they make them more valuable, since it makes the party-state guarantee rarer.

As with many areas of Chinese finance, the literature on CRA and credit rating effect on bond pricing is rather sparse, but Livingston et al. (2018) find that credit rating have a correlation with bond yields and that CRAs have differential impacts on bond yields. They also show that the credit rating system in China is much less finely grained. They find that 90% of all bonds rated by Chinese credit ratings agencies fall in just three ratings AAA, AA+ and AA. Also, while in Western markets a notch in credit ratings has been found to correspond to between 9 and 18 basis-points in interest rate, in China each notch corresponds to 58 basis-point. But how much does the political AAA matter for a company such as CXCIG?

While Chinese credit ratings take explicit account of perceived political support, they are not explicit about the impact that has on their ratings – which makes sense with the less fine-grained credit rating grades. Furthermore, bonds are just one of the ways that companies like CXCIG fund themselves – so banks and other financial institutions make their own internal credit assessments and unlike credit ratings, these are not public. It is therefore hard to precisely say how large the effect of this value of perceived political support is across all the different funding sources. However, we can try to use the effects of credit ratings on bond market rates to estimate the impact that support for CXCIG on their cost of funding.

One way trying to gauge this is to look at international ratings of bonds issued abroad of Tianfu connected companies. As we saw in the case of CDTTJT, Moody's assessment almost exclusively relies on the company's assessment of Chengdu City and its priority of Tianfu. Until 2019 this was translated as three notches above the market-based rating, a fictitious rating which Moody's gave up calculating in 2020 (Moody's, 2020). To estimate the fictitious market rating of CXCIG we use the same three notches that Moody's applied in the assessment of CGGIG. We further apply Livingston et al.'s (2018) estimate that three notches in an international rating corresponds roughly to one notch in a Chinese rating in terms of effect on pricing.

There is reason to think that the likelihood of political support for bonds issued abroad should be lower than bonds issued within China– both because of the willingness and ability of the Chinese local and central government to organize a bailout. In terms of ability, the international bonds are denominated in foreign currency and are held by foreign banks and nationals. This means that a bailout would require access to foreign currency reserves – while China has sufficient reserves at present, a bailout on scale would require involvement of the central government which may conflict with other policy goals. Debt denominated in RMB on the other hand is infinitely fundable by the Chinese state, since it created funds by fiat and the Chinese state has policy tools for managing bailouts discreetly inside China. In terms of willingness, a major default inside China carries the possibility of both financial panic and social instability – but a default of foreign liabilities carries no such political risk, which would suggest a lesser incentive for bailing out foreign as opposed to domestic creditors. If the guarantee is more solid inside China, one should also expect that the impact of the guarantee on the cost of funding should be higher.

So, it is both reasonable to take the minimum estimate of the effect of the guarantee based on the three notch effect seen in an international credit rating or to take a larger effect two notch effect based on domestic credit being more likely to receive political support. Since we are only trying to illustrate the scale of the effect, we will present calculations for both.

Since we through a bond prospectus for CXICIG have access to relatively detailed financial information on that company, we use CXICIG as an illustrative example of the effects of perceived political support on this company's financial position. Doing so requires making several assumptions. The key assumption is that the interest rate discount which applies to the issued bonds is replicated for all the debt the company has including bank loans but excluding all forms of equity and equity substitutes (such as perpetual bonds). While this might seem unreasonable, the main players on the bond markets are banks and to assume that the banks would provide the same interest rate discount to their own lending that they apply to bonds seems logical, if not empirically provable with available data.[3] In the table below, the value of the political AAA is calculated using Livingston et al.'s (2018) estimate that each notch in credit ratings corresponds to a 0.58% effect on interest rates. This should only be seen as an attempt to show the significance for the finances of the company of the perception of political support and not highly accurate calculation.

If compared to the pre-tax profits of the company, the savings from a lower interest rate is almost 33% of profits with a lower interest rate equivenlant one notch lower credit ratings and 66% of profits with a two-notch decrease. Thus, because credit ratings are based largely on an estimate of likelihood of political support in case of default and the effect of credit ratings accounts for from one to two thirds of profits, perception of political support is crucial to profitability and the creditworthiness of the company. In this manner access to credit creates the condition (profitable operations) for further access to credit (See Table 1).

	Estimate for lower credit ratings by 1 notch (from AAA to AA+)	**Estimate for lower credit ratings by 2 notches (from AAA to AA)**
Expected increased interest payments due to lower credit ratings (mio. RMB)	166	332
Total pre-tax profit (mio. RMB)	494	494
Estimate of effect of political AAA on profits (Share of increased interest payment/ total pre-tax profit)	34%	67%

Table 1: Estimates of effects on profitability due to lower credit ratings for CXCIG 2017 financial results (Financial statement 2017, Livingston et al 2018, author calculations)

Just as much as access to land, the success of Tianfu depends on the access to capital, access to funding and the political AAA that the companies investing in the zone enjoy. The ability of Sichuan province and Chengdu city to make a large satellite city in a few years depends on the financial infrastructure of China, which has developed to support politically favoured projects and to channel credit towards such projects.

5. Discussion

Profits from land development rely on scarcity. As we have seen in the Tianfu case, manufacturing this scarcity is not primarily about a physical scarcity in terms of availability of developable land, nor a scarcity that arises from local government pressures against development of land or local resistance against development. Rather it stems from the regulation and governance structure of land management in China not just because of the need for permissions, but also due to perceived political support for development plans. The use of symbols of political support – such as state council support or a visit from Xi Jinping creates the "hype" that enables the concentration of investment needed for a successful development project. The land is made valuable through the perception of political will from the very top. Once a project for land use has received blessing an almost ritual game of grand gestures and magnificent plans breathes life into the project. This narrative politics of land use is the basis on which land rents are created and can be turned into capital.

The accumulation process is connected directly to the organization of finance in China. The politics of finance create differential access to and pricing of credit, which in turn create financial rents. As the financial system has been commercialized and oriented towards profit, it provides credit to enterprises for profit – it lends to SOEs not because they are SOEs but because of the perceived lower risk of lending to them. This perception of lower risk is particularly important for SOEs which are not directly owned by the central state like the ones studied in this paper. Certain types of credit are exclusive to SOEs and signal to financial institutions which SOEs have favour and thus protection and lower risk. Projects that get support from Policy banks or are allowed to issue enterprise bonds can also access credit from the big four state banks since they have proven to have political favour. Private enterprises or unfavoured SOEs have to find funding through more expensive modes of funding such as trusts or wealth management products. Even within riskier credit markets, the differentiation of perceptions of risk is based on a judgement of the likelihood of a central government bailout rather than of the soundness of the underlying investments. We saw this in credit ratings, where these perceptions were directly translated into lower funding costs. This is again not driven by connections to local government or concrete guarantees, but rather a narrative - one that exists in financial markets - of bailout and political support from above. It is the story about support based on signals and prestige that creates credibility and thus credit, not clientelistic networks. This marriage of narratives of bailout creating credibility in a more market-based financial system is what we call financialized political capitalism.

This argument can be taken too far. It is important to stress that we are not claiming that local informal institutions, networks, state entrepreneurship and corruption are not crucial parts of the real estate/credit system in China. What we are arguing is an additional perspective - that a narrative which becomes formalized and institutionally real through government policies and financial markets can be turned into capital. This can create a machine of accumulation which is not based on local and informal institutions, but by formal institutions in the Chinese political economy and the cold calculation of the market. This is easier to highlight in our geographic context - While in the east, the local networks and local connections might alone be key to real estate capital accumulation, further west a story that unlocks access to central financial institutions and markets is needed. So, this finding is to be understood as a supplement and addition to the existing literature (Feng et al., 2021, Pearson et al., 2020) rather than an alternative to and refutation of it.

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1

A State-owned Assets Supervision and Administration Commission (SASAC) is a type of institution in China which owns and manages state assets on behalf of a government entity. These exists on the central level and on provincial and city levels.

2

See Lauridsen (2018) for examples relating to centrally owned Asset Management companies connected to the big four banks.

3

Since issued bonds account for a little less than a third of CXCIGs funding (see figure 3 above) if the calculation was done only for bond financing the effect would be approximately a third of the calculated figure.