

CHINA ACTS TO CONTAIN RISKS OF LOCAL GOVERNMENT DEBT

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Executive Summary

1. Although China's outstanding local government debt increased from RMB15.3 trillion in 2016 to RMB16.5 trillion in 2017, it is still lower than the upper limit of local government debt set by the National People's Congress.
2. However, local governments also have sizeable implicit liability in the country's weakly regulated shadow banking businesses.
3. Bank loans, local municipal bonds and trust loans are among major components of local government debt. Local governments also set up Local Government Financing Vehicles (LGFVs) to borrow money in various forms including Municipal Corporate Bonds.
4. Besides debts borrowed for infrastructure building, LGFVs also borrow money for investing in commercial projects such as real estate development.
5. Local governments have implicit/partial liability for the debts associated with alternative models of financing including Public-Private Partnership projects, government procurement of services and industrial investment fund.
6. Huge local government debt has been associated with shadow banking activities including trust loans and Wealth Management Products. Local government non-bank debt was estimated to account for 48% of total shadow banking activities in 2016.
7. To manage the risks of local government debt, the government has introduced a number of initiatives. First, No. 43 document released by the State Council in October 2014 stipulates that LGFVs are no longer allowed to borrow on behalf of local governments and will be decoupled from local governments.

8. Second, since 2015, the National People's Congress has set an upper limit for local government debt and the ratio of outstanding local government debt to total local government revenue to no more than 100%.
9. Third, in 2015, the Ministry of Finance announced the issuance of low-yield local municipal bonds to pay for local government/LGFVs' debts maturing in the short term. The State Council released No. 50 document in April 2017, forbidding local governments from endorsing the repayment of LGFVs' loans.
10. Fourth, in July 2017, the National Financial Work Conference highlighted the importance of regulating shadow banking activities to address financial risks. Preventing and controlling financial risks was one of the top policy priorities of the Central Economic Work Conference held in December 2017.
11. Unaddressed concerns include how to deepen fiscal reform, slow progress of the regulatory reform, higher financial risks for county and city level governments, underdevelopment of the financial system and low demand for local municipal bonds.