

# **The Party and China's Financial Deterioration**

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## Outline

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What does “financial deterioration” mean?

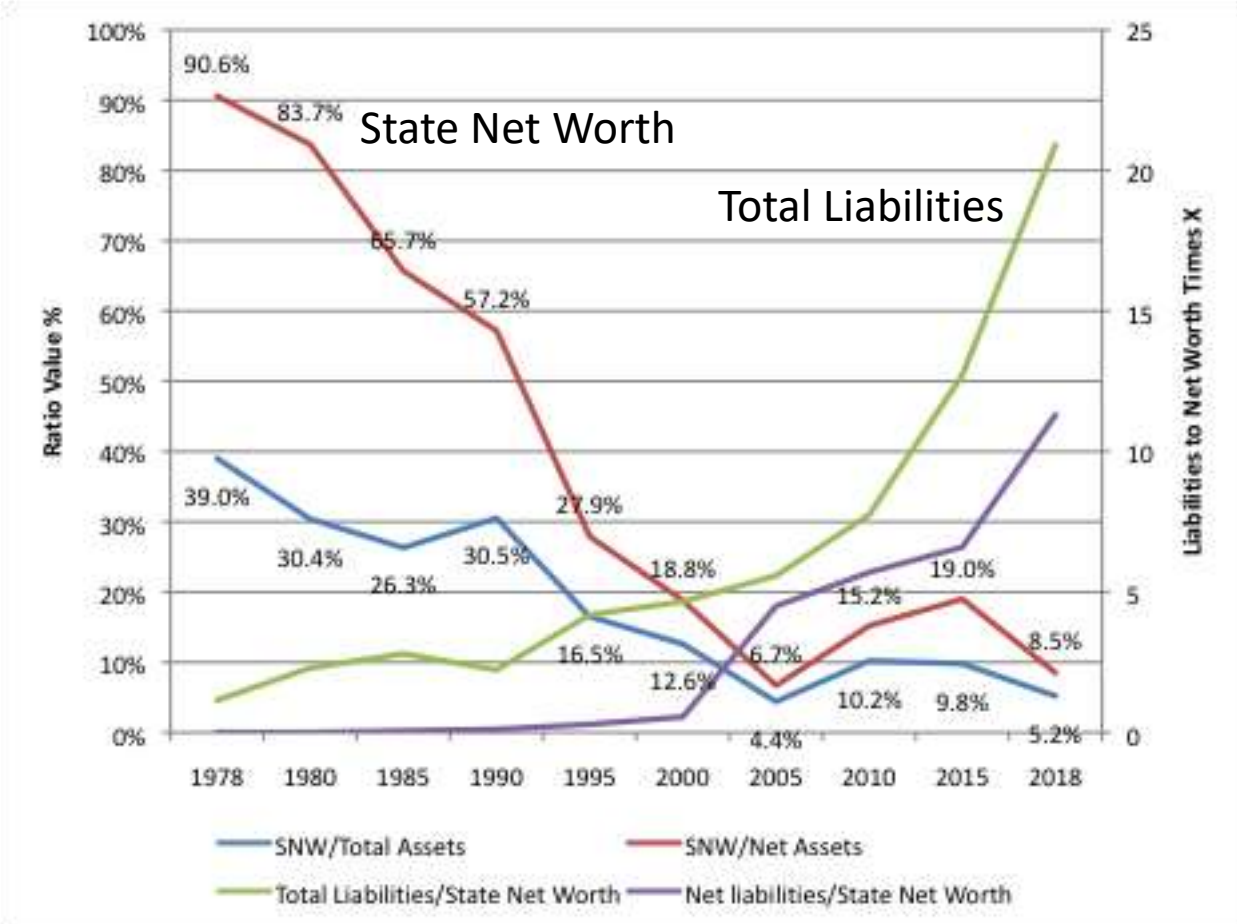
Creating a Chinese government sector balance sheet

What factors led to China’s government sector financial deterioration?

Points of comparison with other country experiences

# China's financial deterioration, liabilities vs. net worth

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Inefficient investment in state capital assets = local government extra-budgetary revenue

%	1978	1980	1985	1990	1995	1997
<b>Industrial SOEs</b>						
Profit/Total Investment	-	-	80.80	22.21	14.71	8.63
	<b>1980/1978</b>	<b>1985/1980</b>	<b>1990/1985</b>	<b>1995/1990</b>	<b>1997/1995</b>	<b>1997/1978</b>
Investment rate of increase %	1.01	1.62	2.13	3.40	1.27	15.08
<b>Investment financing sources %</b>						
<i>Industrial SOEs</i>						
State budget	-	-	-	-	-	2.84
Domestic loans	-	-	-	-	-	32.02
Foreign funds	-	-	-	-	-	7.76
Self-collected funds	-	-	-	-	-	49.30
Other	-	-	-	-	-	8.08
<i>All state agencies</i>						
State budget	62.16	44.66	23.98	13.20	5.00	4.68
Domestic loans	1.69	11.67	23.04	23.60	23.66	22.98
Foreign funds	4.21	7.19	5.27	9.10	7.89	5.07
Self-collected funds	31.94	36.48	47.71	43.18	48.70	52.73
Other	0.00	0.00	0.00	10.91	15.89	14.25
<i>Investment efficiency*</i>						
All state agencies	-	-	69.3	80.65	67.81	79.6
Industrial capital construction	-	-	69.3	77.41	61.22	75.13
Industrial technological updating	-	65.58	64.35	86.68	76.89	81.89

Note: Efficiency = Completed investment/investment expenditures

## Distribution of budgetary revenues and expenses by level of government, 1992-2013

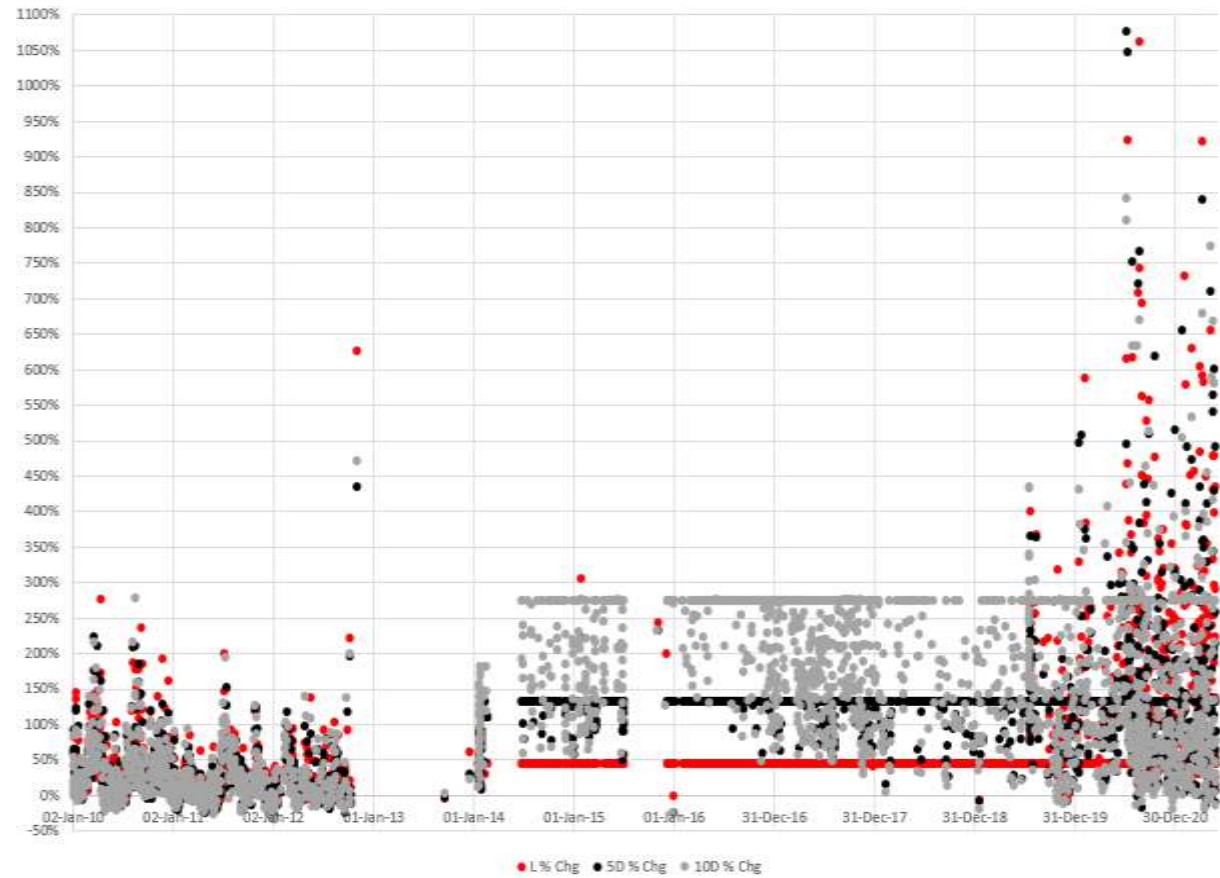
<i>as % of official budget total</i>	<b>1992</b>	<b>1998</b>	<b>2002</b>	<b>2006</b>	<b>2010</b>	<b>2013</b>
<b>Revenues</b>						
Central	34.0	49.5	55.0	52.8	51.1	46.6
Province	11.0	10.5	11.7	12.1	10.6	10.7
Prefecture/City	29.0	19.7	16.3	16.5	15.8	16.2
County	16.0	20.3	17.1	18.6	22.5	26.5
<b>Expenditures</b>						
Central	22.0	28.9	30.7	24.7	17.8	14.6
Province	13.0	18.8	19.6	18.3	17.1	16.1
Prefecture/City	34.0	24.1	28.6	22.5	22.5	22.9
County	16.0	28.2	22.0	34.4	42.6	46.3

## Woefully underpriced public offerings = less SOE assets and capital

	Number of Listings	Average 1st Day Jump %	Average 1st Day Turnover %
2010	127	47	69
2009	99	74	79
2008	77	115	80
2007	126	193	65
2006	66	84	70
2005	14	48	58
2004	100	70	55
2003	67	72	52
2002	68	134	62
2001	77	138	64
2000	135	152	59
1999	93	113	60
1998	92	149	62

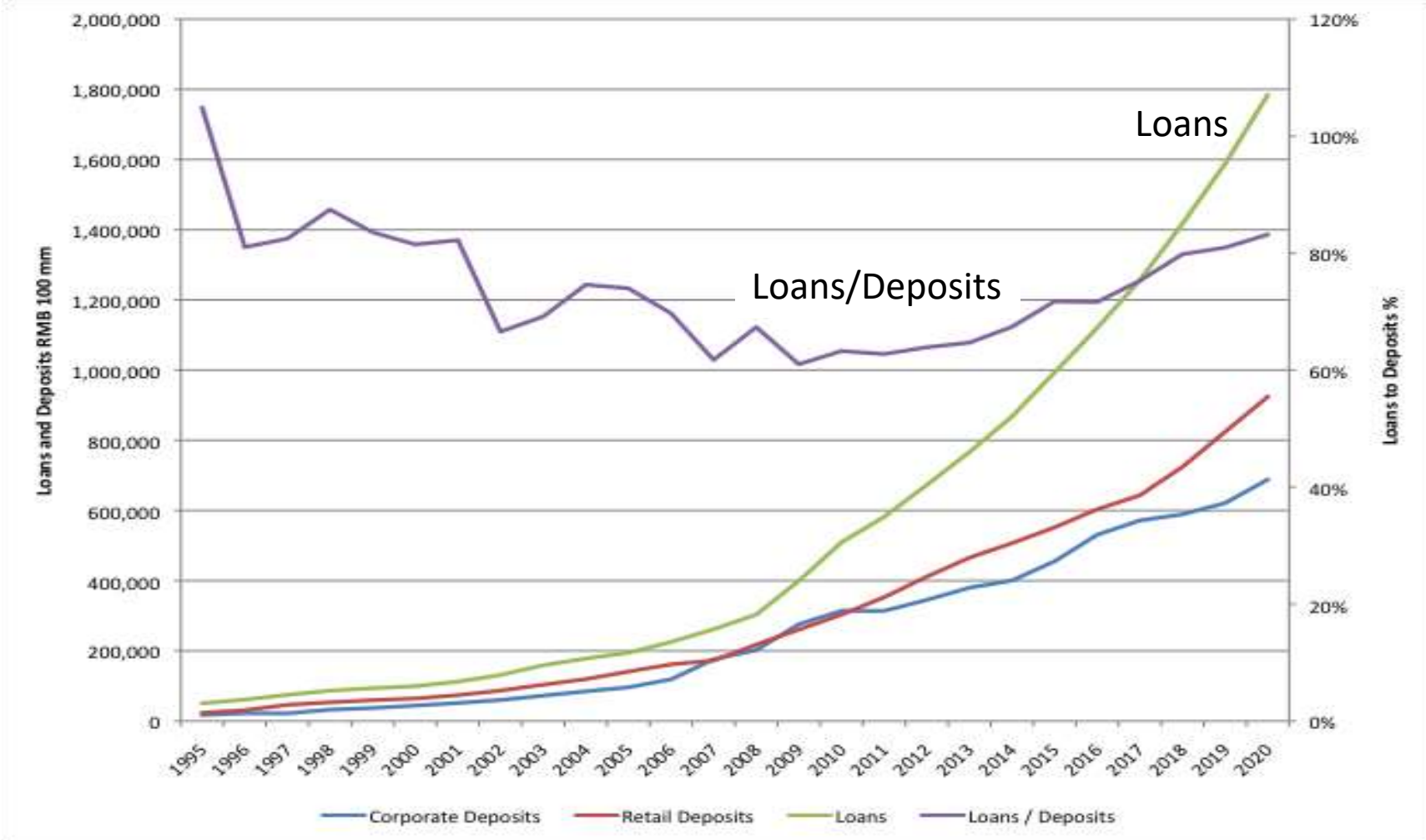
Source: Wind; author's calculations  
 Note: Turnover is the amount of shares sold as a percent of what was allowed to be sold on the first day

Day 10  
 Day 5  
 Day 1 listing price



# Massive deposit growth made possible massive loan growth

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## Can government assets cover obligations to households?

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<i>100 mm</i>	<b>2018</b>	<b>Discounted Values</b>	<b>Discount Rate</b>	<b>Plus Net Current Assets</b>
Household deposits	724,439			
Estimated currency held	57,102			
Savings bonds	7,218			
A share investments	85,204			
<b>Total Household claims</b>	<b>873,963</b>	<b>873,963</b>		<b>762,128</b>
Foreign exchange reserves	212,557	199,919		199,919
SOE fixed assets	393,808	393,808		393,808
SOE investments	106,685	53,343	50%	53,343
Bank loans to SOEs	427,150	256,290	60%	256,290
Net current assets				764,128
<b>Selected State Assets</b>	<b>1,140,200</b>	<b>903,360</b>		<b>1,667,488</b>

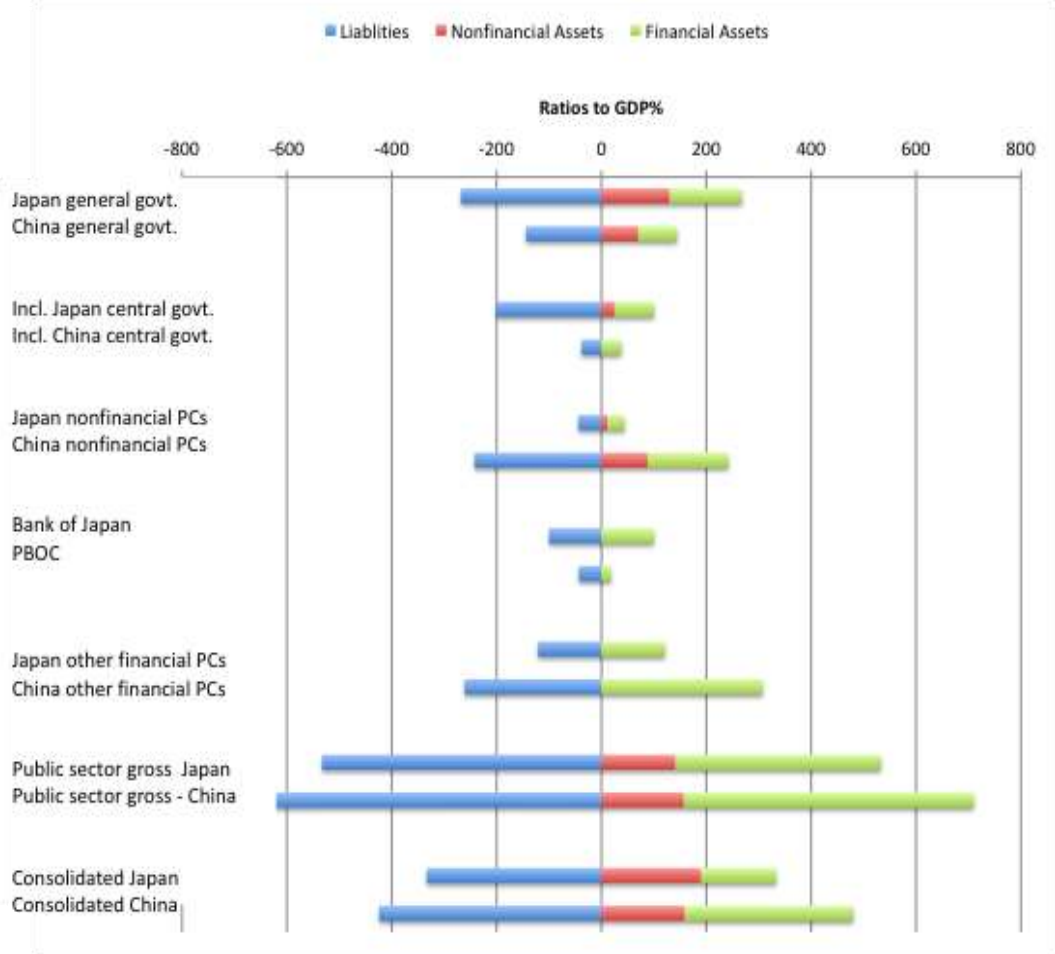


## Comparative government sector balance sheets, 2014

<i>US\$ bn</i>	<b>Financial Assets</b>	<b>Non-financial Assets</b>	<b>Liabilities</b>	<b>Net Worth</b>
<b><i>Broad Definition</i></b>				
Germany 2014	1,091	0	2,449	-1,336
Norway 2014	8,885	0	1,058	7,830
United Kingdom 2014	593	0	2,030	-1,438
United States 2014	1,883	3,244	16,836	-11,709
Japan 2014	6,868	8,293	15,081	-8,213
2014 China - PBOC	6,731	14,428	5,330	15,829
<b><i>Public Definition</i></b>				
2014 China - PBOC	28,132	27,794	37,601	18,325
2014 China - Walter	27,607	13,676	34,259	7,024
2014 China - PBOC adj.	28,132	13,366	32,271	9,227

# Comparative gross government sector assets and liabilities, Japan and China, 2017

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Japan  
Gross 533% of GDP  
Consolidated 333%

China  
Gross 710% of GDP  
Consolidated 480%

## Summary comments

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For China resuming strong economic growth is critical

But not as critical as addressing the aging problem

Reducing in some way the debt overhang

Critical for all of the above is a change in “paradigm”