

An Economic Analysis of China's High Debt—Taking Local Government's Financial Debt Risk as an Example

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Abstract: China's local government high debt and high leverage rate status has been suffering from social concern, which has been made a fuss by the Western credit rating agencies, to promote the "China's debt crisis theory". In this paper, the systematic financial risk theory, financial risk and financial risk linkage theory, the financial soft restraint theory are used to makes some assumptions on the source of Chinese local government debt, and an empirical analysis of the hypothesis is conducted further. According to the results of the empirical analysis, the corresponding normative analysis and policy suggestions are provided, to provide some prospects for the future of China's local government debt.

Introduction

In September 2008, the international financial crisis broke out, and the China's economy was blocked by the abroad impact. There has been bad phenomenon such as rapid decline in growth, migrant workers returning, and the Chinese economy is facing a hard landing risk [1]. In November 2008, the Chinese government launched ten measures to further expand domestic demand and promote steady and rapid economic growth. It is estimated that by 2010, "ten measures" will be implemented thoroughly and it will cost about 4 trillion, so this policy has also been interpreted as a "four trillion plan" by domestic scholars. In this 4 trillion investment, the central new investment is about 1.18 trillion, and the local and social commitment take up about 70% of the total investment [2]. Since the reform of the tax system in 1994, the local government's financial power has been reduced again and again, which mainly relies on one of the few scattered taxes, land transfer payments and hidden municipal debt to maintain the local basic public expenditure, and the local government's financial pressure increase constantly. In order to promote local economic development and improve local competitiveness, the second-tier cities adopt debt financing ways to raise funds for construction besides raising land prices [3].

According to the "Budget Law", the local government shall not open its own bonds. However, before the central authorities franchise Shanghai, Zhejiang, Guangdong, Shenzhen Pilot self-issued debt in 2011, the local government used local state-owned enterprises and other non-governmental entities to issue debt invisibly, which makes the scale of the debt expanded quietly and also makes the central bank determine the total amount of local government debt difficultly [4]. The total size of China's local government debt was announced in 2011, saying that by the end of 2010, the total amount of local government debt in China was about 10.7 trillion, of which more than 8 trillion were from bank credit and the debt situation was controllable and good. Then, the famous international credit rating agency Moody released analysis report to denote that China's local government debt is underestimated 3.5 trillion by the Audit Commission, and the huge amount loans may pose a threat to China's banking system [5]. China's local government used the debt to ease the short-term financial pressure, but it is not helpful for settling the problem highlighted in

local finance. In the long run, such a "drop in the bucket" type of debt deficit may eventually translate into the potential downward pressure on the Chinese economy.

According to the audit results published by Audit Commission in 2013, local governments will usher in a critical period of centralized repayment of debt during the "13th Five-Year Plan" period, and preventing the emergence of systemic and regional financial risks should be the top priority of the current central economic work [6]. Currently, the economy is transited from high-speed growth to the medium-high speed growth, and the local debt risk needs to be constrained from the source and gradually resolved, which is a major uncertainty affecting the security of China's financial system.

Literature review and theoretical basis

Systematic financial risk theory

The theory of systemic finance as a new theory of academic circles has been practically demonstrated in the 2008 international financial crisis. Academics generally believe that the main trait of systemic financial risk can not be eliminated by diversified investment. CrockettA (1977), who first put forward the theory of systemic financial risk, argues that its main feature is related to the integrity and overall nature of economic operation [7].

Dijkman (2010) argues that systemic risk usually refers to the financial shock that is high enough to undermine the real economy, the risk is from a single financial institution to the entire financial system to the real economy, and that this "infection" mechanism is at the heart of systemic risk. Domestic scholar Zhang Xiaopu (2010) also believes that the systematic "systemic" embodied in two aspects: on the one hand can affect the third party, as well as the entire financial system; on the other hand let irrelevant third party also suffered economic losses, So it is complex, sudden, fast infection, spread wide, harm and other characteristics. Zhang Ming (2014) pointed out that once the systemic financial risk outbreak, China's economy may be dragged into the middle income trap [8].

To sum up, the definition of systemic financial risk is mainly focused on the "infection" mechanism, emphasizing that the financial risk of a single financial institution may have linkage, spread or even enlarge the effect. Finally, the breakage of the financial chain of financial institutions is bound to threaten the entity Economic security, affecting the normal operation of the real economy.

Financial Risk and Financial Risk Linkage Theory

In the traditional Western systemic financial risk theory, government, finance and other factors are not taken into account. Steven L (2008) emphasizes that systemic financial risk is an economic and financial concept that has nothing to do with politics and that it should not be used as a political label for any major financial failure and recession [9].

In this regard, domestic scholars hold different views. Wang Jinlong (2005) pointed out that financial risk and financial risk are not only highly relevant in the cause, but also have high correlation in the harm of the results, leading to the ultimate harm of the two, such as the financial risk of " Financial "and financial risk of the" financial ". He also pointed out that the financial risk and financial risk of high correlation is controllable. Specific measures to clarify the financial and financial functions of the division of labor and strengthen coordination [10].

China's financial and financial and did not form a completely separate economic system, which also led to a certain degree of financial and financial to form a de facto dependency relationship. This kind of dependency makes the financial risk possible to the financial risk transformation, the financial risk may further strengthen the financial risk to the certain extent, finally acts on the real economy, causes the physical economy the hard landing [11].

Budget Soft Constraint Theory and Budget Budget Soft Constraint Theory

The theory of budget soft constraints originated in the enterprise, Kornai (1986) argues that in the socialist micro-economy, when state-owned enterprises are losing money, the government often invests, injects, reduces taxes or provides financial subsidies, thus distorting the market's allocation of resources Effectiveness. Domestic scholar Lin Yifu (2004); Gong Qiang, Xu Chaoyang (2008) also hold similar views [12]. Subsequently, this theory was introduced into the financial sector to explain the issues related to China's fiscal revenue and expenditure. The soft budget constraint refers to the lack of effective control over the government's disposition of financial resources, and the budget mechanism is not enough to restrict the excessive expenditure of the government. Due to the lack of effective democratic supervision, taxpayers can not control the flow and use of financial resources, and the government monopolizes the discretion of public finance resources, resulting in local budget soft constraints are very common (Zhao Yongliang, Yang Zihui, 2012; Zheng Hua, 2011) [13].

In view of this, in order to meet China's overall economic growth needs, local governments will be more inclined to increase investment and expand the budget to promote local economic development. Fang Hongsheng and Zhang Jun (2009) found that the local government has implemented the "expansion-oriented" fiscal policy both in the recession and in the prosperous period, and the main reason is that the local government lacks Good budget constraint interaction. This confirms the local situation of the local government's current high debt [14].

Hypothesis of the Causes of Local Debt Risk

Taxation system reform caused by the uneven distribution of financial rights

Since the reform and opening up in 1978, the central government has been living beyond the situation. The taxation pattern of the planned economy era makes the local tax more and more, and the central government can only collect the fiscal tax from the local government. Local financial autonomy to a certain extent led to the gradual emergence of the phenomenon of economic inflation. Some local governments choose to reduce part of the enterprise tax by way of relief, to achieve the results of reform and opening up in the region, while the central has become increasingly poor bad phenomenon [15].

Year after year the fiscal deficit makes the central began to reflect on the "dry system" tax collection model. Since 1992, the central government began to study the "tax-sharing system" reform, re-delineated the central tax, local tax and shared tax types, and confirmed the central and local division of power. The central government is mainly responsible for the national security, diplomatic and central state organs to run the necessary funds to adjust the national economic structure, coordination of regional development, the implementation of macro-control necessary expenditure and the direct management of the central business development expenditure. And local finance is mainly responsible for the operation of the local authorities and the expenditure required for the region's economic and business development expenses.

"Tax system" reform is called China's planned economy from the market economy to change a key step. The central government to achieve an unprecedented rapid growth, in fact, made the economic macroeconomic regulation and control of the dominant position. But it is this policy, after the local finance has brought a huge burden. Local governments need to be responsible for the economic and career development of the region, and even need to bear the blood transfusion responsibility to stimulate the region's economy. Excessive power and relatively weak financial resources to local finance into a quagmire.

The vast majority of local governments will look to the undeveloped land and debt financing, and the two formed an organic combination. According to the Audit Commission data, local government debt is often landed as collateral. This means that the local government put all the financial pressure on all the land prices. It is conceivable that once the land prices are in full collapse, local debt will show signs of rapid growth and difficulty in repayment.

Local government officials appear disorderly competition based on their own interests

Under the current framework of Chinese decentralization, the promotion expected by local government officials is directly linked to the performance of its current location. This means that local government officials will devote more energy to economic construction, thereby increasing the likelihood of their promotion to a certain extent. Local government officials in a place of the term is often limited, they do not have to be too concerned about the situation of the deficit, more inclined to choose "financial soft constraints" to expand the scale of economic investment, as soon as possible in the local economy to take off. This kind of political highly centralized and highly decentralized socialist market economy model with Chinese characteristics has formed a substantial horizontal competition relationship among the local governments, and this horizontal competition will eventually evolve into the "GDP worship" of some officials.

From a legal point of view, the current law on the promotion of officials for the promotion of local economic growth potential of the practice can be described as a blank. The law stipulates that officials can only be found guilty when officials get their power through rent and bribery, and they can not be bound by the fact that local government officials seem to be "one mind". But also indirectly makes the local debt financing problem has been continuously enlarged. China's existing "commission - agent" model of the political structure makes the central and local information asymmetry between the phenomenon, but also increased the local officials regardless of their financial strength of the blind investment.

Local government financing is difficult, lack of supervision and restraint

At present, the functions of the local government are still in a diversified transition period. The functions actually played by the local governments, in addition to the normal government functions, actually play the role of the actual control of the local state-owned enterprises and the local partners of the state-owned banks. Local governments in the need for municipal investment, it is easy to get the bank's credit injection. Part of the local state-owned enterprises and even with local governments to local government guarantees to the various types of financial institutions to borrow. This type of contingent liabilities is a certain degree of concealment of the local government's actual debt value.

Local recessive financing, represented by "city debt" and "municipal debt", can attract high attention in society. The masses tend to increase their investment in these bonds because of their trust in the local government. These bonds are even packaged by banks as "financial products" to the public on sale. This financial products can not completely avoid the risk of default debt. Yunnan Province Highway Development Investment Co., Ltd. (hereinafter referred to as "Yunnan Highway") unilaterally to the creditor bank of the People's Bank of China, ICBC, China Construction Bank announced that "only interest, no return ", 100 billion debt close to default, foreign credit rating agencies immediately announced a reduction in the relevant Chinese state-owned bank credit rating. Such local financing platform for the local construction to facilitate the same time, quietly increased China's systemic financial risks facing.

In fact, the local financing to facilitate, is disguised to assist the local government budget unbundled. In the above, the construction of expressway in Yunnan Province is a positive mistake. In the central and western regions, "want to get rich, first road" is widely circulated, the construction of highways is to improve the central and western regions of the economic backwardness of the best program. But the "Yunnan Highway" only rely on 5 billion registered capital, loaned 100 billion bank loans, and launched too many highway projects, the project has not actually received the benefits of the face of debt service risk. In fact, it is not uncommon for China to approve the approval of high loans in places where "not qualified". Such as the economic development model is clearly unable to adapt to the actual economic situation, bank loans to create a good local economic illusion, blind expansion of the local government's development vision, a direct result of the rapid increase in local debt, indirectly increased debt default risk.

Central command economic policy side to increase the local debt pressure

In recent years, China's economy is facing downward pressure, the central part of the industry sector, enterprises and other subsidies to increase the policy, large-scale economic stimulus policy also occasionally appear. And most of these policies should be funded by local finance, the tax can not be short-term increase in the context of local government debt is also quite upset.

"Four trillion plan", nearly 3 trillion of local investment to a certain extent, pushed up the land transfer price and the total amount of local debt; "red land" policy, strictly limits the local government to change the nature of cultivated land without authorization, This is also a direct reduction of the land finance for the local pulling effect, to some extent affected the local debt situation; the state for high-tech enterprises, export enterprises tax rebates, subsidies often need to be funded by the local government, which also makes the local economy more stretched. A large number of non-profit macroeconomic policies need to be funded by the local, and ultimately will inevitably lead to local finance to make ends meet

Normative analysis and policy recommendations

The central authorities should regularly audit and disclose the size and use of local debt

In recent years, foreign credit rating agencies have repeatedly lowered the relevant credit rating in China, a very important reason is that China's government debt open and serious transparency is insufficient, the leverage rate continues to improve, and the lack of supervision and restraint. From the perspective of the Audit Commission, China has only done two debt audits in 2011 and 2013, and the audit results have been questioned by relevant individuals at home and abroad. Such a public audit of debt audits is clearly difficult to convince.

Local debt, as a matter of fact, in the gray area of the rule of law society, if there is a lack of effective auditing, supervision and restraint, can not prevent local officials from finding the right to rent or even profit Space, China's economic growth has a significant adverse effects. At the same time, local debt is often closely linked with taxation, subsidies and land. The size of local debt is also an economic topic of close concern to the people. The openness and transparency of debt scale and use are conducive to improving the credibility of local government and promoting the rule of law of socialism with Chinese characteristics. The comprehensive development of society.

The central government should restrain the local recessive debt disorderly growth

The local financing platform, which is generated by the Budget Act, has seriously interfered with debt audits and produced a large number of contingent liabilities and secured debts. The level of local financing platform is also uneven, the number of scale is more difficult to estimate. In the first part of the conditions of a second-tier cities to pilot local government debt at the same time, we should continue to improve the local financing platform for the entry threshold, strictly constrain its business scope and growth rate to eliminate no operating capacity, repayment of the source of the financing platform set up.

At the same time, part of the clear violation of the "budget law" to land as a collateral of local government debt, should be a serious inventory. Land is a pledge, is likely to cause the loss of arable land, land dependence, rising house prices and other adverse risks to the national macroeconomic security. The boundary between land and local finance will help the local government to take a virtuous circle to prevent the financial risks and financial risks interlocking and the systemic financial risks caused by the depreciation of land prices. It is true that, in the long run, the local government's financial dependence on land is unsustainable, exhausted and fishing practices, local governments can not rely on land forever to achieve fiscal balance and deficit reduction and deficit reduction, change financial thinking for China's local government debt reform is of great significance.

The central authorities should re-divide the financial and administrative rights

In the past 20 years, China's economy has achieved rapid growth, joined the WTO, and is being absorbed as a fully market economy countries, 20 years ago effective tax system reform for the Today's China is not yet fully applicable. In recent years, the local government in education, medical and other aspects of the investment is increasing, the people to enjoy the demand for quality public resources services more and more urgent. In the social background of the gradual increase of the income of the people and the increase of the central government's revenue year by year, the expenditure of the local government on the public goods is getting bigger and bigger, and the situation of the debt sinking due to the tax reform is more obvious.

The re-division of financial and administrative rights is actually a reflection of the problem of government efficiency. Good division can improve the efficiency of government work and save money. Therefore, the existing situation, financial decentralization than the right to recover more efficient. According to the relevant experience abroad, the division of "who proceeds, who spending" principle can better balance the relationship between the central and local. Therefore, for the national income of infrastructure projects, it should be the central as a major contributor, such as the "four trillion plan" like the national economic stimulus policy should also be funded by the state-based, local funded supplement. This also helps local governments to reduce local debt and avoid bad debts owed by state-owned banks.

Since the feudal era, China has always been the central and local non-cooperative game between the adverse situation. The central government wants to focus its energies and avoid the emergence of local corruption. And in the eighteen years since the solemn clean up the corruption of the social background, we are confident that part of the financial power to the central financial transfer payments, subsidies to the local form of conversion. For the central allocated to the local special funds, by the Audit Commission to carry out targeted tracking and verification, to avoid local officials such as corruption and other bad official phenomenon.

Conclusion

Currently, China's reform and opening up has penetrated deeply, and the local debt problem has become an inseparable bottleneck problem for China's economic development. The economic development requirements, irrational financial system, local government administrative scale expansion, and intense competition between regions stimulate the local government's debt demand simultaneously, leading to the formation of local government debt. It is expected that Chinese local government can get rid of land finance dependence in the future, and issue government debt in accordance with the market law. China's debt management in the local issue is still in its infancy, and the success stories of the United States and Europe as well as Japan's bubble economy provided enough experience for our debt management.

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