

# Discussion of “Subnational Debt of China: The Politics-Finance Nexus”

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# Overview

- This paper examines performance of debts to China local governments – an issue attracted much attention.
- Summary of main findings:
  - Development bank loans have lower delinquency rates;
  - Distressed governments choose to default on commercial loans;
  - Such a strategic default pattern can be explained by promotion incentives of local politicians.
- Overview:
  - Uniqueness and richness of loan data;
  - Very interesting and reasonable findings;
  - Comments mainly on interpretations of the findings.

# Analytical Framework


- Politicians' utility function: maximize social-economical value to enhance promotion chance
- Government policy bank (CDB):
  - ❑ The main long-term financing source;
  - ❑ Share the same social-economical goal;
  - ❑ Subsidized interest rate, longer maturity
- Commercial banks (CBs):
  - ❑ Sporadic source of operation financing;
  - ❑ Mostly active during the 2008-2010 “4 trillion” stimulus program;
  - ❑ Shareholder value-maximizing;
  - ❑ More market-oriented lending with stringent loan contract terms

# Analytical Framework

- Politicians' goal perfectly aligned with CDB's.
- Why would local governments borrow from commercial banks?
  - ❑ Unless they have to
- One selection issue:
  - ❑ governments borrowing from CBs tend to be more risky;
  - ❑ lead to more delinquency
- Question 1: Do distressed governments get to choose which loans to postpone repayment with?

# Main comment 1: Do governments get to choose which loans to default?

- It is likely that CDB screens borrowers and lends to risky governments with
  - higher loan seniority;
  - more bargaining power.

 Possibly not the government's choice to default less on CDB loans

- CBs select to lend to risky governments if risks well managed and compensated
  - Ultimate default is rare (implicit guarantee)
  - Higher interest rates
  - More collaterals (e.g., government lands)
- More information required on loan contract terms to judge.

# Main comment 2: Can governments afford defaulting on CDB loans?

- Question 2: Even if governments get to choose, can they afford defaulting on CDB loans?
  - ❑ CDB: *single* source of *main* and subsidized financing
  - ❑ CBs: multiple sources of supplementary financing
- Key: Hard budget constraint of CDB
  - ❑ If CDB loans defaulted, fewer future loans (shown in the paper)
  - ❑ Policy banks often regarded as having soft budget constraint
  - ❑ Can be explained by CDB managers' own political career concern
  - ❑ CBs' continuing lending to "defaulting" borrowers less affected as long as risks well managed and compensated
- Cannot afford defaulting on the single source of main financing in case of hard budget constraint of CDB.

# Main comment 3: Is It About the Political Power of CDB?

- Arguments made that CDB is at the ministerial level and have more political leverage and powers than CBs.
- Unclear how a policy bank affects local political promotion
  - ❑ Lower-level promotion determined by province
- Evidence against the arguments
  - ❑ When CBs became the major source of financing during 2008-2010, governments tend to default on CDB loans too
  - ❑ Inconsistent with CDB's influence on political promotion
- Local GDP growth is the key to promotion, while CDB loans are the key to local GDP growth.
  - ➡ CDB loans, but not CDB per se, matter.

# Main comment 4: Political Promotion and CDB Loans

- Political promotion is positively associated with CDB loans.
  - CDB loans enhance promotion
  
- Interpretations
  - Selection: CDB choose politicians in lending decisions
  - Reverse causality: Areas with better growth prospects (and hence higher potential for political promotion) are more funded by CDB
  - Omitted variable: Unobservables (e.g., politician's ability) lead to both CDB loans and promotion
  
- At minimum, GDP growth rate shall be controlled in explaining political promotion (Table 5).



# Minor comments

- Provide more summary statistics on sizes and contract terms of CDB and Commercial loans.
- CDB loans are even less defaulted at time of political turnover
  - ❑ Timing of CDB loan origination?
  - ❑ Maturity of CDB loans, coincident with political turnover?
  - ❑ CDB loans originated at the start of the politician's term may not yet mature by the end of her term.
- Some useful cross-sectional analyses of varying impacts on the CDB-default relation:
  - ❑ Regions: Relative importance of CDB loans for different regions
  - ❑ Politicians: Varying career concerns (e.g., young vs. retiring)

# Concluding Remarks

- A unique study on debts to China local governments with rich information
- Interesting findings that link politics and finance in China
- Look forward to reading a revised version in a top journal again