

Grand Strategies for Dealing with Chinese Local Government Debts

Mengzhong Zhang

John W. McCormack Graduate School of Policy and Global Studies
University of Massachusetts Boston

Youwei Qi

School of Public Affairs and Administration, Rutgers University-Newark

PART I INTRODUCTION

- The fiscal crises in Greece and other countries have resulted in significant concerns over government debt and its sustainability globally and China is not an exception (Li and Lin, 2011).
- Many scholars and observers worry that local government debts in China are on the edge of a cliff and that an effective mechanism of controlling the growth of the debts has yet to be found (Shen, 2014; Nagao, 2015; Talley, 2014; Kwong, 2013; Kuijs, 2010).

- Both the current debt figure and the rapid increasing rate are alarming.
- Moreover, we believe that the Chinese local government debts will become uncontrollable if effective measures are not put in action immediately.

- This study examines the root causes and origins of the Chinese local government debts and intends to propose solutions by developing targeted strategies and measures. We thus expect to fill the literature gap and propose effective policy recommendations.

Size: Historical Evolution of Chinese Local Government Debts

- In the 29 years from 1953 to 1981, the government as a whole in 17 years has had either a balanced budget or a small surplus, and in the other 12 years had small deficits. It is understandable that China had adopted a budgetary policy called “balanced-budgetary or a-small-surplus policy” for those years. The Chinese government had neither access to the international capital market nor is accustomed to borrowing money from the public (Li and Lin, 2011).

- From 1979 to 1993, the Chinese government began to borrow limited capital from foreign and domestic markets.
- In 1994, the Chinese government's deficit almost doubled and the central government had a surplus from 1994 to 2009 while the local government had a significant increase of deficit ever since. This rapid change can at least partly be explained by the 1994 Chinese tax for fee reform (Zhang, 2006).

- In order to deal with the Asian Financial Crisis that happened in 1997, the Chinese government followed an expansionary fiscal policy from 1998, and the budget deficits increased sharply in the following years. To cope with the global financial crisis in 2008, the Chinese government adopted an expansionary fiscal policy again. In particular, the Chinese central government issued a four trillion RMB rescue package in 2008. Thus, the government deficits reached new heights in the following years.

- It was estimated that Chinese sub-national government debts increased from about 2.5 trillion Chinese RMB in 2004 to about 10.0 trillion Chinese RMB at the end of 2009 (Zhao, 2011). Furthermore, including the contingent liabilities, the Chinese local governments' debts were calculated to be more than 23 trillion RMB in early 2015 (Bloomberg, 2015).

- A recent article estimated that the China's total debt equals 282% of its GDP, and China's total debt over GDP is higher than some advanced economies such as Australia (274%), United States (269%), Germany (258%) and Canada (247%) (Costa, 2015).

PART III RESEARCH DESIGN

Research Questions:

- Research question one:
What is the size of the Chinese local government debts?
- Research question two:
Are Chinese local government debts controllable?
- Research question three: Who or what caused the rapid increase of the Chinese local government debts?
- Research question four: Is it possible to have individual accountability for increasing local government debts in the future?
- Research question five: Will it be helpful to create a local government debt management organization in the Chinese central government?

PART III RESEARCH DESIGN

Research Methodology:

- We have interviewed eight government officials including three town chief, two county chief, two provincial level financial bureau leaders and one policy analyst as well as one financial company CEO and five scholars from premier Chinese universities (we believe that they are experts in Chinese local government debts) from May to June of 2015. These government officials are scattered in economically developed local governments as well as in less economically advanced local governments in China. Their opinions and views are extremely important to address our research questions and shape our policy recommendations.

PART IV FINDINGS

- For research question one: What is the size of the Chinese local government debts?
- The answers vary a lot. Overall, the government officials are much more cautious in terms of the size of the Chinese local government debts beyond the total of 16 trillion RMB by the end of 2014. Some indicates that the official-owned data of local government debts may be relatively small and not all-inclusive.

- For research question two: Are Chinese local government debts controllable?
- Most respondents believe that the size of the overall Chinese local debts is controllable. They believe that the Chinese government has huge resources to repay the debts with the sale of (or renting out) land or assets of State-Owned Enterprises (SOEs)

- For research question three: Who or what caused the rapid increase of the Chinese local government debts?
- There are several perspectives for the rapid increase of the Chinese local government debts in recent decades.
- It is widely believed that the official promotion mechanism is a key to the local debt burst. Official promotion is substantively linked to the economic performance of the region. Government officials have strong incentives to borrow money to boost the GDP, which helps their further promotions, while the debt problem would be left for the next term of the administration.

- For research question four: Is it possible to have individual accountability for increasing local government debts in the future?
- Almost all of the respondents declare that the local government officials should be blamed to a degree. Debt issue should be a factor in performance evaluation.

- For research question five: Will it be helpful to create a local government debt management organization in the Chinese central government?
- The responses are negative. Every interviewee hardly believes that it cannot do with the existing problem of local governmental debts to establish a debt management department or agency under the State Council (the Chinese central government).

PART V ANALYSIS AND POLICY RECOMMENDATIONS

- First, we recommend drawing a clear line of demarcation between the government and the market.
- If we study the compositions of the local government debts carefully, it is not difficult to find out that the major sources of the local debts are derived from economic activities. If the government behaves ideally following the market mechanism, many of the debts should not be generated in the first place.

- Second, we recommend reforming the current tax sharing mechanism between the central and local governments.
- Our studies have revealed that the 1994 tax for fee reform has largely increased the proportion of central government's fiscal revenue (Zhang, 2006), while decreasing its fiscal responsibilities gradually. As a result of the 1994 reform, the central share of tax revenue jumped from 22 percent in 1993 to 55.7 percent in the following year (World Bank, 2002; also see Table One).

- Third, we recommend holding the relevant officials responsible for the illegal increase of the local government debts.
- Unlike in western countries where the citizens elect the top politicians in every level of government, Chinese leaders are appointed or selected by the higher level Chinese Communist Party (CCP) organizations. The Chinese Communist Party can easily promote or demote or even fire its government officials. This systematic difference between China and western democratic countries results in quite different motivation between Chinese leaders/officials and the western politicians.

- Fourth, we recommend establishing an organization in the central government to manage the Chinese local government debts.
- By June of 2013, Chinese local government debts had reached more than 10 trillion Chinese RMB. Though Chinese central government leaders from time to time have announced that the central government would not take care of the local government debts problem if in the end the locality cannot repay the debt, the respondents and we believe that this is not a credible threat: if the local government debts cannot be repaid, the central government will bail them out. China is a politically unitary country.

Questions?

