

Discussion

“The Great Wall of Debt”

by Andrew Ang, Jennie Bai, and Hao Zhou

Yongxiang Wang

University of Southern California

May, 2017

1. Overview

Research Setting: Chengtou Bonds in China

Key Results:

1. Higher local real estate GDP is associated with lower financing costs (lower yield)
2. Higher corruption is associated with higher financing costs (higher yield)
3. Result 1 only holds in low corruption provinces, and it's the opposite in high corruption provinces.

2. Why an important topic?

---Chengtou Bonds had a market value of 4.95 trillion RMB in 2014 (7.78% of GDP in 2014)

---Local government debt crisis is a big concern for policy makers and practitioners.

WSJ: China Launches Stimulus Aimed at Local Debt Crisis

Reuters: China vows to strictly control local government debt quotas

....

3. Overall Assessment

1. Overall, a very interesting paper and a must-read for researchers interested in the shadow bank system and local government default risk in China
2. Very interesting analyses with rich data

4. Comments and Suggestions

1. **Probably a better framework is needed?**

---The correlation between local economic/political conditions and municipal bond yield has been documented in the US setting. (see Butler et.al. (2009, RFS)). Relatedly, the paper might benefit from specifying how the current study contributes to the existing literature.

---the null hypothesis is that local factors should not matter for Chengtou bonds since Chinese central government will bail them out, which makes it very different from the US setting. So would benefit from providing some evidence on this key assumption.

4. Comments and Suggestions

2. Estimation

1. The data is at the bond issuance—(year*month) level, so we might want to control for Year*month fixed effects rather than just month fixed effects.

Another way is just to aggregate the bond-level variables like excess yield to annual level since the main explanatory variable is annual.

2. Since bonds from different regions might be affected by the macro level shocks, we might want to cluster the SD at both province level and also year*month level.

3. Careful with the interaction results:

---Direct effect of GRAFT-TIGERS, but no interaction effect

---No direct effect of GRAFT-FLIES, but some interaction effect

4. Comments and Suggestions

2. Estimation

4. Construction of corruption index

---based on convicted cases.

---What if conviction is affected by enforcement? Higher numbers of corruption cases then might imply better enforcement rather than higher level of corruption

---Suggestions: any other measure of corruption at the province level?

5. A bit more institutional background on Chengtou

1. Different levels of governments have issued Chengtou bond, including prefectural governments and provincial governments.
2. Some Chengtous have bought insurance; while some have collaterals and also local government guarantees.

6. Conclusion

1. The topic is very important and the results are very interesting
2. *A must-read for people interested in shadow banking and local government debt in China*