

China's Subnational Debts: Problems and Suggestions

**Research Institute for
Fiscal Science, Ministry of Finance
Liu Shangxi**

China's Subnational Debts: Problems and Suggestions

I. Overall Situations and Major Problems of Full Caliber Subnational Debts

II. Relationship between the Reform of Fiscal and Taxation Systems and the Improvement of Local Debt Financing System

III. Local Government Debt Risk Assessment

IV. Countermeasures and Suggestions

I. Overall Situations and Major Problems of Full Caliber Subnational Debts

1. Overall Situations of Full Caliber Subnational Debts

(1) Overall Situation

From the audit results given by the National Audit Office at the end of June 2013 , we can see that Subnational Debts comprise of three categories:

First, debts to be repaid by local governments,

Second, debts guaranteed by local governments,

Third, debts that may be relieved by local governments.

I. Overall Situations and Major Problems of Full Caliber Subnational Debts

At the end of June 2013, the debt levels verified under these three categories were 10.8 trillion yuan, 2.6 trillion yuan and 4.3 trillion yuan, respectively. The first category are direct debts of governments, while the second and third categories are the contingent debts of governments. The direct debts are of large scale, while the contingent debts are of small scale when speak of their scale. Among contingent debts, the scale of statutory or contingent debts is smaller than that of non-statutory (moral) contingent debts. Fig.1

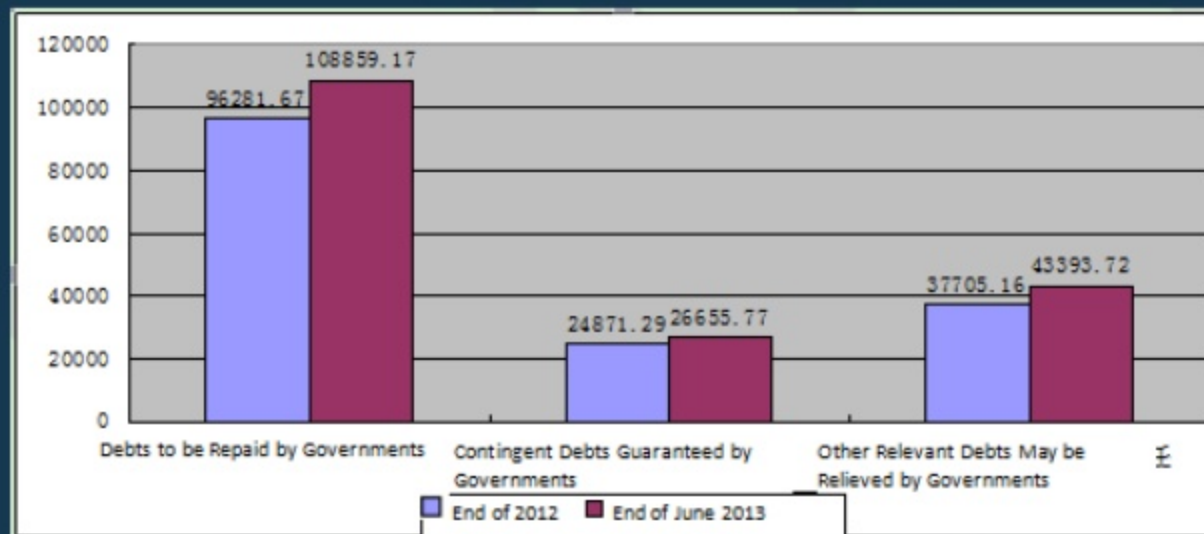


Fig. 1. The Overall Scales of Three Categories of Subnational Debts
(Unit: 100 million yuan)

I. Overall Situations and Major Problems of Full Caliber Subnational Debts

1. Overall Situations of Full Caliber Subnational Debts

(2) Situations at different government levels

Looking from the debt audit results, as of the end of June 2013, the debts to be repaid by local governments are mainly at municipal, district and county levels. Municipal level accounts for 44.5%, county and township levels account for 39.2%, while provincial level only accounts for 16.3%. Table 1. shows the main situation of debts to be repaid by local governments.

I. Overall Situations and Major Problems of Full Caliber Subnational Debts

Table 1. Debts to be Repaid by Local Governments as of June 2013 (Unit: 100 million yuan)

Structure of Debt		Balance of Debt (100 million yuan)	Percentage
Structure of Government Responsibilities	Debts to be Repaid by Governments	108859.17	60.85%
	Contingent Debts Guaranteed by Government	26655.77	14.90%
	Other Relevant Debts That May be Relieved by Governments	43393.72	24.25%
Tiered Structure	Provincial-level government debts	17780.84	16.33%
	Municipal-level government debts	48434.61	44.49%
	County-level government debts	39573.6	36.35%
	Town/township-level government debts	3070.12	2.82%
Main Structure	Financing Platform Companies	40755.54	37.44%
	Departments and Institutions of Local Government	30913.38	28.40%
	Institutions with Outlay Subsidies	17761.87	16.32%
	Wholly State-owned or State Holding Enterprises	11562.54	10.62%
	Self-sufficient Institutions	3462.91	3.18%
	Public Institutions	1240.29	1.14%
	Other Units	3162.64	2.91%
Structure of Fund Sources	Bank Loans	55252.45	50.76%
	BT	12146.3	11.16%
	Trust Financing	7620.33	7.00%
	Issuing Bonds	11658.67	10.71%
	Loans from Other Units and Individuals	6679.41	6.14%
	Payable Payments	7781.9	7.15%
	Others	7720.11	7.09%
	Payable Money	7670.4	7.05%
	Municipal Construction	37935.06	34.85%
	Transportation Infrastructure Construction	13943.06	12.81%
Structure of Fund Usage	Land Expropriation and Reserve	16892.67	15.52%
	Science and Technology, Culture and Health	4878.77	4.48%
	Construction for Agriculture, Forestry, Water Conservancy	4085.97	3.75%
	Ecological Construction and Environmental Protection	3218.89	2.96%
	Low-income Housing	6851.71	6.29%
	Industry and Energy	1227.07	1.13%
	Others	12155.57	11.17%
	Repaid between July and December of 2013	24949.06	22.92%
	Repaid in 2014	23826.39	21.89%
	To be Repaid in 2015	18577.91	17.07%
Term Structure	To be Repaid in 2016	12608.53	11.58%
	To be Repaid in 2017	8477.55	7.79%
	To be Repaid in 2018 and thereafter	20419.73	18.76%
	Total	108859.17	100.00%

Sources : Edit from *The Audit Results of Nationwide Debts* (The National Audit Office 2013No.32)

I. Overall Situations and Major Problems of Full Caliber Subnational Debts

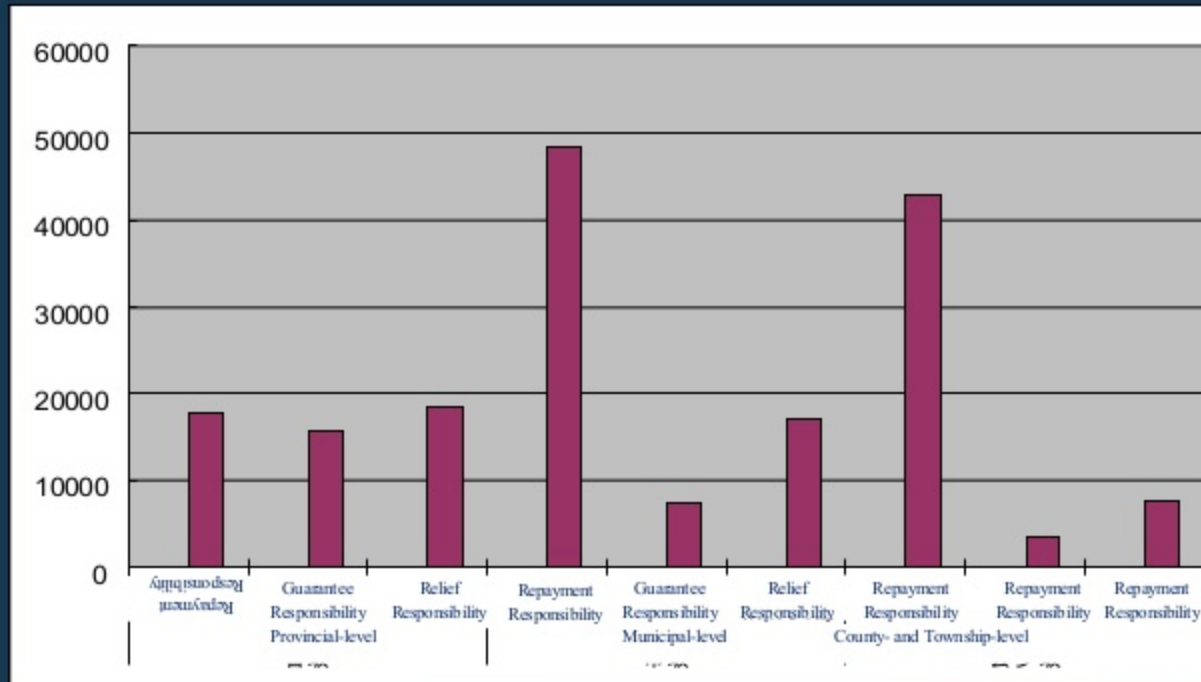


Fig.2 Composition of Provincial-level, Municipal-level and County-level Subnational Debts at the end of June 2013
(Unit: 100 million yuan)

I. Overall Situations and Major Problems of Full Caliber Subnational Debts

1. Overall Situations of Full Caliber Subnational Debts

(3) Situation of borrowers

As for borrowers, apart from debts guaranteed by local governments, the debts incurred through financing platform companies and shall be repaid or relieved by governments are of the largest scale. The departments and institutions of local governments are the borrowers with the largest scale of guaranteed debts.

I. Overall Situations and Major Problems of Full Caliber Subnational Debts

Fig. 3 shows three categories of debts by borrowers. It shows that subnational debts financing platform companies as well as local government departments and institutions account for approximately 66%.

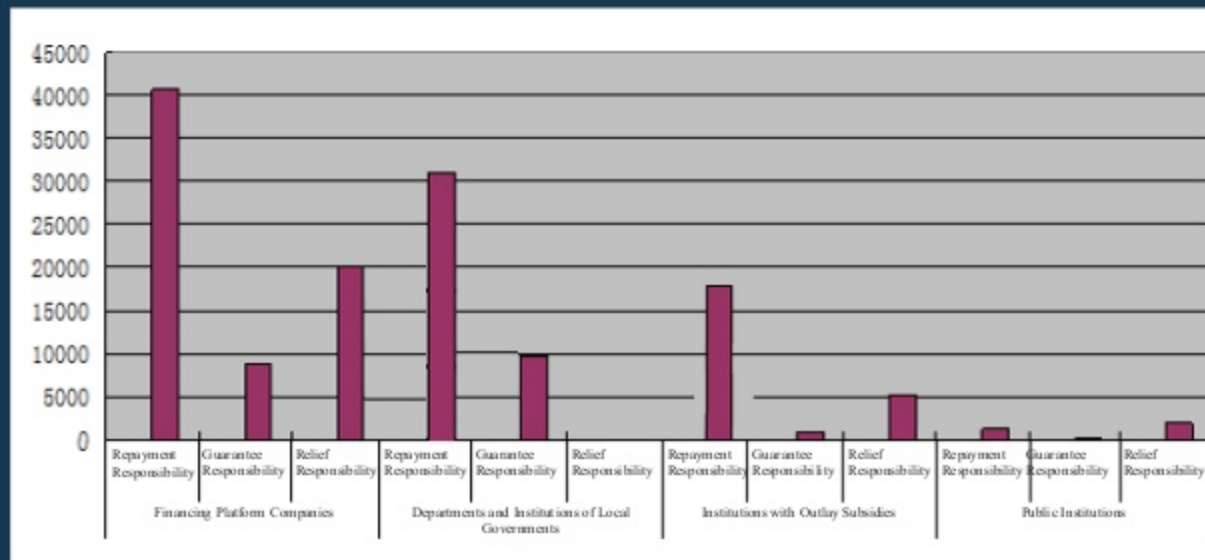


Figure 3. Composition of Main Borrowers of Subnational Debts at the End of June 2013 (Unit: 100 million yuan)

Note: The debts of local government departments and institutions fall within the scope of debts to be repaid and guaranteed by governments, but not to be relieved by governments.

I. Overall Situations and Major Problems of Full Caliber Subnational Debts

(4) Debt-repayment Situation

According to the audit results of 2013, the subnational debts to be repaid in 2015 and thereafter are shown in the following table. Overall, three categories of debts that will mature in 2015 are of the largest scale in the coming three years.

Table 2. Subnational Debts that will mature in 2015 and Thereafter (Unit: 100 million yuan)

	2015		2016		2017		2018 and after	
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage
To be Repaid by Government	18577.91	17.06%	12608.53	11.58%	8477.55	7.79%	20419.73	18.76%
Guaranteed by Governments	3198.42	12.00%	2606.26	9.78%	2298.6	8.62%	11706.75	43.92%
May be Relieved by Government	5994.78	13.81%	4206.51	9.69%	3519.02	8.11%	16669.05	38.41%

I. Overall Situations and Major Problems of Full Caliber Subnational Debts

2. Major Problems

The major problems faced by subnational debts are opaque risks and many uncertainties arising from them.

First, there is a shortage of regular statistics and release of subnational debts data.

Second, there are no governmental accounting standards for the confirmation and measurement of subnational debts.

Third, the debt risk management system is incomplete

Fourth, the debt management system is incomplete

Fifth, there is no connection between local debt management and budget management.

II. Relationship between the Reform of Fiscal and Taxation Systems and the Improvement of Subnational Debt Financing System

The financing system of subnational debts is based on the national fiscal system and focused on the division of administrative powers between the central government and local governments. The specific contents of the financing system of local debts are the arrangements for the borrowing, usage and repayment of money among local governments at various levels.



II. Relationship between the Reform of Fiscal and Taxation Systems and the Improvement of Local Debt Financing System



III. Local Government Debt Risk Assessment

China's subnational debts are accumulated over many years. Currently, the local government debt risk is generally controllable. However, some subnational debts pose certain risks.

According to the audit report issued on December 30, 2013, by the end of 2012, China's total local liabilities amounted to 39.43% of GDP, lower than 60% of public debt-to-GDP ratio, which is often noted as an international limit for debt control. Total debt was 113.41% of government fiscal revenue within the controlled debt ratio proposed by the International Monetary Fund. It could be concluded that the risk of China's government debt is controllable generally, while the risk of government debts mainly lies in the local governments.

III. Local Government Debt Risk Assessment

Among subnational debts, municipal and county governments account for around 80%, financing platform companies and local government departments and institutions make up about 66%, bank loans and debts in disguised form account for about 82% and municipal construction, transportation, land resource collection and reserve, science, education, culture and public health, and low-income housing account for around 70%. The risks are larger in these areas.

In terms of the growth of subnational debts, after June 2013, the growth of local government debt slows down. In the first half of 2014, NAO surveyed the debt of 9 provinces and 9 cities between the end of 2013 and the end of March 2014. The result showed that the growth rate of local government debt slowed to 3.79%, down seven percentage points than the average growth rate in the first six months of 2013. The debt growth rate slows down.

III. Local Government Debt Risk Assessment

Generally, the risk of local government debt is under control. However, the risk is expanded due to increasing debt repayment pressure currently and in the future as the fast debt growth in the past and poor debt management. Also, the risk of local government is further expanded with current economic slowdown, declining the growth rate of financial income (including land income) and rigid growth of expenditure.

IV. Countermeasures and Suggestions

1. Basic Ideas

(1) After the revised Budget Law was deliberated and adopted in 2014, the establishment of standard local government debt financing system is orderly promoted in the whole country according to laws.

The revised Budget Law gives local governments limited right to issue debts. Quota is applied to the issuance of subnational debts. The authority and purpose of local governments are strictly controlled and the subnational debts are included into the budget management and supervised by the People's Congress. The government financing function is separated from the financing platform companies. The liabilities of government and enterprises shall be separated. It is prohibited from transferring the enterprise's debts to the government. The local government debt risk assessment and pre-warning mechanism shall be established, as well as the emergency response mechanism and accountability system. The central government adopts a non-aid principle. The institutional framework for the government and social capital cooperation model has been established and related laws are also in drafting and formulating.

IV. Countermeasures and Suggestions

1.Basic Ideas

(2) Complete the short-term tasks

On the one hand, we need to complete the short-term tasks, control currently expanding debt scale and eliminate the threats on China's economic development, social stability and macro-management. on the other hand, at the micro-level, we need to establish and improve debt scale, and risk and efficiency control system. Also at the macro-level, we need to make a coordinated reform in the aspects of economy, legal environment and financial system.

IV. Countermeasures and Suggestions

1. Basic Ideas

(3) In the short term, an accurate, comprehensive and timely local government debt statistical system, internal reporting system and external disclosure system need to be established. We need to improve local government debt issuance, repayment and management system, suitably expand local government bond scale, transfer annual quota management to balance management and strengthen the discretion of local government to issue and manage government bond. We will further regulate and innovate the local government financing mechanism, and orderly promote the cooperation between government and social capital. Some government assets will be revitalized through the securitization of assets. We actively establish the fund system for government capital expenditure (e.g. equity guide fund and industry investment fund).

IV. Countermeasures and Suggestions

1. Basic Ideas

(4) In the aspect of medium and long term, we need to actively play the role of legal regulation, rule control and market constraint. The boundary of government function and behavior shall be clearly distinguished. Through the legislation, we will regulate the administrative power, financial power, scope of revenues and expenditures and expenditure responsibilities of government at all levels. The local governments will be gradually granted controllable and flexible rights to borrow loans. The local government debt financing management system will be established jointly supervised by the central government, local authorities, people and market.