

Anti-corruption: trillions at stake

Quick Note

Look out for the next pleasant surprise from anti-corruption...

So far, we have seen the negative impact of anti-corruption on a range of consumption proxies globally. We have also seen anti-corruption helping to lift margins among a large group of China SOEs during interim results. We wonder if at some point anti-corruption will also bring a pleasant surprise in the form of filled-up fiscal coffers at the central and local governments. *Phoenix Weekly* reported (26 Feb 2014) that proceeds recovered from criminal and civil cases have long been used to fund local judiciary institutions, with the exception of the likes of Beijing and Shanghai. The article cited a poverty-struck county that once assigned a corruption case to trial which ended with the seizure of CNY20mn in illegal proceeds subsequently used to fund the county's much needed office building. Our anecdotal checks reveal that for cases involving cooperation among various local and central governments, distribution of any recovered funds has largely been based on negotiation among the governments involved.

... a billion here, a billion there

In the *Report on the Work of the Supreme People's Procuratorate* (8 May 2014), the government disclosed that there were 2,581 corruption cases valued at CNY1mn or above in 2013, resulting in recovery of CNY10.14bn in illegal proceeds. *Reuters* reported on 30 Mar 2014 that Chinese authorities had seized assets valued at at least CNY90bn related to the Zhou Yongkang case. *Oriental Daily* reported on 1 Jul 2014 that Xu Caihou had turned in CNY1bn-plus of illegal proceeds and may have another HKD10bn tucked away in Hong Kong. We note that reported corruption cases have occurred in some well-oiled sectors, including the military, coal, energy and utilities. With Beijing expanding investigations into local governments' past land sales and the financial space, on top of the SOEs, total seized assets will likely rise. Hypothetically, if 3% of China's GDP since 1995 went to corruption, this would total CNY4tn, assuming the amount was compounded at the modest PBOC 1-year benchmark savings rate and a 25% recovery rate. We note the actual amount could be even higher considering the decade-long bull market in various assets.

So, perhaps the LGFV risk is not so unmanageable after all?

While the distribution of seized illegal gains among central and local governments would be subject to technicalities, we are talking about a lot of money that could help to fix quite a few problems. China's fiscal income was CNY12.9tn and fiscal deficit was CNY1.1tn in 2013. As of end-June 2013, the balances of China's local government funding vehicle (LGFV) and local government debt were estimated at CNY7tn and CNY10.9tn, according to the National Audit Office. While family members have been allowed to retain illegal proceeds in cases where the official(s) involved are deceased or out of jurisdiction, we expect tougher efforts by Beijing to seize all illegal gains under the new *Code of Criminal Procedure* effective in 2013, the Ministry of Public Security's "Fox Hunting 2014" project and the APEC anti-corruption network established in August 2014.

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Fig. 1: Scenario analysis for possible recovery of the illegal proceeds from corruption

From 1995 to 1H14

(CNY bn)		Recovery rate				
		10%	15%	20%	25%	30%
Corruption as % of GDP	1.0%	546	818	1,091	1,364	1,637
	1.5%	818	1,228	1,637	2,046	2,455
	2.0%	1,091	1,637	2,182	2,728	3,274
	2.5%	1,364	2,046	2,728	3,410	4,092
	3.0%	1,637	2,455	3,274	4,092	4,910
	3.5%	1,910	2,864	3,819	4,774	5,729
	4.0%	2,182	3,274	4,365	5,456	6,547
	4.5%	2,455	3,683	4,910	6,138	7,366
	5.0%	2,728	4,092	5,456	6,820	8,184

Source: Wind data, Bloomberg data, Nomura research

Note: We assume constant corruption and recovery rate throughout the years starting from 1995 when SOE ownership reform was first implemented in a large scale. We assume that the corrupted amount be compounded at PBOC 1-yr benchmark saving rate.

Fig. 2: PBOC benchmark household savings deposits 1-year rate

Year	%
1995	9.15
1996	7.47
1997	5.67
1998	3.78
1999	2.25
2000	2.25
2001	2.25
2002	1.98
2003	1.98
2004	2.25
2005	2.25
2006	2.52
2007	4.14
2008	2.25
2009	2.25
2010	2.75
2011	3.50
2012	3.00
2013	3.00
1H14	3.00

Source: Bloomberg data

Appendix A-1

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