

China's Local Government Loan Platform and Local Financial Problem

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Contents

- I. Introduction
- II. Local Finance and Loan Platform
- III. Debt Soundness of Local government
loan Platform
- IV. Concluding Remarks

I. Introduction

- Since global financial crisis in 2008, Chinese government has tried to change economic development policy from export-led growth to domestic demand-driven growth.
- For the boosting domestic market, central government needs to push less developing inland regions.
 - Local governments should undertake as key players to drive their economies under this macro policy.
- Generally Chinese local government are struggling under the budget constriction, so they set up loan platforms as sub-companies for boosting their fixed investment and economy instead of themselves.
 - The loan platforms, calling as the *Urban Construction Investment Corporations(UCICs)*, are doing public projects instead of the local governments and borrowing money from banking sector guaranteed by local governments.

Why Loan Platforms are issued in China:

- Recently comparing with the European fiscal crisis, the debt problem of China is concerned that how big it is and how it will influence to Chinese economy.
- In China, loan platforms are related to financial soundness of local government and performing core factor for boosting domestic consumption driven by government policy.
- So in this paper, we try to analyze that the loan platforms will be worsening the local financial soundness which is treated as one of the main weak points of Chinese economy or driving the local domestic market as Chinese government wanted.

II. Local Finance and Loan Platform

1. Definition of Loan Platform

- It's a kind of local government-owned sub-company, which instead government to get loan fund from banking sectors to support SOCs and public projects, that facilitate urban development.
- Local governments have motivation to setup a loan platform under their influence for easily borrowing money from Bank.
- The loan platform put the money into the infrastructure or land developing projects which are decided as necessary businesses by local leaders to boosting their economy no matter how much values they have than others.

Loan Platform can be grouping as three categories:

- 1) It is established for public projects which can not make a profit like constructing public squares, urban parks, and bridges.
 - Basically, those projects should be performed by local government budget, i.e. tax revenues, however local governments do not have enough money to do the project and central government also tolerate these behaviors of local governments.
- 2) For public projects which create revenue, however the total benefit does not reach the total cost like constructing toll road or rail road.
- 3) For real estate development projects which make a lot of money exceeding their cost.

Different Estimation for Loan Size of Local Platforms(2010)

	National Audit Office of the People's Republic of China (审计署)	China Banking Regulatory Commission (银监会)	People's Bank of China (人民银行)
# of Platform(ea)	6,576	9,828	about 10,000
Loan Balance (trillion yuan)	4.97	9.10	max 14.4
Categories	loan platform corporation (融资平台公司)	local loan platform corporations (地方融资平台公司)	Local gov't loan platforms (地方政府融资平台)

- In case of local transport agencies(交通部门) as gov't departments not corporations, they were included in the categories of PBC but excluded that of CNAO (审计署) and CBRC(银监会).
- CNAO(审计署) only included the loan of loan platforms which were taken the responsibility on the local gov'ts, however PBC and CBRC counted the all amounts of local platform loans.

III. Debt Soundness of Local government loan Platform

Table 1. Loan Balance of Local Gov't Loan Platform by Banks(2010)

	Loan Balance (billion yuan)	Portion of Total Loan on Each Bank(%)
Total	91,000	18.6
Industrial and Commercial Bank of China	7,800	13.2
China Construction Bank	5,500	10.9
Bank of China	4,800	7.3
Bank of Communications	1,200	7.2
China Merchants Bank	1,100	9.9
China CITIC Bank	2,100	19.0
China Minsheng Bank	1,900	19.2
China Shanghai Pudong Development Bank	1,800	18.1
China Industrial Bank	1,590	18.0

Source: wind(万得资讯, www.wind.com.cn)

Table 2. Loan Structure for Provinces

(billion yuan, %)

	Loan balance	Ratio
Yangtze river delta region	27,300	30.0
Zhu jiang delta region	10,010	11.0
Bohai rim region	18,200	20.0
Three northeastern provinces	7,280	8.0
Central province	12,740	14.0
Western province	15,470	17.0

1. Evaluation for Debt Soundness of Loan Platform

1) Assumptions for calculation:

- (1) Construction period for project was 3 years and the principal would be paid back within next 5 years at the end of the construction period.
- (2) The loans were paid at a 50%/30%/20% ratio to the platform during 3 years(this ratio has changed at a 40%/30%/30% since 2010).
- (3) Banks should allocate a 25% of loans for the new projects of current year and a 75% of loans for the continuing projects.

* This assumptions are applied from 王飞, 熊鹏, 2011

Table 3. Calculation for the Outstanding Loan of Local Gov't Loan Platform(trillion yuan, %)

	2009	2010	2011E	2012E	2013E	2014E	2015E
Outstanding loan	7.38	9.10	9.07	8.28	7.40	6.19	4.92
Fresh loan	3.72	2.39	0.97	0.95	0.86	0.53	0.40
Net increase of loan	3.05	1.72	-0.031	-0.79	-0.88	-1.22	-1.27
Interest rate(5Y, %)	5.76	6.30	6.30	6.30	6.30	6.30	6.30
Principal and interest payment	0.97	1.21	1.57	2.26	2.02	2.14	1.98
Principal payment	0.67	0.67	1.00	1.74	1.55	1.75	1.67
Gov't debt service ratio(%)	10.9	14.6	19.2	24.6	19.5	18.5	15.2

* Since 2012, the fresh loan would be reached to the 33% of existing loan according to the assumption #3(0.25/0.75=0.33).

** Outstanding loan of 2008 was 4.33 trillion yuan.

*** Local fiscal revenue of 2009 and 2010 were 6.12 and 10.56 trillion yuan.

- The outstanding loan in 2011 would be reached to 9.07trillion yuan, however, it will be reduced to 4.92 trillion yuan in 2015, the equal level in 2008.
- The principal and interest payment would be touched the highest level in 2012, and then will be gradually reduced.
- If Gov't debt service ratio(*principal and interest payment/gov't revenue*) is growing up, local government will get a trouble to pay back the debt.
 - This ratio would be reached up to 24.6% in 2012, and then will be gradually decreased.
- Recently the annual growth of tax revenue of local government may reach above 15%, so the volume of fiscal revenue could easily exceed the principal and interest payment.

2. Calculation for the Potential Bad Loan of Loan Platform

- According to the Wang Fei, Xiong Feng(王飞, 熊鹏, 2011), the default rates of loan of loan platform are naturally variety depending on the regions.
- So, assumed that the default rates would be increased by steps from eastern to western regions and from city level to county level.

Table 4. Scenarios for Occurring Fresh Loan in Loan Platform

	Positive Scenario	Neutral Scenario	Negative Scenario
Six eastern developed provinces	1.00%	1.20%	1.50%
Western region			
Provincial level	1.20%	2.00%	3.00%
City level	3.00%	5.50%	15.00%
County level	5.00%	10.00%	50.00%
Other region			
Provincial level	1.00%	1.50%	2.00%
City level	2.00%	3.50%	5.00%
County level	3.00%	6.00%	10.00%

a) Results of the Positive Scenario (2010, RMB 100million)

	Six eastern developed provinces	Western region			Other region		
		Province level	City level	County level	Province level	City level	County level
Fresh loan of platform	11,603.3	1,134	453.6	680.4	4,001	3,001	3,001
Portion	100%	50%	20%	30%	40%	30%	30%
Newly bad loan	116	13.6	13.6	34.2	40	60	90.0
Sum of newly bad loan	116	61.4			190		
Portion of newly bad loan	31.6%	16.7%			51.7%		
Total	367.4						
Bad-loan ratio	1.5%						

* The sum of fresh loan of local loan platform in 2010 recorded 2,387.5 billion yuan
 ** According to the Huatai Security(华泰联合证券, 2010), the fresh loan can be divided by 4 8.6% for six eastern developed provinces, 9.5% for western region and 41.9% for other region.

*** Six eastern developed provinces: Beijing, Shanghai, Guangdong, Zhejiang, Shandong, Jiangsu, Western provinces: Neimenggu, Shanxi, Xinjiang, Qinghai, Ningxia, Gansu, Xizang, Yunnan, Guizhou.

b) Results of the Neutral Scenario(RMB 100million)

	Six eastern developed provinces	Western region			Other region		
		Province level	City level	County level	Province level	City level	County level
Newly bad loan	139	22.7	24.9	47.6	60	105	181
Sum of newly bad loan	139	95.2			345.6		
Portion of newly bad loan	24.1%	16.4%			59.5%		
Total	579.8						
Bad-loan ratio	2.4%						

- As total amount of banking loan will be recorded 69.71 trillion yuan in 2012, the loan repayment can be a hot issue in the near future (by 2010年中国全部金融机构本外币存款贷款及其增长率. [中商情报网] 2011.06.13).
- The sum of fresh loan of local loan platform in 2010 recorded 2,387.5 billion yuan, so the bad-loan ratio would be reached 2.4% in the neutral scenario.

c) Results of the Negative Scenario(RMB 100million)

	Six eastern developed provinces	Western region			Other region		
		Province level	City level	County level	Province level	City level	County level
Newly bad loan	174	34.2	68.0	340.2	80	150.1	300.1
Sum of newly bad loan	174	442.4			530.2		
Portion of newly bad loan	15.2%	38.6%			46.2%		
Total	1,146.6						
Bad-loan ratio	4.8%						

IV. Concluding Remarks

- The aim of local government loan platform is boosting domestic market with government sectors but be worried with the rapidly increasing fresh loan and potential bad loan.
- According to this research, the level of bad loan would become 1.5%~4.8%(based on 2010) of the annual fresh loan in the banking sector.
- The amount of bad loan would occupy a small portion comparing to the volume of total banking loan because the loan from loan platform has occurred just 2 or 3 years ago and central government hardly allowed the local level loans until now.

- Therefore, if Chinese central government manages the loan of local loan platform more strictly, local government could easily avoid the default situation.
- China can strategically use a loan platform as a trigger to motivate their growth engine in a short term.
- However, Chinese government would approve the loan schemes indiscreetly when the Chinese economy do not revive as fast as they expected, the fiscal soundness of local government might be worsened.

Thank You