China’s New Financial Institutions

Chang-Tai Hsieh (University of Chicago)
China since 2008

1) Debt

2) Investment

3) Current Account

4) Growth Slowdown
New Financial Intermediaries

Local Financing Vehicles

Shadow Banking (Trusts and Wealth Management Products)
World Bank Doing Business Indicators

Ease of Starting a Business in China: 151 (out of 180)

Same as Congo (yes this is Mobutu’s Congo)
Small City in Southern China

- Actively look for quality prospects
- Initial discussion to learn about investor
- Feasibility Analysis
- Identify land and other needed services
- Approval by Vice-Mayor
- Sign agreement
Organization of Local Government

Party Secretary

Mayor

9 Vice-Mayors

Each Vice-Mayor assigned 20 "important" projects
Local governments had high powered incentives to provide special deals to favored firms

But subject to severe capital constraints

Revenues controlled by central government

Budget law made borrowing illegal

But otherwise little controls on local governments (until 2013)
<table>
<thead>
<tr>
<th></th>
<th>Planned Investment</th>
<th>On-Balance Sheet Spending</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Central</td>
</tr>
<tr>
<td>Housing Security</td>
<td>0.40</td>
<td>0.20</td>
</tr>
<tr>
<td>Rural Livelihood and Infrastructure</td>
<td>0.37</td>
<td>0.20</td>
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<tr>
<td>Railway, Road, Airport, Water Conservancy and Urban Power Grids</td>
<td>1.50</td>
<td>0.27</td>
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<tr>
<td>Health, Education and Culture</td>
<td>0.15</td>
<td>0.11</td>
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<tr>
<td>Environment Protection</td>
<td>0.21</td>
<td>0.05</td>
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<tr>
<td>Self-Independent Innovation and Structural Adjustment</td>
<td>0.37</td>
<td>N.A.</td>
</tr>
<tr>
<td>Post-Disaster Reconstruction</td>
<td>1.00</td>
<td>0.23</td>
</tr>
<tr>
<td>Total</td>
<td>4</td>
<td>1.05</td>
</tr>
</tbody>
</table>
2011-12: Crackdown Bank Lending to Local Financing Vehicles

⇒ Gave rise to Shadow Banking

2014-15: Crackdown by CBRC and Ministry of Finance on Borrowing by Local Financing Vehicles
Investment Rate and Budget Deficit

![Graph showing investment rate and budget deficit over the years from 2000 to 2014. The graph indicates the percentage of capital formation and total deficits relative to GDP.]
Publicly available data on local financing vehicles:

- **WIND**: Financial statements of LFVs that issue bonds

  Individual data on LFVs, **total** debt

- **2011 and 2013 Audit of all LFVs** (National Audit Office)

  Only covers “Official” debt.

  “Debt that government has responsibility to repay or debt the government would fulfill the responsibility of guarantee or for bailout when the debtor encounters difficulty in repayment.”
Aquatic Cube and Bird’s Nest
Owned by Beijing Asset Management Company (BSAM)

Total 2015 debt (as reported in WIND): 70 billion Yuan

Also owns financial, real estate, and manufacturing companies

Shareholder of Bank of Beijing and Beijing Auto Group
Beijing Capital Group

http://www.beijingcapital.org/group.html
Annual Change in Local Financing Vehicle Debt (trillion)
Panel A: Lending to Local Government

Panel B: Corporate+Household Liability

Panel C: Bonds and Reserves
Medium Run Effects

- Increase in Investment Rate

- Decline in CA Surplus (from 10% of GDP in 2008 to 2-3% of GDP)

Aside: David Lipton praises “external rebalancing” but condemns increasing debt
Long Run Effects

Efficiency in Capital Allocation?

Local financing vehicles vs. treasury bills?

Too much infrastructure investment?

Too much public investment?

Removed financial constraints that makes Chinese “special deal” regime different

Chinese special deal regime starts to look more “normal”