Local Government Ownership of Banks and Public Financing in China

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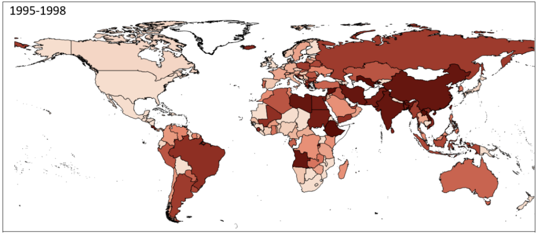
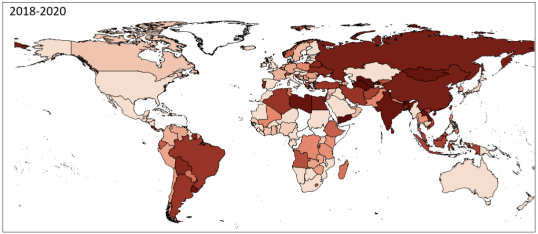
The Share of State-owned Banks is Rising



(a) 1995-1998



(b) 2018-2020

Motivation and Research Question

- Pros of state ownership in banks: stabilize the credit supply
- Cons of state ownership in banks: credit misallocation (due to political distortions)

Research Question

- Does local government ownership of banks affect local public financing in China?
- What are the driving mechanisms?
  - Political incentives.
  - Stability concerns.

Institution Background

Bank Loan Demand through LGFVs is High

- Tax-sharing reform in 1994
- Local leaders undertake large infrastructure investments due to "promotion tournaments"
- Bond issuance is limited even after the enactment of "Budget Law" in 2015

The "Two Participations and One Control" Regulation (IV)

- Major shareholders invest in at most two commercial banks
- Control no more than one commercial bank

This Paper

Data

- Focus on urban commercial banks
- First layer of shareholder information and transaction-level loan data form Wind
- Detailed shareholder information form Qixinbao (ownership penetration principle)
- Prefecture-level information from CSMAR

Identification Strategy

- Treatment group: 6 UCBs that TPOC-violating private shareholders decreased their shares
- Control group
  - 6 UCBs that TPOC-violating private shareholders did not reduce their shares
  - 72 UCBs that did not violate TPOC

Key Findings

First and Second Stage Regression Results

- Local government ownership $\uparrow$ after the TPOC regulation
- Local government ownership $\uparrow \Rightarrow$ actual lending to LGFVs $\uparrow$
- Local government ownership $\uparrow \Rightarrow$ Share of board members with local government backgrounds $\uparrow$

Key Mechanisms

- Party Secretary has strong promotion incentives (discontinuous at the age of 55)
- Local government faces social stability pressure (measured by unemployment)

Other Tests

- Local government ownership $\uparrow \Rightarrow$ banks' lending decisions deviate from maximizing profit
- Substitution between bank loans and bond financing is stronger for riskier LGFVs

Comment: On the Pitch

- The fundamental question is whether the state ownership of bank is good
- The paper starts with the trade-off between stability and misallocation
- The paper finds that local government ownership $\uparrow \Rightarrow$ actual lending to LGFVs $\uparrow$, but it stops here
- Does more lending to LGFVs mean more stable economy? Maybe
    - Implicit local government debt risks
    - Housing bubbles
    - Discussion of debt sustainability or NPL risks post-TPOC
- Does more lending to LGFVs mean misallocation?
    - A relevant evidence in the paper could be that banks are not maximizing profit
    - But profit$\neq$welfare
    - It is hard to conclude without a macro model
- What is the role of local government? The paper seems to imply that local government is not an altruistic social planner

Comments (Cont'd)

Treatment Group Banks

- Treatment group consists of only 2 entities: Tomorrow Group and Xinhua Lian Group

Social Stability Measure

- The paper uses employment
- "Social Stability" is a broad term, therefore, worth some robustness checks
- For example: crime rate. Financial stability measure: non-performing loans

Bank Characteristics as Control

- HHI: bank market power
- Risk-based capital ratio
- Leverage ratio
- ...

Conclusion

- Interesting and intuitive idea!
- Robust identification and rich results!.
- A very nice paper! I enjoyed reading it and learned a lot!

Good luck with publication.