CHINA TO CURTAIL LOCAL GOVERNMENT DEBT

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EAI Background Brief No. 1165

Date of Publication: 25 August 2016

Executive Summary

1. Many years of expansionary fiscal policy have not only greatly stimulated China's infrastructure development and economic growth, but also resulted in large accumulation of government debt, putting into question China's fiscal sustainability and long-run economic growth.

2. In 2014, total government debt, including debts of central and local governments, China Railroad Corporation and social security's personal account, was an estimated 60% of gross domestic product (GDP). This is close to the upper limit set by the European Union for its member countries.

3. The shortage of local government revenue and the strong investment demand are key to rising local government debt. Meanwhile, the central government's expansionary fiscal policies to cope with the Asian financial crisis in 1997 and the 2008 global financial crisis further fuelled the recent surge.

4. Fast government debt accumulation was a consequence of the need to stimulate China's infrastructure development and economic growth. The loans to local governments may become nonperforming loans and could imperil the financial sectors.

5. The debt may threaten economic development of the heavily indebted regions. High government debt may even hinder China's economic growth and threaten China's fiscal sustainability.

6. The Chinese government has adopted a precautionary fiscal policy. The new administration pledged to keep budget deficit and government debt at manageable levels and set budget deficit at 3% of GDP for 2016, lower than the actual size in recent years.

7. The government announced that this year's budget deficit would come mainly from tax cuts and government budget revenue will grow only 3.2% in 2016!

8. The central government has also announced the abolishment of the local government financing vehicles, through which the local governments have borrowed money from commercial and policy banks.

9. It legalised local government bond issuing in 2014 and has started “the debt swap” reform. This year the government has set aside 0.4 trillion yuan of local government bonds for special projects and allowed local governments to issue more bonds for the debt swap.