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The Chinese Government Debt – What Do We Know and What Should Be Done?

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Abstract

A review of the economic press and literature reveals that there is little research and analysis on the important issue of the Chinese governmental debt and budget deficits. This is astonishing since the Chinese economy has by now climbed to the second position in global GDP ranking. Thus, China's government debt matters increasingly to the rest of the world as well, both in a corporate and a macroeconomic perspective.

Furthermore, not enough is known about the real size of the total Chinese government debt. Insufficient statistical transparency is an important reason for this shortcoming, but this should not serve as an excuse. Increasing efforts are needed to provide China and the rest of the world with better information on the real state of Chinese government debt.

In this paper, an attempt is made to explain and discuss the real situation when it comes to the Chinese government debt. The current Greek/Southern European debt misery clearly shows that opaque statistics cannot be hidden away forever without sooner or later puzzling and/or frightening the financial markets. On the other hand, China cannot be analyzed completely with Western eyes.

The sooner Chinese decision-makers decide on greater transparency in the government debt situation, and decisive steps towards more efficient fiscal policy are taken, the better the consequences for China itself and the global economy. The alternative - continuous opaqueness and a possible future fiscal explosion - could certainly do a lot of harm to China, but also to the global economy. There is no reason to underestimate this medium and long-term risk. The short-term perspective looks safer.

There should be room for a greater exchange of views and co-operation between EU and China, too. The EU's own bad experience from the past few years could be a realistic starting point.

JEL Classifications: D02, D82, H70, H74, O53, P35

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Introduction – where is the literature?[1]

I can hardly remember a situation while preparing a paper where the available literature on my chosen topic was so limited. This makes conducting deeper research on the Chinese government debt fascinating - but also very difficult. Positive exceptions are two publications by the OECD ("China in the Global Economy - Governance in China" from 2005 and "Challenges for China's Public Spending - Towards Greater Effectiveness and Equity" from 2006). It would be most interesting to study new editions by the OECD as soon as possible.

The real problem is that there is no way to get applicable statistics on the general government debt. Too many different numbers are circulating. In many publications - international organizations included - the debt of the Chinese central government is even equated with total government debt. This is, of course, completely wrong since local government debt must be included in total government indebtedness.

Looking at the annual or quarterly statistics of the Chinese National Bureau of Statistics (NBS), nothing illuminating can be found about government debt, expenditures and revenues in percent of GDP, etc. A somewhat more detailed summery and description of China's very important local government debt situation can, however, be ascertained from a special report on total local debt that was published in May 2011 by the National Audit Office (NAO).[1] This report gives additional information on Chinese local government debt. But this report is considered too mild by a large part of the independent experts involved [2] and, thus, still most probably underestimates the real amount of Chinese public debt.

Furthermore, international organizations such as the International Monetary Fund (IMF) and the World Bank (IBRD) do not contribute significantly to more transparency either. Sure, the World Bank's very readable report on China ("China 2030") [3] is a relatively open-minded publication that addresses many structural shortcomings - but not in all respects. It is interesting to read that - according to "China 2030" - local governments in the past "circumvented the rule against borrowing by establishing Urban Development Investment Corporations and other special purpose vehicles that can borrow using land as collateral" and that "such indirect borrowing plays an important role in financing infrastructure investment".

But one can also read that total Chinese province, prefecture, county and township level debt - which are usually summarized in the term "local government debt" - in 2010 amounted to 26 percent of GDP which is exactly the number that has been published by the National Audit Office. Also the World Bank is using the Chinese NAO figure for local government debt - despite the statistical shortcomings.

This statistical priority should not be seen as a particular surprise since the "China 2030" document was not just produced by the World Bank itself but also by China's Development Research Center of the State Council. This co-authorship leads to at least one of the following four conclusions:

- that not even a leading multilateral organization such as the World Bank seems to feel that there are better statistics on local Chinese indebtedness than these of the NAO,
- that the qualitative and structural conclusions of the "China 2030" report give substantial weight to the Chinese partner's views,

[1] Any incomplete understanding or misunderstanding of already existing, transparent facts on the Chinese government debt are entirely the responsibility of the author of this paper - despite attempts to avoid such insufficiencies.

- that other estimates may be closer to reality - but may analytically look even more like guestimates,

- that the obviously increasing Chinese influence in international organizations is also reflected in the choice of above-mentioned debt statistics.

Another hint at the insufficient statistical quality or transparency of government debt can be derived from the statistical summary of the years 2011 and 2012 by the NBS [4] which - in its English version - does not give any clarifying details on Chinese government debt.

Despite these numerical insufficiencies and disparities, it should be conceded that verbal openness on the state of the Chinese economy has improved substantially in the past few years all the same, particularly in newspapers like China Daily and Shanghai Daily and - not to forget - in many structural parts of the opening speeches by the Prime Minister at the NPC. At the NPC of 2012, for example, a special hint was given by then Prime Minister Wen Jiabao that ”we fully audited local government debt in a timely manner” [5]. Right or wrong - according to my own understanding of thorough analysis and research - I would think, however, that such a far-reaching conclusion could not even be made within two months for a similar analysis in a small country like Sweden. Two months were the official time frame but it could - or hopefully rather should - unofficially have been more than this short period of time.

This chapter on insufficient literature on Chinese government debt should, however, not be closed without mentioning a very interesting, in 2011 published article on Chinese institutions by Xu Chenggang.[6] Xu comes to the conclusion that ”the central government has control over personnel, whereas subnational governments run the bulk of the economy: and they initiate, negotiate, implement, divert, and resist reforms, policy, rules, and laws. China’s trajectories have been shaped by decentralization. Spectacular performance on the one hand, and grave problems one the other hand are all determined by this government structure.”

Xu’s analysis leads, consequently, to the correct conclusion that Chinese subnational governments are extremely important for national development. Contrary to widely-held opinion, China is one of the most decentralized countries in the world. Xu explains ”that all major reforms were initiated and carried out by subnational governments since they had not only the incentives to do so, but they also have the resources to proceed” which according to Xu may partly explain why ”China is the only country where the local governments have played a leading role in increasing rates of growth”. This is why Xu supports decentralization.

It should, however, be added that successful decentralization is not an ”automatic game”. A lot of concrete structural efforts have to be made in the Chinese debt case, such as financing local government debt at market conditions - preferably on the bond market and to a much lesser extent by using bank credits - market-oriented loan rates, a radically re-shaped local taxation system with much less dependence on land sales as an important source of tax revenues, the creation of many other improved local incentives, liberalized regional and urban moves of the labor force, etc.

Conclusion 1:
Literature - academic research included - on Chinese government debt is by far too limited. Efforts in this respect are badly needed.

Support from theory and empirical research

Usually, I start a paper like this by pointing out a couple of applicable theories and research results. What the Chinese government debt is concerned, of course, the regular literature on the advantages/disadvantages of a solid/weak *government debt* performance can be applied. We do not need an introductory chapter on this specific topic. But we should keep in mind that an individual country's resilience against exogenous shocks - such as the subprime crisis and the European debt crisis in the past few years - tends to be stronger when a country has a solid public debt and financial position. This conclusion is well analyzed in the EEAG report from February 2012 by taking a closer look at the Swedish example.[7]

A little bit more should be said about fiscal debt and transparency. In this context, we come to the issues of public governance and, consequently, *institutional economics*. Research has provided a lot of theoretical and practical evidence to show that improved institutional conditions lead to a positive impact on economic growth or - as at least theoretically possible before the recent subprime crisis and the European debt crisis - the avoidance of (major) economic accidents. One of the main conclusions drawn in the above-mentioned EEAG report - taken from the Swedish example in the 1990s - is that ”well-defined fiscal objectives, fiscal transparency and a qualified economic-policy debate may be more important to fiscal discipline than binding rules and automatic correction mechanisms”.

Institutions matter to economic growth according to a lot of the academic literature - a conclusion that certainly can be applied to China as well. Markedly improved institutional conditions on local levels could mean an unexplored long-term growth potential for the Chinese economy. Transparency, market conditions on the municipality credit market, supervision, statistics, etc., belong to these institutional areas. In their recent book, *Acemoglu* and *Robinson*[8] very thoroughly explain the theory of institutional change and its impact on economic development. Quite a number of thoughts and conclusions by Acemoglu and Robinson are - or may be - applicable to the Chinese debt situation. They conclude in their long-term historical studies that Chinese institutions can be termed as “extractive” which means that resources are not really flowing to the people but to the state and the limited number of privileged benefiters who belong to the country's elite. Thus, incentives, innovation, individual prosperity and - consequently - economic growth are not optimized. Their concern is that China - in line with historical experience from other countries - cannot achieve sustainable, good economic growth over time, unless Chinese political leadership will lead to an inclusive, clearly less authoritarian institutional framework. The consequent application of Acemoglu's and Robinson's definition of extractive institutions would also give a negative impact on China's fiscal balance - most probably in a longer perspective. This could include an increasing government debt/GDP ratio also from this point of view - which, by the way, can be understood as one aspect of what generally is called the “middle income trap”.

Asymmetric information is another research area that fits in well with the case of Chinese government debt. Asymmetric information is usually behind a situation or transaction in which one side has more and/or better information than the other party. One can suppose that China's top political leaders of the Communist Party certainly know much more about central and local government debt than Chinese and foreign debt analysts do. It seems to be somewhat improbable that Chinese and foreign financial experts have different conditions in their asymmetric information stance. One may also give the asymmetric Chinese debt information a *game-theoretical approach*.

There is plenty of academic research and evidence out there that clarifies that Chinese political leaders should do everything to disarm potential future explosions of government debt bubbles. In the worst case scenario - particularly when the capital (financial) account will have been (widely) deregulated - a very negative herd mentality can arise on global financial markets. This takes us to the research area of *behavioral finance* - a research area that, unfortunately, still has not been given the attention it really deserves. Psychology will certainly play an important role on future (deregulated) Chinese financial markets.

Conclusion 2:
There is plenty of academic literature and research that supports the view of maintaining or bringing Chinese governmental debt under structural control.

Reasons for the limited discussion on Chinese government debt

As in many other cases when it comes to China, the big question is: what do statistics tell us and how should the existing numbers be interpreted? Currently, the issue of Chinese government debt is not a hot topic at all - neither for global financial markets nor in research. There are a couple of reasons for this neglect. An attempt is made in this paper to find out whether we are dealing with a benign or a malign neglect. Some of the reasons for the afore-mentioned neglect are as follows:

The first reason is that China runs surpluses in its balances on current account which means that it does not need to act as a net borrower on international financial markets. In other words: there is an ongoing surplus in China’s national savings which - with current capital account restrictions and foreign exchange policy - adds to the country’s currency reserve. However, a careful debate had been started about the sustainability of China’s current account surplus[10] in spring 2012 - but is now fading again.

The second reason for the analytical neglect may be psychological. China sometimes is mentioned as a kind of magical financial source for the rescue of the euro and Greece - whatever this may mean. Given this - probably only theoretical - possibility, the question of the real state of China’s government debt is not regarded as an urgent issue for discussion.

The third reason may be the difficult - or even total lack of - access to statistical data. The lack of data implies many times that financial markets ”postpone” relevant topics for discussion. We also saw this before the eruption of the subprime crisis in 2007 and before the worsening of the Greek (EMU/EU) crisis in 2010.

The fourth reason for the insufficient attention to certain Chinese topics such as fiscal deficits and total accumulated government debt (central plus local) has already been touched upon: the (mostly) weak interest from the professional researchers and even the press. This explanation may be related to the assumption that the Chinese debt problem does not appear to be a major issue in the short- or long-term perspective.

The fifth reason could be the tendency of financial markets to deal with just one major issue at a time. We have the European debt crisis in the first place since 2010 - a worrisome development that still has not come to an end. Only at certain occasions, the U.S. debt problem gets some additional attention. Thus, there is currently no room for government debt discussions on China.

However, the question remains: which numbers on Chinese government debt are really available - without instantly considering the quality of these statistics further? The answer seems to be simple, but not very satisfactory: it is just the central government’s debt that can quite easily be found. This is certainly the case for the non-Chinese speaking analytical community, too - but I doubt that more details on local government can be found by analysts who can read Chinese characters. Otherwise it would be very disappointing if international organizations kept these numbers secret or barely made them available to the general public.

Previous Prime minister Wen Jiabao stated in 2012 that ”all local government debts must be in the fiscal budget and be subject to the people’s congress of the same level”.[11] Hopefully, the next generation of China's political leaders and the municipalities themselves will support the need for better local debt accounting and transparency.

Conclusion 3:
Even if there are explanations for the neglect of China's fiscal development, there is no reason to continue with this sloppy attitude. China is an economic powerhouse already today - and this status will only increase. It is therefore only logical to ask for more statistical transparency and accurate calculations with regards to the real size of China's total government debt – whatever eyes one may use, domestic, European or global ones.

What should we know about Chinese government debt?

Total Chinese government debt consists of different segments - with varying degrees of difficulty when it comes to summing up the accumulated amounts. These segments are:

direct

- central government debt (should not be very difficult to arrive at a reliable figure),
- local government debt (provincial and below, difficult to sum up to a total amount),
- debt of other government institutions (which may be difficult to identify)

indirect

- "commitments" vis-à-vis banks for bad loans to poorly performing state-owned enterprises with obvious write-off risks;
- other loans/guarantees with concrete credit loss risks on the local level (may include parts of 6 576 municipality financing vehicles that were established to circumvent rules for local borrowing needs - a particularly opaque issue, by the way); according to the NAO[1] , almost half of the volume of local debt in 2010 has been financed by the municipality financing vehicles, many times with insufficient control systems; so far, changes or potential improvements of these numbers could not be singled out.

Real transparency about the *total central government* direct debt related to GDP is quite easy to achieve with appropriate efforts; in this paper we assume a number under 20 percent in 2012 - after 17–18 percent in 2010 and 2011 - which is probably relatively close to reality when excluding implicit debt commitments.

With regards to total *local government debt*, the spread between Chinese official numbers and independent foreign estimates is far too great, from official 26 percent of GDP up to the 60–80 percent in the highest private estimates. This wide range may reflect that the national budget law and regulations do not allow local governments to run budget deficits which may incline authorities to keep the local debt numbers artificially down. In this context, we have significant analytical shortcomings and impossibilities. Since local government debt tends to be contained in bank loans, banks should be able to give realistic numbers - at least when credits to the financial vehicles of local governments are included. This does not happen these days in a transparent way. Improvements are a matter of corporate and political governance which should be addressed very seriously by the new generation of political leaders - also for China's own sake. The issue of strongly improved local debt transparency should be tackled as a main political governance objective for the rest of this decade.

Obviously, *local credit loss risks* should be treated much more thoroughly than has been the case so far. The reasons for this conclusion are:

- that the four predominantly state-owned major banks in worst case scenarios will most probably receive government support if necessary,
- that domestic bank credits amount to as much as roughly 150 percent of GDP - with a high share of the past few years' increase going to local government investments, which can partly turn out as non-performing at some point; currently, only 1.2 percent of all bank credits are officially recognized as bad loans[12],
- that financial fundamentals of local governments are weak because of their insufficient abilities to raise or introduce taxes; local governments stand for 80 percent of total government spending for basic education, health, housing, infrastructure, existing unemployment insurance, etc., but receive only 40 percent as transfers from total government income [1],
- that there still exists a worrisome maturity mismatch, as loans to local governments are typically short-term (3-5 years), but investments have long-term time horizon; during certain years, high amounts of credits have to be rolled over which possibly should be observed more in the future.

Conclusion 4:
For the sake of transparency, research and appropriate policy decisions, the Chinese political leadership should give high priority to realistic numbers on central government debt, local government debt and non-performing bank loans that are related to government obligations.

A China-adapted interpretation of government debt

It should be kept in mind that Chinese government debt should not be totally equated with government debt definitions that are common in more advanced market economies. Since government debt in the Chinese system to a very large extent is set up vis-à-vis other public institutions, most government debt remains within the public circle. Private lenders to the government sector are - contrary to the situation in market economies - statistically irrelevant. Thus, public debt is managed within the public sector - even when major losses occur, for example, on the local level or at banks. There is a rescue chain from the central government to the local level and the banks - without involving the private sector.

This brief introduction into the Chinese government debt system should clarify that the European debt formation and the current crisis - by strongly focusing on private lenders and their risks - certainly has other dimensions than the Chinese model would imply in the foreseeable future.

The question, however, is how the ”foreseeable future” can be defined. For China it is a function of the *speed* of:

- the domestic financial marketization (particularly of interest rates and bond markets),
- the opening up of the capital account for cross-border capital flows,
- the internationalization of the Chinese currency, the RMB,
- the creation of transparency in government debt,
- the urgent ambition to create more domestic investment alternatives for Chinese investors (insurance companies included).

Using the ”China-adapting interpretation model” would imply that the Chinese government debt situation will be under control in the forthcoming years - unless a strong explosion of property asset prices or another major shock was to happen earlier.

An important question in this context is how long Chinese and foreign analysts will continue to accept and apply the current mild interpretation of (hidden) Chinese government debt levels - a mild interpretation that is either based on the assumption that the Chinese policy makers are supposed to continue with their current intergovernmental debt clearing system, or the assumption that uncertainty about debt numbers has led to an analytical ”laissez-faire”. An answer to this question may be given at least by the end of this decade - though it could happen earlier.

Conclusion 5*:*
Attention to Chinese government debt should be paid already now - no matter whether the current special conditions of the Chinese government debt with its public inner circle debt-clearing system are analytically applied or not.

The ways to increase fiscal transparency

This paper shows that China so far obviously rejects *major* efforts to increase transparency in its fiscal situation which probably - unless we receive information that shows the opposite - supports the view that China’s total government debt is higher than global financial markets currently assume. How much higher, we don’t know.

Greater transparency concerning its own government debt would be beneficial for China itself, at least in a somewhat longer-term perspective - but also for Europe, the U.S. and the rest of the world. The road to more - or rather sufficient - transparency concerning fiscal debt will certainly be very bumpy. The higher and more hidden government debt really is, the more complicated the search for the right way to increased fiscal transparency will turn out to be. But it is not either easy to really value, for example, Victor Shih’s in 2012 published estimate of Chongqing’ municipality’s and local state-owned companies’ debt of around USD 160 billion[13] - a number that amounts to roughly 100 percent of the Gross Regional Product[14] . Is this number realistic, too high, or still too low?

However, since nobody outside the inner top party circles knows what the situation is really like in the beginning of a future transparency process, recommendations on the most appropriate way to create sufficient fiscal transparency can vary. The variables that should be part of the risk model are

- the real state of total government debt,
- the degree of deregulation of financial cross-border movements,
- the degree of marketization of domestic financial markets,
- domestic and global confidence in the total government debt numbers (when they are finally published).

Relevant Chinese decision-makers probably will - or at least should - aim for a strategy that puts (relatively) free cross-border capital movements at the end of the chain - unless China's real debt situation turns out to be clearly more favorable than, for example, the author of this paper and a fairly large number of independent China experts assume.

But even if a relatively benign public debt situation at some point were to be officially confirmed by new facts and a large number of independent experts joined this view, the question remains as to what extent relatively benign numbers can create a broad degree of confidence in these debt statistics. In order to underline the transparency ambitions more generally, it would be a good idea if a visible statistical progress could also be achieved in other complicated or sensitive statistical areas such as employment.

Despite the above-mentioned difficulties, it makes sense to summarize some conclusions about the different ways to go forward.

- *First*. It is questionable whether a *gradual* change towards satisfactory fiscal transparency still can be achieved in this impatient globalized financial world once cross-border movements have become substantially liberalized. Thus, it seems reasonable that China should - as soon as possible - do the necessary ”fiscal and financial homework” before abandoning sensitive cross-border capital regulations. An alternative strategy that is based on the assumption that markets will price the shortcomings in Chinese transparency at appropriate levels seems to be too risky. The American subprime crisis, for example, and the current European government debt crisis demonstrated very clearly that risks on the CDO market and on the sovereign debt market were priced insufficiently.

- *Second.* The other option - a kind of *”statistical big bang”* in the sensitive area of public finance and debt - could mean a lot of risks and potential turmoil if such a step is not taken from a position of strong structural improvement and a good level of stability and confidence. Furthermore, such an option should only be chosen if China's total government debt position - the implicit debt part included and made available for analysis - is considered truly reliable. But how can we know?

- *Third.* The important issue of sequencing is very complicated, too. It could be interesting for Chinese decision-makers to look somewhat closer at some previous Swedish failures. We know this from the Swedish example of 1985-89 when a number of financial deregulations - including the abolition of credit ceilings and the cross-border liberalization of financial markets - were in part implemented in the wrong order, which favored the creation of private debt and the real estate bubble, and, ultimately, led to the serious and well-known Swedish banking crisis and the sharply increasing government budget deficits. [15, 16] Thus, the Swedish experience from about 25 years ago puts an obvious emphasis on the correlation between the credit boom and the bursting asset price bubble on the one hand, and the fiscal deterioration in the early 1990s on the other hand. This fiscal disaster could be directly linked to the recession that followed after the wrong sequencing of deregulations and the parallel psychological and market exuberance in the second part of the 1980s.

- *Fourth.* How can the appropriate path and speed to a greater marketization of domestic financial markets be determined? According to Linnaeus University's China Survey Panel from December 2011, the marketization of financial markets (banks, stock market, bond market) is still only about 4 in a range from 1-10 (10=very good). [17]

  Under all circumstances, more marketization should happen in the next few years to make the Chinese financial system more workable, modern and fundamentally robust. Managing government debt - particularly local government debt - is related to a great degree to the stability, strength and modernization of financial markets. Local governments need to obtain access to bond markets which would be a very suitable way to enforce more transparency. Bank credit conditions must be brought in line much more with the financial, qualitative and future-oriented position of local governments. There is no reason for Chinese decision-makers to delay these necessary and inevitable reforms of their financial markets - even if it means reduced political influence on certain institutional finance decisions.

- *Fifth.* China should also consider the psychological mood of the global financial markets once a decision is made on publishing more details on government debt. It would be an advantage to take such a step towards acceptable transparency when global financial markets and domestic investors feel confident about the current and future development - and not the other way around. Otherwise much less favorable scenarios can occur. "Confidence" has really become a key word for forecasters and global financial markets.[18]

Conclusion 6:
China's development towards more economic and financial transparency won't be easy. This is particularly true of the government debt situation. The issues of graduality, timing and sequencing will be difficult to handle. It is preferable under all theoretical and practical circumstances to speed up the processes of improving government debt conditions and the functioning of financial markets. Such a policy would certainly facilitate China's way to better transparency and decrease psychological and real vulnerability - and that includes the interpretation of all kinds of government debt.

Conflicts of interests

As I have described in a previous article [19], there are plenty of conflicts within Chinese economic policy. One of them deals with the issue of limited transparency versus further marketization. The process of ”marketization” means per definition an increasing ambition to make a country more transparent, both to domestic and international analysts and observers - an ambition that currently is becoming increasingly concrete in China's serious attempts to become more broadly accepted as a market economy, especially by the EU.

So far, the EU has rejected the Chinese initiative, particularly by arguing that China is not complying with market criteria within EU rules. Even with a neutral view on this issue, it is hard to argue that China has already achieved the status of a market economy. It is more accurate to say that the Chinese economy is ”increasingly on a market-oriented track”. (Look, however, at another small, positive piece of progress in 2012 when the relatively rich provinces of Guangdong and Zhejiang along with Shanghai and Shenzhen were permitted to issue bonds on their own [20]; this may again serve as an example of China's strategy of cautious gradualist approach towards more market economy).

China's way to a more transparent description of its real government debt status and genuine fundamental government debt improvements will be a tough task. Tough in the sense that such a process will be accompanied by many conflicts of interest that need to see decisions on priorities. Some of these burdening conflicts for the political decision-makers are:

- *political influence versus improved statistical government debt standards*
  - improved debt statistics may imply less political influence on (local) credit decisions;

- *limited transparency versus marketization of financial markets*
  - more marketization means decreasing political influence;

- *economic growth versus more restrictive controls of local government credibility*
  - a healthy case if the latter option is taken - but some negative impact on investment;

- *opaqueness versus more open preferences in fiscal spending*
  - greater transparency should lead to clarifications about priorities, e.g. for the environment;

- *limited transparency in local matters versus the declining risk of financial bubbles*
  - less (local) political power supports the avoidance of asset price bubbles (on property markets);

- *local ambitions versus national growth objectives*
  - excessive local growth conditions may be tackled more easily in a transparent debt system when the national perspective urges for a cooling down of the Chinese economy

Conclusion 7:
China's way to a more transparent accounting system of its total and local government debt has to be regarded by far more complicated than many analysts may think, particularly since it simultaneously means decreasing political influence.

Potential benefits for both China and the rest of the world

The starting point for the analysis in this chapter is the status of sufficient balance in Chinese total government debt - which is expected to become true at some point (as an assumption, not as a forecast). I do not look in this context at *how* such a satisfactory situation and reliable transparency may have been achieved.

Global financial markets watch government debt as one of the main indicators of the economic stability/instability of a country. And the more the country has opened its financial borders, the more analysts become interested in debt development. It will be important for China to satisfy the future analytical needs of domestic and global investors/lenders - but also to stick to the confidence (hopefully) gained from financial markets and participants in the real economy. Such a trend would be beneficial for China and the global economy.

a) The **benefits for the Chinese economy** - ceteris paribus - from a solid course of government debt and transparency would be:

   - a good contribution to general confidence in the renewed Chinese economic model,
   - low or more limited incentives for domestic and particularly international financial markets to speculate against China and the RMB in a future environment that already has been implementing relatively free cross-border financial movements,
   - the avoidance of uncomfortable delays in other related reform areas,
   - a decreasing role of SOEs as a policy tool - resulting in better competition on local markets,
   - the establishment of a more consumer-friendly financial market caused by accelerated financial marketization,
   - an important contribution to social stability and potential GDP growth.

Conclusion 8:
Transparency and a strong government debt situation creates stability and favors potential Chinese GDP growth in the long run.

b) The **benefits for the global economy** from a transparent and an acceptable or good Chinese government debt performance - ceteris paribus - should/could be:

   - more stable conditions for exporters to China,
   - more stable conditions for foreign FDI in China,

- more predictable conditions for the Chinese exchange rate (if/when floating more freely),
- a positive contribution - ceteris paribus - to global financial markets,
- a decrease in international concern about social tensions in China and possible contagion effects.

Conclusion 9:
The list of benefits from transparency and a fairly well-managed Chinese government debt development for both China and the rest of the world, underlines that it is worthwhile for China to work hard towards a positive and stable government debt environment.

Summarizing conclusions

- Analyzing the Chinese government debt has to be regarded as a tough task, not least due to statistical shortcomings. These shortcomings are particularly obvious when it comes to local government debt, government revenues and different kinds of implicit debt commitments. Consequently, there is currently no way to capture the real state of Chinese government debt. This insufficiency calls for rapid improvements. Why not in partial co-operation with EU?

- Official international organizations use Chinese debt numbers, but often only including central government debt. This is completely misleading, since local government debt - according to Chinese sources as well - is considered to be much higher than central government debt. This means that international institutions with good analytical resources often do not contribute essentially to a better analysis of Chinese government finance.

- Many private institutions inside and outside China tend to have a much more skeptical view of Chinese government debt than official sources. But they usually have smaller analytical resources to deal with the issue which does not necessarily mean that the private estimates are further away from reality than official reports - maybe quite the opposite. My own analysis leads to the conclusion that the real numbers for Chinese government debt are closer to the private than the official estimates.

- There are two approaches for considering the future risks of Chinese government debt. The first one is longevity of the ”China-adapted” debt interpretation, taking into account the system of moving around government debt between state organizations - if necessary.

  The other approach is the Western way of looking at government debt by focusing more and more on the government debt/GDP ratio. In this paper, one important assumption is that China analysts and global financial markets will gradually move from the specifically China-adapted debt model towards a Western-style debt interpretation. The starting point and speed of this transition will be a function of fundamental government debt improvements, the credibility and size of the published debt ratios, transparency and the marketization of the currency and domestic financial markets.

- It will, thus, be quite a bumpy and risky road to a sustained, healthy and trustworthy Chinese government debt environment. Minimizing future risk implies that structural debt improvement measures should be commenced as soon as possible.

- It should be added that a successful Chinese fiscal policy can only be achieved by finding priorities for a number of more or less obvious conflicts of goals. This makes the whole ”debt opening-up process” quite complicated and may lead to temporary major problems at some point in the future - a point that may be a whole decade away.

- Benefits from open government debt accounting would dominate if the “rules” of government debt stabilization and sustainability of positive achievements are followed.

- China should still have time to get on a structurally healthy government debt track - at least according to current knowledge about Chinese government debt. But this chance must be taken in the next few years. Otherwise there is an obvious risk that insufficient Chinese government debt management can have a considerable negative impact on global financial markets at some stage in the future. The somewhat deteriorating fiscal outlook for 2013 [21] should not make conditions for future fiscal reforms and improvements more difficult if this remains a temporary phenomenon.

- In the worst case, persistent insufficient Chinese government debt management can lead to considerable negative reactions on merchandize markets as well. Such a development would also counteract China’s strong ambitions of internationalizing its currency RMB - or to make it completely convertible as the final step.

These hidden risks show that the Chinese themselves and the rest of the world should know more about the real state of Chinese government debt.

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