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# Research on the Operating Transformation of Local Government Financing Platforms

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**ABSTRACT**
Due to the current policy, the financing behavior of the government financing platforms has been greatly constrained despite their significant contribution to the growth of local economy. In this context, the paper puts forward the transformation path and specific strategies for local government financing platforms based on the analysis of the relevant literature. Firstly, this paper reviews the early literature related to government financing and debt, and extracts the phased conclusion that the change of productivity and the way of use resource determine the significance of government financing. Then, the paper explores the development, operating risks, transformation paths, and strategies of financing platforms. The research finds that actively investing in new infrastructure and new regions and introduce private capital can help optimize the traditional business direction of the financing platforms. What's more, some measures can optimize the management mechanism of the financing platforms, such as bringing the government into the assessment, involving the supervision of the People's Congress, and strengthening performance management.

***Keywords:*** *local government financing platforms, operating model, transformation strategy.*

## 1. INTRODUCTION

The local government financing platforms have solved the dilemma that the local government cannot legally finance from financial institutions in a certain period and made brilliant contributions to urban construction. However, in recent years, with the increasing saturation of urbanization and the change of industrial environment, government financing platforms with traditional operating model have exposed many problems in such a new environment. Firstly, the financing platforms face huge debt. According to the data of the Ministry of Finance of the People's Republic of China, the debt scale of local government financing platforms has reached 23.4 trillion yuan, showing an expanding trend. This problem reveals the low operating efficiency of the financing platforms and a low level of investment income. Secondly, according to the new national policies and regulations of regulatory authorities, the projects that can be undertaken by the financing platform have declined year by year.

In this context, this paper focuses on literature research and explores the transformation path and strategy of the business model of local government financing platform.

## 2. THE VALUE AND SIGNIFICANCE OF GOVERNMENT FINANCING

Financing platforms are the main channel for local governments to obtain financing. Summarizing the relevant research on government financing platform and refining its value and significance can lay a solid theoretical foundation for subsequent research.

### *2.1. Early economists' negative opinions of government financing*

Adam Smith believed that the government's responsibilities could be summarized as protecting social order, protecting social (national) boundaries, and building public facilities. Obviously, none of the three functions can directly provide economic returns. Therefore, financing that serves government functions would also fail to follow economic principles to earn an investment return higher than the financing principal.

Marx also criticized the government debt of feudal countries. He believed that the government (countries in the Middle Ages) was an irreconcilable product of class contradictions and a tool to exploit the working class on behalf of the ruling class. For the purpose of maintaining and enhancing its own power, the government was bound

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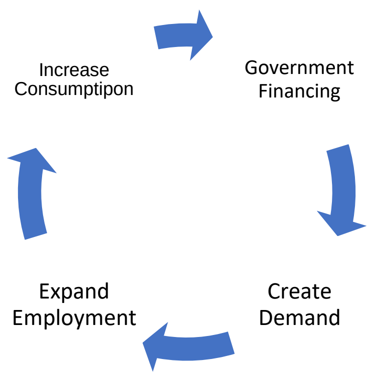
to expand fiscal expenditure and employed every conceivable means like taxes and government debt to increase national revenue. However, the government at that time was not the main body of production, and the financing obtained was mainly used for war and employ public officials. When social resources consumed in such fields, the capital accumulation could not be formed, which has a negative impact on reproduction.

Based on the comprehensive analysis of Adam Smith and Marx's views on government financing, it is found that the early economists had a negative evaluation of government financing. The reason was that the government in that period focused more on the interests of upper classes, military and diplomatic responsibilities but pay less attention to such economic construction, industrial upgrading, and employment.

### *2.2. Keynesianism and government debt*

From the late 1920s to the early 1930s, the U.S. fell into an economic crisis due to overcapacity and unfair distribution. Later, Roosevelt launched the "Three R's of New Deal" and issued more paper dollars. With the new currency, the Roosevelt government expanded infrastructure investment and promoted residents' employment. The purchasing power of unemployed residents who gained income increased significantly, and the consumer market was injected with vitality. The market demand further drives producton,thus restart the virtuous cycle of the U.S. economy.

People have different opinions on the theoretical origin of Roosevelt's New Deal, but the pragmatism coincided with Keynesianism. Keynes assumed that macroeconomy affects individual behavior, aggregate demand is the key factor of determining production and employment, and fiscal and monetary policies can serve as the tool to stimulate demand. Based on Roosevelt's New Deal, this paper briefly summarizes this idea in the following figure:




Economic Cycle

**Figure 1:** A brief analysis of Roosevelt's New Deal and Keynesianism

Figure 1 illustrates the ideological core of Keynesianism and regards the government financing node as the driver of the economic cycle. By extrapolating clockwise, it can be found that government financing can create social demand after entering the market. The increased social demand will inevitably expand employment, and residents' income will increase accordingly. Residents with higher income will spend money buying food, clothing, and housing so that the problem of overcapacity will be alleviated.

The criticism against Keynesianism has never stopped. However, in practice, the U.S., Japan, Europe, and other developed countries have adopted Keynesianism at different stages. The government financing, debt, and other financial measures emphasized by Keynes have also been applied in all mainstream schools. According to the data of fecn.net, by the end of 2018, the global government debt ratio had reached 69.3 trillion dollars, accounting for 82% of the global GDP in the same year. By the end of 2019, the debt ratio of major countries further increased, as shown in the following table:

**Table 1:** Government balance sheet of major countries

| Countries | Debt ratio | Countries | Debt ratio |
|---|---|---|---|
| U.S. | 106% | India | 69% |
| EU | 80% | Brazil | 92% |
| Japan | 238% | China | 38.5% |

## 3. THE DEVELOPMENT MODEL AND OPERATING RISKS OF LOCAL GOVERNMENT FINANCING PLATFORMS

Local government financing platforms are not only an intermediary channel for government financing, but also an enterprise aims for developing infrastructure projects. Such platforms can repay or replace the existing debts through land appreciation and company operation, they also can solve liquidity problem by finance from financial institutions or direct finance in the open market.

### *3.1. Development model of local government financing platforms*

The development model of local government financing platforms in China can be observed from macro and micro perspectives. From the macro perspective, Yao Yang believed that government finance is the lifeblood of government operation. The development of local government financing platforms provides local governments with financing channels that are separated from the central fiscal and tax management. This phenomenon occurs because the central finance in the 1990s could not provide the funds needed for local construction. Yang Feihu and his coworkers made a comparative analysis of six financing platform operation models from a micro perspective. The study showed that the development model of local government financing platforms can be defined as the operation mechanism in which under the leadership of the government, the land is exchanged for financing to develop infrastructure construction, thus driving land appreciation[1].

Based on the previous research results, this paper simply summarizes the development model of the local government debt platform as a business model of gaining income through land appreciation to develop local urban construction under the guidance of the government will. Details are shown in the figure below:

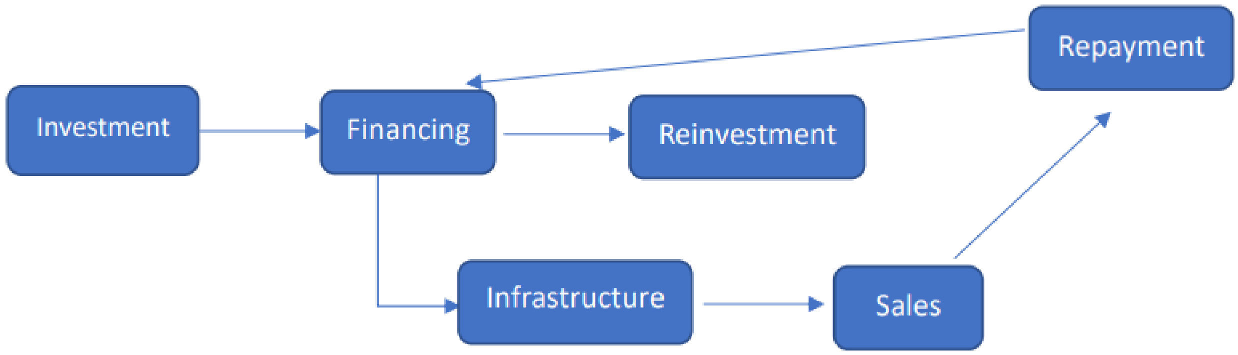



**Figure 2:** Development model of local government financing platform

### *3.2. Operating risks of financing platforms*

Government financing has been faced with two inevitable challenges, namely, difficulty in principal and interest repayment and keeping low inflation rate. However, the government financing model with the financing platform as the channel can repay the financing through land appreciation and asset operation, and those finances based on enterprise liabilities do not need additional currency issuance. In this way, the main problems of government financing seem to be under control, and investment income and sustainability have gradually become the main indicators to evaluate the financing risks of the platforms.

After the implementation of the "Four Trillion" economic stimulus plan, Wu Jinglian proposed that excessive monetary investment would result in resource mismatch and the occurrence of a large number of invalid projects. Yang Yan also believed that local governments are the leading entity of local government financing platforms. If some projects of the financing platforms cannot repay the financing in time, the government needs to use local financial funds to compensate the project deficit. Thus, the corporate default risks will become government default risks[2]. Liu Hao compared and analyzed the main risks of local government financing platforms based on 50 samples. The investment structure in the samples shows that only 22% of the platform finances used for operation projects that can generate cash flow and only 12% for the land arrangement and development that available for sale. Other investments are all kinds of public facilities that have difficulty in obtaining economic returns and require tremendous in maintenance costs. This investment structure will decrease investment income and increase operating risks[3].

According to the results of previous studies, this study summarizes the main risk of local government financing platforms as the risk of capital chain break caused by the failure to connect products with market demand, as can be shown in the "Keynesianism model" in Figure 1. The study further obtains Figure 3：

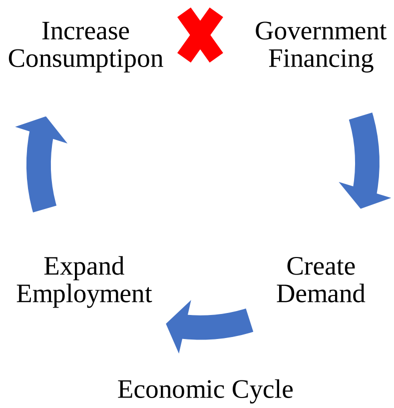



**Figure 3:** Risks confronted by local government financing platforms

Figure 3 is derived from the idealized government financing model in Figure 1. Based on the research conclusions of scholars, the study finds that the main risk faced by China's local government financing platforms is the failure to ensure the capital return and the long-term investment overstock in infrastructure projects.

# 4. TRANSFORMATION DIRECTION OF LOCAL GOVERNMENT FINANCING PLATFORMS

The main risk of local government financing platforms comes from loan default caused by the problem of overstocking and sluggish sales of products. In terms of this problem, this paper explores the future development direction of the financing platform in two aspects, namely, management mechanism and operation direction,in order to control the default risk.

## *4.1. Academic research on management mechanism*

In the study of the operation model of local government financing platforms, Yang Feihu and his coworkers pointed out that the market management mechanism of financing platforms in economically developed regions tend to be more market-oriented. While those in economically underdeveloped regions tend to be government-oriented.

Li Yining assumed that government supervision should be strengthened on local government financing platforms. The research pointed out that the local government financing platforms serve the local infrastructure and cannot be seperated from the administrative management. Local governments should take the main responsibility and implement more strict supervision on local financing platforms in combination with the performance evaluation [4].

Zhao Fang believed that No. 19 Document Issued by the State Council [2010] clearly defined the corporate attribute of local government financing platforms, and the promulgation of No. 43 Document Issued by the State Council [2014] further strengthened the independence of local government financing platforms. Based on the two documents, the financing platforms should gradually strengthen their independent legal entity status in order to fully implement corporate governance[5].

Local government financing platforms are mostly state-owned enterprises that have a close relationship with the local government. So based on this, central ministries, commissions, and regulatory departments should include local governments as the assessment subjects. This strategy can prevent local governments from evading the financing platforms default responsibility. It also can prevent local government from requiring the financing platforms to undertake non-profit projects.

## *4.2. Academic research on business direction*

In practice, local government financing platforms have exposed many problems. Hence, to deal with relevant challenges, domestic scholars also carry out research on transformation strategy from the perspective of corporate operation.

Wen Tiejun believed that China's economy has been plunged into the "three bubble crisis", involving the real estate bubble, debt bubble, and financial bubble. Since the city investment has become saturated, additional investment will inevitably lead to a decline in marginal revenue and increase the risk of the bubble burst. Given this situation, the local government financing platforms should shift their business direction to the countryside to obtain a large-scale unexploited market[6].

Chen Ping believed that the city investment bonds issued by the financing platforms have faced the risk of default. In the process of improvement, the government needs to ease the pressure on the financing platforms with the help of the Public-private partnership (PPP) model. In the traditional operating model, the financing platforms are the main provider of infrastructure investment. Hence, if there is any business risk, the financing platforms must bear the full amount. However, the PPP model can leverage social capital. Under this model, the financing platforms will be transformed into the project manager or participant so that the debt risk will be alleviated[7].

The basic principle of this business direction is to follow the law of scientific and technological development and invest major resources in new industries and technologies.

# 5. TRANSFORMATION STRATEGY OF LOCAL GOVERNMENT FINANCING PLATFORMS

Government financing and investment should be performed mainly based on the development principle of production technology. According to the current objective environment, this paper puts forward the transformation strategy of local government financing platforms in six aspects, that is, investing in new technology industries, investing in new towns, adopting the PPP financing model, bringing the government into supervision, strengthening supervision, and improving operating efficiency. Details are shown in the following table:

**Table 2:** Development strategies of local government financing platforms

| Transformation objectives | Transformation paths | Transformation strategies |
|---|---|---|
| Transformation of business direction | Investing in new technology industries | 5G, charging piles, new energy network, etc. |
| | Investing in new towns | Towns around the city circle |
| | Adopting the PPP financing model | Change roles: Project management or trust investment; |
| Transformation of management mechanism | Bringing the government into supervision | Include the debt of the financing platform in the government debt; |
| | Strengthening supervision | The local people's congress and the superior people's congress should bear the supervision responsibility; |
| | Improving operating efficiency. | Improve platform performance through financial reform. |

## 6. CONCLUSION

Based on the literature analysis, this paper summarizes and analyzes the academic views on the research of government debt and local financing platforms. The paper finds that the change of productivity and the way of financing are the main indicators to evaluate the significance of government financing, and the return on investment is the main factor to evaluate the local government financing platforms' performance.

The research shows that in the new era, the financing platforms should take 5G, charging piles, new energy network, and other projects as the main investment direction, the towns around the urban circle as the main investment area, and the PPP model as the main development financing mean. In the meantime, the debt of the financing platforms should be included in the government debt, and the local and superior people's congresses should be invited to conduct joint-supervision. Based on the internal performance reform, the financing platforms can realize the transformation.

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