China to audit government debt “black hole”

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The Chinese leadership has ordered a comprehensive audit of government debts, from the national to the municipal and village levels. The audit, to be carried out by National Audit Office under the instructions of the State Council, started on August 1.

There is widespread concern in China and internationally that, as a result of Beijing’s 2008 stimulus package, unsustainable local government debts amounting to some $US2-3 trillion could destabilise the world’s second largest economy.

The audit decision was followed by a Chinese Communist Party (CCP) Politburo meeting headed by President Xi Jinping last week, which called for “steady growth” under “extremely complicated domestic and international conditions.” China’s economic growth slowed to 7.5 percent, year-on-year, in the second quarter of 2013, down from 7.7 percent in the first quarter.

The last nationwide audit, carried out in 2011, found that local government debts within the 31 audited provinces had reached 10.75 trillion yuan by the end of 2010, equal to $US1.75 trillion at today’s exchange rate. That figure was widely regarded as an understatement. Three years on, it is generally thought that many local governments have become more deeply mired in debt in order to repay earlier loans.

Following the 2008 global financial crisis, 23 million Chinese workers lost their jobs, threatening a social explosion. Under the slogan, “maintain growth,” the CCP regime frantically mobilised every level of government and business to deliver a massive stimulus program.

Local governments, which cannot issue bonds directly, were encouraged to borrow from banks via “financing vehicle” companies, using government assets like land as collateral. They used the money in a scramble to build infrastructure as well as develop real estate projects, often in collusion with business cronies.

At the root of this debt crisis is the lack of an outlet for China’s vast industrial output. Following 2008, Beijing hoped that the American and European economies would quickly recover, reviving China’s export markets. But that did not eventuate.

It has been clear for some time that the Beijing regime’s debt-driven stimulus was unsustainable. With exports faltering, activity is slowing in the rest of the economy, causing a decline in government revenues—the source of state-led infrastructure investment over the past two decades. At the same time, because of the unprofitability in actual production, the deluge of bank credit was channeled into risky property speculation.

Nobody really knows the true extent of the debt problem. That is why China’s media widely refers to it as a “black hole.” An International Monetary Fund (IMF) report in July warned that the overall government debts equalled 45 percent of China’s $8.23 trillion gross domestic product (GDP).

The *Economic Information* newspaper, published by the official Xinhua news agency, reported that the latest audit aims to find out just how much new debt has been incurred since 2010. Unlike the 2011 audit, which focused only on three levels of government (provincial, municipal and county), this year’s investigation involves five tiers, extending to township and village authorities, where the piles of debt are regarded as particularly risky. “The markets are worried that this audit will produce an ‘earthquake’ impact to the markets,” the journal said.

In June, the National Audit Office published an audit of the debts of 36 local governments—only a small portion of China’s total. The results worried the authorities. The combined debt of 3.84 trillion yuan represented an increase of 12.94 percent since 2010. Of these 36 administrations, the liabilities of nine major cities surpassed their total assets, in some instances by

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as much as 219 percent.

June's partial audit pointed out that many local governments depend totally on the real estate bubble to repay their debts. Of the 36 governments, four provincial administrations and 17 capital cities relied on selling long-term, land-use rights as their main source of loan repayments. However, land sales revenues had dropped significantly over the previous year. Last year's loan repayments were 231.5 billion yuan—1.25 times the total income from land sales.

According to *Beijing News*, 2013 is a crunch year for local government debt repayment. The newspaper cited "incomplete statistics" showing that, of the 10.7 trillion yuan of debt held in 2010, about 11.37 percent must be repaid this year. In addition, three-year bonds issued by Beijing on behalf of local governments worth 138.4 billion yuan are due this year, plus interest totalling 150 billion yuan. None of these calculations include the 650 billion yuan of credit that local governments raised through trust companies, a portion of which must also be repaid this year.

The latest audit itself has increased the financial risks, according to Li Xunlei, an economist at Shanghai-based Haitong Securities. He told *Economic Information*: "The local governments often repay old debts with new ones. With the audit, as the checking over the sources of financing becomes more rigorous, the harder it becomes to raise new debts. If new loans are not allowed, then the repayment pressure for the old debts will become greater. This kind of risk is widespread."

Last month's bankruptcy of Detroit has been widely discussed in the official Chinese media, with grim parallels being drawn with China's many industrial towns that depend on exports of single commodities, usually cheap consumer goods—cities known, for example, as "jean city" or "sock town."

Detroit's bankruptcy is also being used for definite political purposes. A July 25 *People's Daily* editorial attributed Detroit's plight to American workers "living beyond one's means," rather than the machinations of the Wall Street financial elite. The newspaper warned that "Detroit's fall sounds the alarm." The CCP regime is using the "lesson" of Detroit to ideologically justify an onslaught against millions of impoverished Chinese workers in a new wave of pro-market restructuring involving plant closures, streamlining and privatisation.

Last month, the Ministry of Industry and Information Technology ordered 1,400 companies in 19 industries to shut down "overcapacities," including in steel, ferroalloys, electrolytic aluminum, copper smelting, cement and papermaking. More than 92 million tons of cement capacity and about 7 million tons of steel capacity are expected to shut down immediately.

According to China's financial newspaper *Caijin*, this is only the first stage of a restructuring, with a total planned reduction in steel output by 45 million tonnes a year, estimated to eliminate the jobs of 170,000 steel workers. Closing large sections of industry, especially those owned by local government, will push these governments deeper into the red and result in savage austerity measures against the working class and rural poor, while enriching a tiny corrupt elite connected to Western financial capital.

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