

RESEARCH REPORT

China's local fiscal adjustment: land revenue, debt conversion and supplier liquidity

China's local debt conversion can lower funding costs while land-revenue losses and unpaid supplier bills persist. Consolidated cash-flow and asset-value accounts show where refinancing relief becomes durable fiscal capacity.

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The central finding

Refinancing local obligations can ease a funding constraint without resolving the operating imbalance that created it. In China, this distinction is especially consequential because land-related receipts, local service responsibilities, financing vehicles and supplier payment conditions connect several balance sheets. An assessment confined to the newly issued government bond can miss both the relief delivered to firms and the liabilities that remain elsewhere in the system.

The appropriate question is whether the adjustment leaves the local public sector able to finance essential services, maintain productive assets and meet recognized obligations from a credible stream of resources. That requires more than a lower coupon or a longer maturity. It requires identifying the fiscal perimeter, the cost of acquiring land-related receipts, the commercial cash flow of project entities and the use of any released liquidity.

This report develops that assessment through a consolidated funding framework and expressly hypothetical cases. It uses Chinese budget and property statistics, the IMF's detailed fiscal assessment and the World Bank's regional analysis as historical evidence. It does not estimate an undisclosed national arrears stock or assign a probability of default to a province. Its contribution is a testable distinction between liquidity relief, loss allocation and recurring fiscal repair, together with a method for tracing the consequences into private working capital.

The evidence describes several different problems

The Ministry of Finance's report on 2024 budget execution records local own-source general public budget revenue of 11.926641 trillion yuan, central transfers of 10.039716 trillion and local general public budget expenditure of 24.389207 trillion. Local spending represented 85.7 percent of national spending in that budget. The same report records government-managed fund revenue falling 12.2 percent, principally because of lower land-use-right sales, and a six-trillion-yuan increase in the local debt ceiling for replacing hidden debt. These are different budget categories and a financing authorization, not one homogeneous revenue series. [Ministry of Finance, 2024 execution and 2025 budget report](#).

Property-sector evidence supplies a related but separate observation. NBS records real estate development investment falling 10.6 percent in 2024 and commercial-building sales value falling 17.1 percent. The release covers developer activity and transactions; it is not a direct measure of local-government net land income. [NBS, real estate development in 2024](#).

The IMF's 2025 Article IV staff report, published in February 2026, distinguishes the authorities' legally defined hidden debt from a wider economic government perimeter. It finds that conversion can lower debt service and enable arrears clearance while leaving financing vehicles' weak operating capacity unresolved. That is the staff's assessment, not an independent estimate produced here. [IMF, China Article IV report, fiscal vulnerabilities section](#).

The World Bank's December 2025 analysis adds a geographical dimension. Its local-debt discussion associates greater fiscal pressure with weaker land receipts and identifies especially difficult conditions in several lower-income regions. The report warns that debt burdens can reinforce regional disparities. This evidence supports disaggregating local capacity; it does not justify giving every locality the same stress parameter. [World Bank, China Economic Update, fiscal discussion and Box 1](#).

Taken together, the documents identify a revenue problem, a funding problem, an institutional-boundary problem and a distribution problem. Those categories overlap but are not interchangeable. A bond transaction can address the funding problem while a weaker development market continues depressing revenue. A transfer can support service delivery without making a project commercially viable. A supplier receiving an overdue payment can become more liquid while consolidated public debt remains unchanged.

The fiscal unit must be defined before the debt is measured

A local treasury, a public utility, a financing vehicle and a contractor can all participate in the same infrastructure project. Their legal relationships determine contractual claims, but the economic assessment must also follow control, revenue and responsibility for losses. A financing vehicle with the appearance of a commercial corporation can undertake a noncommercial task. A government-owned enterprise can also operate a genuinely market-based business. Ownership alone does not settle the statistical perimeter.

Three views should therefore be maintained. The first is the legal debt account, which identifies the named borrower, guarantee and enforceable obligation. The second is the statistical public-sector account, applying a documented institutional classification. The third is a fiscal-risk account that includes exposures capable of reaching the budget under specified conditions. Keeping these views side by side is more transparent than replacing them with an unexplained aggregate labeled public debt.

Consolidation eliminates transactions inside the chosen boundary. If a treasury transfers ten to a controlled entity, and the entity uses that ten to pay an outside supplier, the local sector has not spent twenty on the supplier. If the entity owes the treasury a loan, including the loan as both a public asset and a separate external public liability would likewise exaggerate the consolidated position. External creditors and counterparties should remain identified after internal claims are removed.

The boundary also affects the interpretation of a conversion. Replacing a financing vehicle's external loan with a local-government bond raises debt in the legal government account. If both borrowers were already inside the economic perimeter, consolidated external principal may remain unchanged. The apparent deterioration in reported government debt can accompany greater transparency and lower financing costs. Conversely, removing an entity from an administrative list does not establish that its economic risks have disappeared.

An analyst should preserve a stable entity identifier through those changes. Otherwise the old liability can vanish from one dataset and the new liability appear in another without a bridge. The reconciliation should record the predecessor obligation, extinguishment amount, new instrument, residual balance and creditor. It should also state whether the conversion includes disputed invoices, commercial bills or only particular recognized debts. The label debt swap is insufficient to reconstruct that boundary.

A credible report would consequently publish two movement tables. One shows changes in debt caused by borrowing, repayment, valuation and reclassification. The other shows changes in the fiscal perimeter. Mixing the two can make a recognition exercise look like newly incurred expenditure or make a transfer of responsibility look like debt cancellation. Neither interpretation follows without the underlying transaction record.

Land receipts are not a recurring tax base

Land-use-right sales connect a long-lived asset or development right with a current funding inflow. Their fiscal significance differs from a broad recurring tax collected as activity continues. Gross proceeds also differ from cash remaining after compensation, site preparation, infrastructure commitments and other associated costs. An analysis of spending capacity should identify those obligations before treating the entire receipt as freely usable income.

Consider a hypothetical locality receiving one hundred from a land transaction. Assume compensation and preparation consume sixty, contractual development costs consume twenty and administrative or other associated costs consume five. The remaining cash is fifteen. If gross receipts fall to eighty while the committed costs remain eighty-five, the net contribution becomes minus five. A twenty-percent decline in gross proceeds has eliminated twenty units of usable cash, rather than merely reducing a fifteen-unit margin by twenty percent.

This is not a reconstruction of any Chinese locality's land account. It demonstrates a margin mechanism. When associated costs are partly fixed or committed before sale, net resources can be more sensitive than gross receipts. The appropriate empirical question is how those costs move with the market and which commitments can actually be deferred. Applying a constant national net-to-gross ratio would conceal this operating leverage.

Land transactions inside the local public sector require additional care. Suppose a controlled company buys a right from the treasury using bank debt. The treasury obtains cash, but the consolidated public sector has sold an asset internally and borrowed externally. Its external net worth has not improved simply because the receipt is classified as a land sale in one account. The result depends on the subsequent development value and the debt-service capacity of the purchaser.

This mechanism should be investigated with ownership and funding evidence rather than assumed to explain every observed transaction. A private purchaser paying from independent resources presents a different counterpart. A controlled company with a commercially viable project can generate future earnings. The analytical task is to identify where the cash originated and which outside income will ultimately service the borrowing, not to classify every transaction by its headline form.

A land-revenue recovery can therefore improve liquidity while leaving a structural issue unresolved. Selling more rights brings forward resources, but the future path depends on demand for development, remaining assets and obligations attached to the sales. A sustainable service budget should not assume indefinite repetition of a favorable one-year disposal. A recurring revenue stream, an asset sale and financing proceeds belong on separate lines of the funding account.

A consolidated cash waterfall

The following hypothetical account concerns one local public sector for a single year. All figures are common monetary units. It includes the treasury and a financing entity, eliminates their internal transfers and assumes no valuation changes. It is an analytical account rather than an official Chinese budget presentation.

Consolidated item	Before conversion	After conversion
Recurring receipts and external transfers	100	100
Net land-related cash contribution	10	10
Essential services and maintenance	95	95
Interest paid to outside creditors	12	6
Cash available before principal and arrears	3	9

Consolidated item	Before conversion	After conversion
Principal falling due	30	10
Unfunded amount before new borrowing or arrears settlement	27	1

The conversion lowers interest by six and principal due by twenty. The financing gap falls by twenty-six. Only the interest saving creates an immediate six-unit increase in recurring cash capacity under the assumptions. The twenty-unit maturity extension moves principal into later years. It is valuable funding relief, but it is not a twenty-unit cancellation of the debt.

The distinction becomes clearer if the locality has outstanding supplier arrears. Using the newly available six to settle old invoices can improve private cash flow, yet the year also contains a residual principal gap of one. If new borrowing covers both the gap and a further arrears settlement, the resulting debt increase must be recorded explicitly. The same financing proceeds cannot simultaneously repay principal, clear arrears and fund new construction in full.

Now let the net land contribution fall from ten to minus five, as in the earlier margin example. After conversion, receipts total ninety-five, services and maintenance use ninety-five, and interest requires six. The current cash balance is minus six before principal. Despite the lower coupon, the locality is still borrowing or accumulating obligations to maintain the stipulated operations. The refinancing intervention has reduced the gap, not eliminated the underlying flow problem.

This waterfall separates four quantities often merged in discussion: current primary resources, interest, contractual principal and arrears clearance. Each has a different economic meaning. Interest savings can recur while the replacement rate remains lower. Principal deferral changes timing. Paying arrears transfers liquidity to creditors. New investment purchases additional assets or services. An assessment that groups all four under stimulus cannot identify the mechanism producing the observed change.

The exercise also clarifies why a ceiling authorization is not expenditure. Authorization creates legal room subject to implementation. Actual issuance produces financing. Allocation determines which obligations are extinguished. Settlement determines which creditor receives cash. The final use and timing matter for demand. An announced amount cannot be inserted directly into a consumption or GDP equation without following that chain.

Liquidity relief can coexist with an unrecognized loss

A longer maturity can be appropriate for an asset that generates dependable returns over decades. It can also postpone recognition that an asset’s revenue will never cover its costs. Distinguishing these cases requires a project cash-flow assessment. The maturity of the financing should fit the viable revenue stream; maturity extension should not be treated as evidence that such a stream exists.

Consider an invented project with annual receipts of eight and operating costs of five. Before capital maintenance, it produces three. Suppose economically necessary annual renewal of equipment costs two, leaving one available for financing. A debt balance of one hundred at a two-percent coupon requires two annually even before principal repayment. The project remains unable to cover the full obligation despite apparently modest interest rates.

If an external public-service payment of three is reliably budgeted because the project provides a valued service, its financing capacity changes. The project now has four after operations and maintenance. That can support a different debt structure. But the payment is a fiscal cost elsewhere, not newly created consolidated revenue. Consolidation prevents the subsidy from appearing as a free solution to the local sector's resource constraint.

Another possibility is that the project charges below an economically feasible tariff for distributional reasons. Raising the tariff can improve its own account while reducing users' disposable resources or raising firms' costs. The net policy assessment needs both sides. A project can be worth supporting even when not commercially self-financing, but the support should be explicit and financed rather than hidden inside assumptions about refinancing.

A third case involves assets whose original purpose or demand forecast no longer holds. Continuing them can absorb maintenance and financing without commensurate services. The appropriate comparison includes closure, repurposing or sale as well as refinancing. Those alternatives require realistic recovery values and transition costs. An appraised book value is not automatically a realizable source of debt repayment.

The analytical finding is consequently conditional. Lower-cost debt is most likely to create durable capacity where the problem is a temporary funding mismatch or an unnecessarily expensive liability against viable resources. Where the problem is recurring operating losses, the intervention needs a separate plan for service funding, asset disposition or loss allocation. Treating the two cases identically risks preserving obligations without restoring the capacity to honor them.

Value the asset without using the debt as its value

A project should not be valued by the amount borrowed to build it. Historical cost can remain on the books after demand, operating costs or intended use changes. The relevant financial valuation follows expected cash available to the owner, while a public-service appraisal also includes benefits and costs outside that cash flow. Those two evaluations should be reconciled rather than forced to equal the outstanding liability.

For an additional hypothetical calculation, suppose an asset produces five units of annual cash after all operating and maintenance costs for twenty years. Assume no terminal value, no growth and year-end payments. At a three-percent discount rate, its present financial value is approximately seventy-four point four. At two percent, the value is approximately eighty-one point eight. The formula is $5 \times [1 - (1 + r)^{-20}] / r$.

Both valuations remain below a debt claim of one hundred. Reducing the discount rate improves the assessed value, but it does not recover the full claim under the stated cash stream. A maturity extension alone changes

neither the asset's physical output nor that stream. The comparison identifies the amount requiring some other source of recovery; it does not prescribe a haircut, because actual creditor priority, guarantees and additional resources have not been modeled.

The sensitivity is also informative in the opposite direction. A commercially valuable asset may have temporary cash deficits during construction even though its completed revenue can justify its financing. Selling it quickly at a distressed price could destroy value. The distinction between a liquidity shortfall and a solvency shortfall therefore requires an operating forecast, a realistic completion plan and a range of defensible asset values, not an immediate assumption that every funding difficulty implies insolvency.

A public-service benefit can justify fiscal support without belonging to the project's debt-service cash flow. A bridge might save users time that the operator cannot charge for. Those savings can matter to a social appraisal, but creditors cannot be repaid directly in saved minutes. If the budget is to monetize part of that benefit through a service payment, the appropriation and financing need to be explicit. Keeping social value and financial resources separate permits a stronger case for worthwhile services while exposing the fiscal commitment required to sustain them.

Supplier arrears transmit fiscal pressure into private production

An overdue public payment is an asset on a supplier's balance sheet and a liability elsewhere. The supplier can report revenue from work delivered while lacking cash to pay wages, purchase materials or service its own loans. A fiscal cash shortage can thus become a working-capital constraint even when the supplier's underlying activity is commercially viable.

China's 2025 announcement of revised SME-payment regulations emphasizes payment deadlines, supervision and complaints. It demonstrates an official concern with settlement conditions; it does not measure compliance or establish that all overdue public claims have been paid. [State Council policy announcement on SME payments](#).

A hypothetical supplier illustrates the transmission. It has a valid receivable of twenty, cash of two and immediate obligations of fifteen. Without payment or new finance, it faces a thirteen-unit cash shortfall. Settlement of ten reduces the receivable to ten and raises cash to twelve. If it first meets ten of those obligations, cash returns to two and the remaining near-term shortfall is three. The payment has relieved a constraint; it has not created ten of new sales on the settlement date.

The distinction matters for demand measurement. Work may already have been recorded when delivered. Paying the invoice changes financial positions and can enable subsequent production, but it should not automatically be counted again as current output. Any new spending response depends on how the supplier allocates the receipt among wages, inputs, loan repayment, taxes and liquidity reserves.

The economic effect can be larger for suppliers unable to borrow against disputed or slow-paying claims. It can be smaller where the receivable has already been financed and settlement mostly repays the lender. Those are

competing transmission channels, not reasons to assume one national multiplier. The required evidence includes invoice age, confirmation status, financing arrangements and the supplier's subsequent spending.

Payment sequencing also has distributional consequences. Settling a large bank obligation first can reduce refinancing risk but leave small contractors constrained. Paying many small verified invoices can ease operating pressure while a large financial maturity remains unresolved. A defensible strategy should identify its objective and constraints explicitly. The size of the debt converted does not reveal which creditors received relief or how much of that relief reached current production.

Banks, creditors and the allocation of the adjustment

A debt conversion can alter a bank's asset yield, duration and regulatory treatment. Those changes need not have identical effects on reported capital, economic value and future credit supply. A lower-risk claim at a lower coupon may be preferable to a doubtful high-yield claim; a maturity extension can nevertheless lengthen interest-rate exposure. The outcome depends on terms and balance-sheet positions rather than on the word swap.

From the creditor's perspective, three comparisons matter. The first is the expected recovery on the original claim. The second is the value of the replacement instrument, including payment timing and liquidity. The third is the funding and capital required to hold it. A reduction in contractual interest is not necessarily an equal reduction in economic value if the original promise was unlikely to be fulfilled in full.

Conversely, changing the instrument does not eliminate a real resource loss. If an asset produces insufficient value, someone must absorb the difference through lower recovery, fiscal support, reduced public services, higher user payments or another explicit transfer. Keeping the claim at face value in every account can postpone recognition without recovering the missing resources. A consolidated assessment should show where the adjustment sits.

Credit supply is therefore an empirical outcome. A bank receiving a safer asset might become more willing to lend to private firms. It might instead use the improvement to repair its own balance sheet, meet liquidity needs or offset lower income. A supplier receiving settlement may repay a bank rather than obtain a larger facility. The amount of public refinancing alone cannot select among these paths.

An evaluation should follow both quantities and terms. Changes in approved private credit, collateral requirements, maturities and rejected applications provide information that an average lending rate misses. The pricing of completed loans can improve because riskier applicants no longer receive credit. Observing a lower average rate after conversion is therefore insufficient to establish broader financing relief.

Competing explanations for weak private demand

The fiscal-balance-sheet channel is plausible, but it is not a complete explanation of China's domestic demand. Households may change spending because of employment prospects, housing wealth or uncertainty about future resources. Firms may postpone investment because demand is weak, capacity is ample or expected profitability has fallen. Export orders and technology investment can move differently from local construction. These mechanisms can operate simultaneously.

The empirical distinction is whether public-payment exposure predicts additional private adjustment after accounting for those conditions. If suppliers with large overdue public claims reduce production more than otherwise similar firms, and recover after verified settlement, the arrears channel gains support. If unexposed firms experience the same pattern, a broader demand or financing explanation becomes more important.

Property-market weakness also creates reverse causality. Lower development activity can reduce local receipts, while local fiscal restraint can weaken activity further. A correlation between land revenue and construction does not reveal which direction dominates. An analysis should distinguish shocks to purchaser demand, financing conditions, local land supply and public expenditure rather than label their shared movement a single causal effect.

Regional composition is another alternative. A locality with an older industrial base, weaker population growth or limited private demand may simultaneously have lower tax receipts and higher debt. Its slower growth cannot automatically be attributed to debt. The World Bank's regional evidence motivates examining this heterogeneity, while a causal estimate requires controls and a credible comparison beyond the observed association.

The strongest research design would therefore test several mechanisms together. It would track firms' public receivables, financial exposure and customer demand; local fiscal resources; and the timing of actual debt settlements. A finding that only one outcome improved would narrow the interpretation. For example, lower interest expense without faster supplier payment would indicate liability relief before a working-capital transmission, rather than failure of every aspect of the operation.

An evaluation design with observable milestones

The unit of observation should match the intervention. For debt conversion, a locality-year panel may describe fiscal aggregates, but an invoice or creditor-level record is needed to identify settlement. For a supplier response, firm-quarter observations may be appropriate. Linking those units requires verified identifiers and treatment dates, not an inferred date based on a national announcement.

A practical design begins with the recognized obligation before conversion. Record its amount, original rate, remaining maturity, creditor, payment status and project connection. Then record the replacement instrument and actual settlement. The difference in scheduled service can be calculated directly. The use of released resources can be observed separately through payments, cash balances and new commitments.

A comparison group should face similar demand and regional conditions while differing in exposure to the specific converted claims. Simple before-and-after growth is weak evidence because national policy and property conditions change at the same time. Matching firms or localities on observed characteristics can help but cannot remove unobserved selection by itself. A causal claim would need a documented allocation rule or another defensible source of variation.

Anticipation should be tested. Suppliers may alter borrowing or spending when they expect settlement, before cash arrives. Localities may postpone payments in anticipation of a recognized refinancing channel. Such behavior changes the measured event window. Examining pre-intervention trends and commitment dates helps distinguish anticipation from an immediate liquidity response.

The relevant outcomes should be pre-specified and economically connected. At the local level, these include net current resources, maintenance spending, verified arrears, new commitments and refinancing peaks. At the supplier level, they include cash conversion, payroll, input purchases, investment and debt repayment. At banks, they include exposure quality, capital use and private credit availability. A positive result in one category should not be generalized automatically to all others.

Transparency about missing data is essential. If receivables cannot be matched to public counterparties, report that limitation rather than estimate precise arrears from a residual. If debt scope changes, provide a consistent-perimeter series or a bridge. The purpose of the framework is to make competing interpretations distinguishable, not to manufacture a comprehensive dataset from incomplete accounts.

Sequencing durable repair

A coherent adjustment has three linked objectives: recognize obligations, restore viable current funding and allocate losses where resources are insufficient. The sequence should protect essential services and avoid creating a new round of unpaid bills. Paying an old invoice while entering a new commitment with no funding can improve a snapshot without changing the underlying process.

Debt management can address maturity concentration and unnecessarily high financing costs. Revenue and transfer arrangements address the recurring resources available for local responsibilities. Project restructuring addresses assets that cannot cover their costs. Payment enforcement addresses the terms on which the public sector obtains private goods and services. These instruments complement one another because they solve different parts of the problem.

A useful medium-term plan would show the path after temporary refinancing relief expires. It would include maintenance and operating costs of completed assets, realistic land-related net receipts and the timing of replacement principal. A plan that balances only because of another assumed conversion has not yet demonstrated recurring capacity. Stress analysis should vary the specific resource or financing assumption that determines the gap.

The national aggregation should preserve regional differences. Common reporting rules can coexist with different adjustment paths where tax bases, service responsibilities and asset quality differ. Uniform restrictions may limit new risks but can also constrain productive spending in places with sound projects. Differentiated

treatment needs transparent criteria so that it does not become an unexplained exception or an incentive to underreport obligations.

For firms, the relevant commercial assessment is similarly specific. Public-sector revenue exposure should be evaluated through contract terms, verified receivables, payment history and counterparty resources. A favorable national refinancing announcement is useful context, but it is not a substitute for evidence that a particular obligation has been settled or that a new contract is funded.

Commitment control closes the loop

The funding account should also begin before an invoice becomes overdue. A new contract can create future obligations even when no payment occurs this year. If a locality reports only cash expenditure, it may appear to remain within a spending limit while entering commitments that the next budget cannot meet. An adjustment program should therefore track contract authorization, delivery, acceptance, due date and settlement as separate events.

That record distinguishes a genuine dispute over completed work from an undisputed bill delayed for financing reasons. It also identifies whether payment deadlines are reset through repeated acceptance procedures or changes in the form of the claim. These are questions for documentary verification. They should not be inferred from a supplier's receivables total, which can include private customers and invoices that are not yet due.

For recurring procurement, the strongest evidence of repair is not simply a temporary fall in old arrears. It is a sustained reduction in overdue amounts alongside normal delivery and timely settlement of new verified claims. A fall achieved by stopping essential procurement has a different economic interpretation. The appropriate comparison retains service provision, new commitments and payment performance together, making the budget constraint visible at the point where obligations originate.

Scope and conclusion

The report's numerical accounts are controlled examples, not estimates of provincial budgets or a forecast of China's fiscal path. Its actual evidence spans 2024 budget and property observations, 2025 policy and regional assessments, and the IMF report published in early 2026. These sources establish institutional and historical conditions. They do not provide complete current creditor-level records, consistent commercial valuations of local assets or an independently verified national supplier-arrears stock.

Within those limits, the main conclusion is clear. Local debt conversion should be evaluated as a change in funding terms and recognized responsibility, then connected to recurring resources and outside creditor cash flow. A lower coupon can create genuine relief. A maturity extension can reduce a near-term funding peak. Supplier settlement can release working capital. None of those effects independently establishes that the local public sector's assets and revenues can support its continuing responsibilities.

Durable repair is demonstrated when the same accounting perimeter shows funded services, sustainable operating arrangements, declining verified arrears and a credible principal schedule without renewed hidden commitments. That standard recognizes the value of refinancing while distinguishing it from the broader work of restoring viable public and private balance sheets.

Source addresses

The links below retain the source addresses cited in the analysis. References should be read within their stated periods and scope.

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