

A Reconsideration of China's Regional Debt Problems: With a focus on Local Government Financing Vehicles (LGFVs)

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Summary

In China, the rapid urbanization of recent years has been progressing, and accompanying it the demand of residents for the construction of basic infrastructure such as roads, railway lines, bridges, and sewers, has also been continuing to increase. Ordinarily, when local governments attempt to procure urban development funding, there are three methods in the main. First is the beneficiary liability method. That is, approaches such as the adjustment of local tax rates and the establishment of new local taxes. Second is the method of market adjustment. That is, the approaches of issuing local bonds in expectation of future potential, and of raising funds from the market. Third is the method of financial management transfer from higher-level government. That is, the approaches of strengthening financial management transfer from higher- to lower-level government, and of striving for interregional balanced development. In the local financial management systems in present-day China, however, for whichever of the above three methods the current situation is one of them being difficult to realize. How to raise the investment costs for the huge construction of infrastructure accompanying the progress of urbanization is a great challenge for local governments in China.

After the Lehman shock of 2008, via the guidance from the central government's extensive financial management policy, the local government infrastructure investment rush further accelerated, and the formula for procuring financing taking LGFVs (Local Government Financing Vehicles) as its medium developed, and spread rapidly across the whole of China. At the same time as this, however, via radical infrastructure investment, there was the situation where local government debt swelled rapidly.

While there is the aspect that the method for procuring financing taking LGFVs as its medium comes up with the investment costs for local governmental construction of infrastructure within the framework of the existing local government financial management systems in China, and contributes greatly to the progress of urbanization, on the flipside the point has been made that it impedes the strengthening of local financial management. In this paper, I would like to reconsider the real problem points for regional debt in China and the location of risks, examining the method of procuring financing via Local Government Financing Vehicles (LGFVs), called a major cause of the swelling of local government debt in recent years, and the scheme for management thereof.

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