Subnational Debt of China: The Politics-Finance Nexus

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Abstract

Using unique proprietary loan-level data, we provide the first comprehensive study on China’s local government debt, which was off-balance sheet. Policy and commercial banks, both of which are state owned, are the main financiers of local governments. We find that notwithstanding their prevalent nonprofit goal of raising social welfare, policy loans perform remarkably better than commercial loans. Distressed local governments would choose to default on commercial bank loans but avoid default on policy bank loans, which are strategically more important for local politicians’ promotions. Our findings suggest that career concerns of politicians can serve as a discipline on government borrowers.

Key words: Local Government Debt; China; China Development Bank; Policy Loans; Political Promotion