Asia Pacific Science Press

Asia Pacific Economic and Management Review
ISSN(O):3005-9275
ISSN(P):3005-9267
Vol. 2 No.2 (2025)

The Triple Direction of Local Government Debt Governance in the Perspective of Government Credit

Shukun Liang*

School of Law, University of Washington, Seattle, WA 98105, USA

Corresponding author: Shukun Liang, ShukunLiang456789@163.com

Abstract: With the rapid development of my country's economy and society and the deepening of fiscal system reform, local government debt issues have increasingly become an important factor affecting national fiscal security and regional economic stability. Based on the value connotation of local government debt governance from the perspective of government credit, this paper proposes innovative paths to improve local government debt governance from the aspects of strengthening top-level design, promoting debt management system reform and implementing talent introduction, aiming at the problems of mismatching financial power and administrative power, the need to improve the debt management system and the shortage of relevant professional talents in the current governance of local government debt. This paper provides some references for the modernization of the local government debt governance system.

Keywords: Debt Governance; Government Credit; Local Government

Published: Apr 9, 2025

DOI: https://doi.org/10.62177/apemr.v2i2.233

Introduction

In the current process of my country's economic and social development, local government debt governance has become an important issue that needs to be solved urgently. With the deepening of the economic and fiscal system reform process, the scale of fiscal expenditure of local governments, as a key component of the national governance system, continues to expand, and the debt problems accumulated in this process have become increasingly diverse and complex. With the diversification of local financing channels and the continuous growth of debt volume, exploring reasonable governance paths to effectively control fiscal risks and maintain the stability of regional economic operation and the sustainability of social development has become a core issue of common concern in academia and practice.

Government credit is the credit capacity of government entities to perform their duties and administrative commitments based on contractual relationships. Its core framework includes composite parameters such as the ability to abide by public commitments, the accessibility of governance information, the expected stability of governance behavior, and public value orientation. Government debt is generated based on financing activities endorsed by direct or indirect government credit. New government debt provides a new path for the government to obtain sufficient financial resources to achieve its main functions and goals. The complementary relationship between government credit and government debt determines that when government credit expands disorderly, government debt will inevitably increase , accompanied by government debt risks. Therefore, in order to improve local debt governance within the framework of government credit value, it is necessary to systematically build a legal debt management framework, relying on mechanism innovations such as process standardization, information disclosure, and clear rights and responsibilities, and ultimately form a long-term prevention and control mechanism for debt risks.

Based on the actual operating background and key issues of local government debt governance, this paper systematically analyzes the innovative mechanism of debt governance under the government credit framework, constructs a debt management paradigm that adapts to the modern fiscal system, and proposes a feasible plan for strengthening the construction of the government credit evaluation system.

1.The value connotation of local government debt governance from the perspective of government credit

1.1 Ensure stable growth of local economy

Excellent government credit is reflected in the institutional norms, information transparency and sense of responsibility of local administrative entities in the process of debt. This positive credit representation can not only strengthen the resource allocation efficiency of the public sector in the capital market, but also significantly narrow the financing spread, thereby forming a positive incentive mechanism in expanding the investment and financing channels of public utilities. By building a systematic debt governance mechanism, the public finance department can improve the efficiency and precise allocation of fiscal resources, thereby providing continuous and stable value support for infrastructure construction, people's livelihood services and industrial transformation in the jurisdiction. In the context of macroeconomic pressure cycle and tight fiscal balance, a sound debt regulation framework can promote the coordinated evolution between short-term fiscal pressure relief and medium- and long-term economic momentum cultivation, ensuring the resilient development and quality and efficiency upgrade of the local economic system.

In the operation of the modern financial system, the stability of government credit and the predictability of the policy environment are the core support for market efficiency. The establishment of an institutionalized debt management system and a transparent debt information disclosure framework by local power institutions can effectively strengthen the trust and consensus of the public and economic participants on fiscal policies, thereby enhancing the competitive attributes and trading vitality of local bonds in the capital market. When regional governments rely on standardized debt management mechanisms and good credit records to gain recognition from investors, they can more efficiently allocate financial instrument combinations in financing practices, effectively reduce the risk compensation rate of debt financing, and promote the rationalization of debt structure and the improvement of resource allocation efficiency.

1.2 Standardize local government debt management

The conceptual dimension of government credit involves not only the contractual capacity and self-discipline of public authorities in debt repayment, but also the principles of rule of law and institutional norms in the process of debt regulation. When local authorities maintain credit ratings by building a sound credit evaluation mechanism and a standardized debt management system, their administrative behavior will inevitably reflect the rigid adherence to the rule of law framework and policy system. Institutional regulations can effectively curb the problems of disorderly debt, institutional breakthrough debt and leverage overweight that may arise in the financing activities of administrative entities, and promote the standardization of local government debt management and rational decision-making behavior. The construction and maintenance of public power credit essentially constitutes an endogenous incentive transmission system, which prompts administrative entities to strengthen the concept of rule of law and institutional boundary cognition in debt regulation, and ultimately realize the scientific and standardized operation of the debt governance system.

Based on the existing fiscal management framework, the systematic construction of the local fiscal credit system can not only optimize its credit qualification evaluation effectiveness in the open market, but also deepen the strategic recognition and consensus of market players on government debt management. Through the coordinated operation of standardized debt management mechanisms and systematic information disclosure platforms, the public sector can not only significantly improve the transparency and management credibility of debt management, but also promote the continuous improvement and development of the trust mechanism between entities.

1.3 Enhance social trust in local governments

The key criteria for the public to evaluate the government's public behavior norms and social benefits are rooted in the credit awareness and repayment guarantee level demonstrated by the administrative body in the debt management process. By building an institutionalized debt supervision framework and a systematic fiscal coordination plan, the local government credit system is dynamically optimized and upgraded, thereby forming a social consensus on policy implementation strategies and social development directions. This credit construction result can improve the execution effectiveness and institutional authority of debt management, and can also enhance the public's understanding and support for the policy system, building a solid social recognition foundation for regional public services and governance innovation.

The effectiveness of public credit ratings and the trust expectations of governance entities form a significant linkage relationship, which is reflected in the regional debt governance framework as a transmission mechanism of credit evaluation indicators to social cognition. Good credit qualifications can enhance the credibility expectations of social groups for fiscal risk management and control, and then promote the formation of institutional recognition and coordinated response to the public sector's debt disposal capabilities. Through the construction of a standardized credit assessment mechanism, administrative entities can strengthen the public's scientific recognition of fiscal decision-making and promote the construction of a behavioral decision-making model based on rational cognition. The trust coordination mechanism built on the public credit expectation guidance framework can systematically resolve the society's systematic concerns about local debt pressure and create a stable consensus basis and implementation conditions for the construction of fiscal risk prevention and control systems and the practice of regulatory plans.

2.Challenges of managing local government debt from the perspective of government credit

2.1 The mismatch between financial power and administrative power still exists

Under the framework of the division of fiscal powers, the key sources of revenue for the provincial fiscal and taxation system mainly rely on the vertical transfer payment mechanism coordinated by the central government and special fiscal subsidies. China's Budget Act established the tax-sharing system in the early 1990s, shaping the central-local fiscal and taxation structure that continues to this day. Due to the institutional restrictions on tax autonomy, local governments find it difficult to establish a sustainable fiscal and taxation growth system. The current fiscal and taxation allocation mechanism concentrates high value-added taxes on the central government, while local tax sources mainly rely on value-added tax sharing, resource-based non-tax revenues and scattered taxes. Compared with the social governance and public affairs responsibilities assumed by local governments, their fiscal resource allocation presents a significant asymmetric feature of power and responsibility.

Under the framework of contemporary social governance, the power and responsibility structure of local administrative organizations shows multi-dimensional and complex characteristics, especially in core areas such as economic planning and social governance coordination, long-term operation and maintenance of infrastructure, and basic guarantee of public services, which have derived multiple basic governance functions. It is worth noting that the widespread problem of misallocation of fiscal resources in the process of policy implementation will cause continuous tension between functional expansion and budget limits. From the perspective of expenditure structure, local finances continue to tilt towards key projects such as new project maintenance, social security system efficiency improvement, and ecological environment system improvement. The fixed expenditure attributes of such projects have a significant antagonistic effect on the demand for scale expansion.

2.2 Local government debt management mechanism needs to be improved

Although the current local debt management system framework has been improved by the central government through the issuance of a number of normative documents, its system structure still lacks full-cycle management elements and insufficient system connection. In core areas such as debt financing, fund utilization, debt repayment and supervision mechanisms, the practical guidance and binding effect of current regulations are relatively limited, causing local governments at all levels to face problems such as inconsistent implementation standards in practical operations. In particular, in terms of the scope of financing authority and the norms of fund investment, the vague definition and institutional vacuum of relevant clauses have objectively caused some local governments to have management disorder and illegal operations in debt control, exacerbating the accumulation and transmission effect of debt risks.

The country's current debt supervision framework is still based on macroeconomic regulation and administrative supervision at the central level, and lacks a refined tracking management and full-cycle dynamic monitoring mechanism for local fiscal entities. In the practice of fiscal budget execution and risk prevention and control, it is difficult to achieve three-dimensional supervision of local debt operations with full coverage of the process, especially for non-standard financing behaviors such as off-balance sheet liabilities. The current system has significant structural defects and monitoring vacuums. Due to the lack of a sound systematic supervision framework and risk pre-identification system, the illegal borrowing and misappropriation of funds by local fiscal entities cannot be timely checked and balanced through the existing mechanism, which ultimately leads to a hierarchical accumulation of debt risks, significantly increasing the complexity of overall governance.

2.3 Implicit transfer of local government credit

As an institutional exploration to alleviate the debt problem of local governments, non-traditional investment and financing models involve multiple parties in their operation. Among them, the participation mode dominated by platform companies has greater legal risks. The core lies in the implicit transfer of local government credit, which indirectly leads to medium- and long-term fiscal expenditure responsibilities and new debts.

First, the non-independence between platform companies and local governments is the core source of risk. Most platform companies undertake the functions of infrastructure and public services in their regions. Their debts have the attributes of municipal bonds, and they are highly dependent on local governments in terms of capital structure and personnel arrangements. Even if local governments are expressly prohibited from providing a guarantee, society generally expects that the government will "rescue" them, thus forming an implicit guarantee, making it difficult to break the rigid payment.

Secondly, the legal risk extends to non-traditional investment and financing practices such as the "PPP model" and the "ABO model". Local governments circumvent the provisions that platform companies cannot replace government debt through the Government Procurement Act and construct civil legal relations with government procurement contracts, which is essentially similar to a gambling agreement, that is, if the platform company fails to achieve the performance target, it will not be repaid, and the government will not bear the bottom line responsibility. Subsequently, the platform company and social capital jointly established a project company to promote the project, which appears to be in line with the market principle, but in fact it is often not truly market-oriented in economically weak areas. Once the platform company defaults or goes bankrupt, whether the government provides financial assistance will directly affect the increase in debt. From the perspective of social capital, its investment willingness is more based on the expectation of "implicit guarantee" from local governments rather than confidence in the return of the project itself. In addition, most projects use land transfer income as the core source of funds, implement rolling development and closed operation, amplify the leverage effect, and aggravate local debt risks. Therefore, although the design of the non-traditional investment and financing system is aimed at achieving a legitimate and moderate expansion of local government credit, due to the interweaving of the non-independence of platform companies, regional market differences and operational risks, it has led to the re-increase of local government debt and further implicit transfer of credit in practice.

3.Improvement of the path to manage local government debt from the perspective of government credit

3.1 Strengthen top-level design and improve the matching degree between financial power and administrative power

In the process of promoting the reform of the fiscal power and responsibility system, it is necessary to coordinate the systematic empowerment and institutional norms of local fiscal governance authority. The central level needs to improve the system architecture of the tax-sharing reform and orderly expand the autonomy of local tax governance and fiscal adjustment authority. For example, the Budget Act gives local governments the power to set debt ratios. At the same time, efforts should be made to implement tax structure reform, flexible adjustment mechanism for income distribution, and optimization of transfer payment efficiency to effectively enhance the long-term support capacity of local finance and the economic risk resistance efficiency. For regions with weak development foundations, efforts should be made to improve the spatial balance and rational allocation of fiscal transfer payments, and help local governments build a public service supply guarantee system and a long-term income support mechanism for regional development. At the same time, local governments should be supported to promote the diversification of tax sources and the construction of innovative revenue increase mechanisms in accordance with the law, and systematically improve the financial source cultivation system to improve the level of comprehensive fiscal governance.

In order to strengthen the matching of fiscal power and responsibility, it is urgent to systematically build a legal framework and policy coordination mechanism for local debt governance. The central government should regulate the local debt management chain through legislation, and strictly define the statutory responsibilities of debt-raising entities in financing planning, fund utilization, principal and interest repayment, and process supervision. Relying on the legal norms system, the whole process of local financing behavior should be uniformly constrained, and the use of debt funds and risk disposal mechanisms should be precisely regulated to ensure that debt operations are on a standardized and legal track. It is necessary to simultaneously improve the binding institutional arrangements for local government debt financing, build a central-local coordinated supervision framework, and form a hierarchical governance structure with power and responsibility matching through the functional interface.

3.2 Improve local government debt management mechanism

It is necessary to establish a standardized local debt management system framework at the central level, and clearly divide the power allocation and functional scope of different administrative entities in debt governance. It is recommended to establish a professional debt regulatory agency to coordinate the formulation of financing plans, debt repayment stress testing, data governance standards and repayment process optimization. By improving the management agency structure and operating mechanism, the coordination and implementation effect of local governments in debt risk management can be effectively strengthened. At the same time, a multi-department collaborative network and data sharing system can be established to strengthen the dynamic coordination of financial, auditing and financial regulatory departments in the field of debt monitoring, and build a full-process supervision chain covering the establishment, approval and execution of financing projects, thereby achieving structural optimization and efficiency improvement of the debt risk prevention and control system.

Build a budget control and performance management system covering the entire life cycle of government debt, and integrate financing matters into the fiscal budget management system. Through dynamic control of the entire process of budget compilation, implementation, approval, and supervision and review, accurately constrain the circulation path and compliant use of debt funds. In the budget compilation and review stage, government departments need to formulate an annual plan for special debts, fully disclose the financing scale, expenditure scope, and debt repayment mechanism in accordance with legal procedures, and achieve three-dimensional integration of debt budget and fiscal development strategy. Establish a supporting debt full-cycle performance evaluation framework to systematically evaluate capital operation efficiency and economic and social benefits. Based on the quantitative indicator assessment system and intelligent monitoring platform, dynamically identify the core nodes of debt risk, optimize the financing portfolio and risk management mechanism in a targeted manner, and significantly improve the efficiency of public resource allocation and the level of modernization of fiscal management.

3.3 Strengthen supervision of implicit transfer of local government credit

Government credit not only reflects public confidence, but also concerns fiscal order and market rules. Once government credit is implicitly transferred to platform companies, it will not only distort market behavior, but may also lead to the increase of local government debt and the spread of related risks. Therefore, the control of implicit transfer of local government credit should be strengthened from the two levels of internal supervision and external supervision. Internally, a long-term mechanism of “penetrating review” should be established and improved. Independent review agencies such as the resident commissioner’s office of the Ministry of Finance and the local special office of the National Audit Office have a good foundation. In the future, the review content can be further refined and divided into formal review and substantive review. The former focuses on identifying whether the project is guaranteed in disguise through letters of commitment, letters of knowledge, etc., while the latter needs to include the entire process of investment and financing projects in the field of vision, focusing on the rolling development arrangements and funding sources in the project establishment stage, whether the funding allocation during the project implementation violates the agreement, and whether there is a disguised guarantee of fiscal funds. For projects with large investment amounts or long cycles, a regular review mechanism should be implemented, and the results should be compared and evaluated with the initial goals during the project delivery stage. If deviations are found, they should be rectified within a time limit, and local governments are prohibited from using fiscal funds to settle project funds on their behalf. Even if platform companies face legal risks, in the long run, it will help eliminate companies with insufficient operating capabilities and promote market clearing. In terms of external supervision, the market-based judgment mechanism of social capital should be strengthened. The current credit rating system of platform companies mainly focuses on their debt repayment ability, ignoring the degree of marketization and entity. In fact, whether platform companies are truly market-oriented and whether they can decouple from the government is the key to getting rid of implicit guarantees. Therefore, the marketization degree of platform companies should be included in the rating system to guide social capital to make investment judgments based on real market risks, thereby weakening irrational expectations of government guarantees and promoting the return of local government debt management to the track of norms and the rule of law.

4.Conclusion

Promoting the modernization and transformation of the local government debt governance system is a multi-dimensional system project, covering the continuous optimization of institutional frameworks and policy tools, and also involving the coordinated innovation of governance capabilities and technical means. From the perspective of government credit construction, establishing a scientific, standardized and efficient local government debt management mechanism is considered to be the core support for ensuring the steady development of the regional economy, building a solid financial security barrier and improving the government credit ecology. It is necessary to adhere to the dual-wheel drive of institutional innovation and governance capacity improvement, continuously improve the new governance model that fits the actual national conditions, and promote the modernization of the local government debt governance system to achieve a qualitative leap.

Funding

no

Conflict of Interests

The author(s)declare(s) that there is no conflict of interest regarding the publication of this paper.

Reference

[1] WANG L, SHA Y, DING L, et al. Risk mitigation strategies in urban investment bonds: Insights from local government implicit debt governance[J]. STRUCTURAL CHANGE AND ECONOMIC DYNAMICS, 2024,70: 607-618.

[2] ZHU J, ZHU M, YANG Z. The financialization of local government debt in China and its risk transmission to commercial banks[J]. ECONOMIC MODELLING, 2024,133.

[3] TAO K. Assessing Local Government Debt Risks in China: A Case Study of Local Government Financial Vehicles[J]. CHINA & WORLD ECONOMY, 2015,23(5): 1-25.

[4] WEN X, LI W, SHEN Z. Local government debt and corporate asset-debt maturity mismatches: Evidence from China[J]. CHINA ECONOMIC REVIEW, 2024,88.

[5] WU Y, TIAN C, WANG G. Local Government Debt and Corporate Investment Behavior in China : Real versus Financial Investment[J]. SUSTAINABILITY, 2023,15(22).