

Study of the Impact of Fiscal Transparency on Local Government Debt

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Abstract: Since socialism with Chinese characteristics has entered a new era, the important task of reforming the fiscal and taxation system has been put on the agenda, and the report of the Twentieth National Congress proposes to accelerate the improvement of the modern financial and budgetary system, and it is necessary to establish a comprehensive, standardized and transparent budgetary system with scientific standards and strong constraints. This paper starts from the direction of standardization and transparency to study the problems related to fiscal transparency. We do empirical analysis and research on fiscal transparency and local debt scale, and finally conclude that there is not a single relationship between the two, but both promote and inhibit the effect. Finally, it puts forward relevant suggestions from the perspectives of fiscal transparency, proxy and budget constraint.

Keywords: Local Debt Scale; Fiscal Transparency; Proxy; Soft Budget Constraints.

1. Introduction

After the subprime crisis that swept the world in 2008, a considerable number of Nordic countries had sovereign debt problems, debt credit stratification, credit spreads widened dramatically, and eventually defaulted, resulting in the inability to repay or delayed debt repayment. Finally, each country in crisis through the purchase of national debt to solve the crisis, the essence of this practice is to convert national debt into currency. In the case of our country. Our local governments will adopt macro policies based on national instructions, through the issuance of bonds to finance debt, this measure will not only be conducive to local infrastructure construction, but also has an important impact on business investment and local economic development level. However, the status quo of excessive and continuous growth of local government debt and insufficient repayment capacity is not optimistic. The problem of local government debt in China is mainly caused by China's financial system, and local governments always try to utilize financing to solve the problem of insufficient funds. In addition, in 2008, the central government put forward the "four trillion" economic stimulus plan, although the economy has been recovered, but the scale of debt has also appeared in the spurt of growth. At the same time, the role of the government has not changed since the era of unlimited supply of low-cost labor, with its focus on promoting economic growth, which is clearly incapable of responding to the era of technological supply that requires the provision of socially necessary public goods.

2. Literature Review

2.1. Relevant Studies on Fiscal Transparency

With the reform of fiscal and taxation system in full swing, fiscal transparency has received more and more attention. The concept of fiscal transparency has not yet formed a completely unified consensus in the academic community, and the higher authority is proposed by Kopits and Craig (1998) and adopted by the International Monetary Fund IMF. At present, it seems that scholars pay more attention to the

economic consequences of fiscal transparency, Alesina et al (1999) found that countries with higher transparency have lower fiscal deficit rates; Yamamura& Kondoh (2013) studied Japanese prefecture-level municipalities from 1998-2004 and found that increased transparency can reduce fiscal expenditures in certain sectors, thus improving fiscal efficiency; Alt & Lowry (2010) empirically found that higher transparency in the U.S. can lead to larger fiscal size; while Li Yan, Wang Xiao (2016) subsequently concluded that increased transparency can effectively improve fiscal expenditure efficiency, and drew different roles for each of the overall and regional; Li Ying, Niu Yi (2014), and Li Jingtao (2016) all argued that increased fiscal transparency can effectively curb officials' corrupt behavior. From the Shanghai University of Finance and Economics has been releasing a more authoritative and complete "China Provincial Fiscal Transparency Report", China's current fiscal transparency is at a lower level, the average score of 2017 only reached 48.26, which shows the seriousness of the problem of governmental openness in some regions, but Xiao Peng, Yan Chuan (2013) has empirically proposed the path to improve the choice of fiscal transparency, and the governmental information disclosure must To solve the problem of financial performance, economic society, resource capacity and other factors on the impact of fiscal transparency.

2.2. Research on Local Government Debt

The scale of local debt is a problem that needs to be solved in China. The theory of local debt arose after the 1930s, Li Yonggang (2011) analyzed the debt problem from the perspective of its influencing factors and put forward some countermeasures to resolve the risk, including, improving the local tax system, strengthening supervision, etc.; on the expansion of the debt, Liu Ziyi, Chen Zhibin (2015), Liang Hongmei, Wu Guanyi (2019) used the provincial local government municipal bonds to find that the signaling of the internal incentives and external government governance pressures all have an impact on debt size, drawing the empirical conclusion that the degree of corruption, promotion incentives, and the level of economic development of the

region are positively correlated with debt size, and that fiscal transparency and the degree of fiscal decentralization are negatively correlated with it; Yu Yingmin et al. (2018) found that the degree of fiscal decentralization has an exacerbating effect on the risk of local debt with a comprehensive study of data; however, Lv Jian (2015) added liquidity into consideration, the study concluded that borrowing local debt can improve economic development through the construction of public resources, the performance of government officials and other aspects, but nowadays, borrowing new and repaying old has become an important means for localities to cope with the maturing debt, and this way will weaken the debt to the extent of reducing investment opportunities and scale, and slowing down the rate of economic growth.

2.3. The Relationship between Local Debt and Fiscal Transparency

Most of the foreign studies on fiscal transparency and local debt size conclude that fiscal transparency can reduce the size of government debt (Alt & Lassen, 2006; Arbatli & Escolano, 2015; Monters, 2019). From a domestic perspective, Pan Jun et al. (2016) added the impact of fiscal decentralization and fiscal transparency test on local debt financing, and also proved from the perspective of the source of officials that it can weaken the inverse effect of transparency and debt risk; Xiao Peng, Fan Rong (2019) found that there is in fact a non-linear relationship between fiscal transparency and debt size by using the panel data of 30 provincial provinces from 2009 to 2015, and the two The relationship shows an inverted U-shape and derives an inflection point, which strongly provides a more refined indicator for the government to deal with the debt problem. Ma Wentao and Zhang Peng (2020) suggest that the path of fiscal transparency on local debt size can be inhibited by macro-level countercyclical regulation and systemic risk.

3. Theoretical Foundations

3.1. Principal-agent Theory

The principal-agent problem is that in real life, due to information asymmetry, resulting in inconsistent or even completely opposite interests of the principal and the agent. Because the principal often lacks sufficient understanding of the agent's situation, it is difficult for the principal to have enough time and energy to supervise the agent's every move; and even if he has such time and energy, he may lack the necessary knowledge and skills, and thus be unable to effectively supervise the agent's behavior. In such a relationship, the agent may pursue his own goals at the expense of the principal. An arrangement exists whereby the principal-agent problem arises whenever the interests of one person depend on the behavior of another. A certain principal-agent relationship exists between the local and the central government, and between the local government and corporate citizens. Therefore, for reasons of personal and public interest and the complex principal-agent problem in local debt, local governments must improve their fiscal transparency to be accountable to the central government and the public. Moreover, the central government and the public should let the design make the interests of the localities linked to their own interests, the central government should introduce relevant policies to mitigate the consequences of the expansion of the scale of local debt due to the entrusted agent, and the public should also reasonably express their demands

and increase the supervision of local governments.

3.2. Budget Constraint Theory

The theory was first proposed by Hungarian economist Kornai in 1980, and the general meaning of budgetary soft constraint is that when an economy is in a state of loss, the superior or other external parties will directly give it funds to make it continue to survive. Kornai earlier thought that the theory of soft budget constraints was unique to socialist countries, but of course, in hindsight, this view is untenable, as the central governments of capitalist countries also bail out enterprises on the verge of bankruptcy. He regarded the state and the government as the father and the loss-making enterprises as the children, also known as "paternalism". In China's research, the scholar Justin Yifu Lin has made a more profound inquiry into the theory of budgetary soft constraints, and he opposes Kornai's view that privatization of enterprises can eliminate budgetary soft constraints, but on the contrary, privatization may aggravate the phenomenon of rent-seeking and lead to more serious problems for enterprises. In the case of local government debt, the local government is the budget constraint while the central government is the support body. To put it simply, the act of raising debt has many benefits for local governments, but the existence of budgetary soft constraints to a large extent makes the local government generally exists even if the size of the debt will also have the central government to cover the idea of a fluke, which strengthens the possibility of local blind debt behavior, resulting in an increase in the size of the debt. It is also not conducive to the optimal allocation of resources, and to a certain extent promotes government borrowing and extrabudgetary expenditures, leading to an increase in debt risk. Therefore, fiscal transparency requires strengthening supervision of local governments, reducing external borrowing, and enhancing hard budget constraints.

4. The Relationship between Fiscal Transparency and Local Debt Scale

This paper believes that fiscal transparency has a double impact on local debt, so this paper will start from fiscal transparency, from two theoretical perspectives to analyze the promotion and inhibition effect on the scale of local debt respectively.

4.1. The Promotion Path of Fiscal Transparency on Local Debt

Fiscal transparency is an important indicator to measure the health and rationality of government operation. At present, consumption, investment, import and export is the "troika" to promote China's economic development, investment is an important and indispensable part of it, when the fiscal transparency is improved, it will release positive signals, the market will get effective information, from the point of view of the principal-agent theory, enterprises, private banks and so on, will take the initiative to provide more investment to the government, and the economy will be accelerated. In the process of accelerated development, it may be more economical for the local economy to borrow money to finance public investment, and the operating costs of public services will be lower. The government will also have more incentives to finance more infrastructure construction, and take the initiative to build a better business environment for investment, which is usually financed by the government

through the issuance of local bonds, which in turn attracts more investment and contributes to the virtuous circle, and as a result, the size of the local debt will also grow appropriately.

4.2. Fiscal Transparency Inhibits the Path of Local Debt

From the perspective of principal-agent theory, the central government is the principal and the local government is the agent, and the central government entrusts the local government to manage local affairs. It can also be that the corporate public is the principal and the local government is the agent. Either way, there is bound to be information asymmetry between the local government and the other, the central government pursues the development of the whole, while the local is responsible for safeguarding the interests of the region, but it is impossible for the central government to have full access to all the information of the local government, so in the absence of fiscal transparency, the local government will expand the scale of the debt to pursue short-term economic development. On the other hand, local governments are largely able to utilize banks, including deposits, to raise debt, but when fiscal transparency improves, the public and businesses in the central government will increase their supervision of the government and reduce unreasonable loans.

From the point of view of budget soft constraint, when it is less than a certain value, when the local debt problems, the central government will use a series of means, such as transfer payments, to underwrite for the local, and the local government will not let commercial banks go bankrupt, so there will be a more adequate source of debt raising. When fiscal transparency is improved and supervision is strengthened, all these non-compliant practices will be reduced to a certain extent, and the over-indebtedness of local governments will also be reduced.

5. Conclusion

This paper starts from the current status quo of the huge scale of debt, puts forward the idea that it must be remedied, utilizes the principal-agent theory and the soft constraint theory of the budget, and puts forward the hypothesis, carry out the empirical research on the fiscal transparency and the scale of the local debt, and finally verifies the relationship between the fiscal transparency and the scale of the local debt. Main conclusions drawn.

First, the relationship between fiscal transparency and local debt scale is non-linear, i.e., fiscal transparency has both promoting and inhibiting effects on local debt scale. There is an inflection point in the relationship between the two, fiscal transparency is less than the inflection point, fiscal transparency will increase the size of local debt, and when it is greater than the inflection point, the size of local debt will be reduced with the improvement of fiscal transparency, this empirical evidence for the government to improve fiscal transparency to provide more theoretical support for research.

Secondly, the level of economic development has a positive moderating effect on the relationship between fiscal transparency and local debt scale, that is, the higher the level of economic development of a region, the more obvious the inhibiting effect of fiscal transparency on local debt scale. This suggests that localities should not only improve their fiscal transparency to be accountable to the public, but also continuously improve their level of economic development for the benefit of the public, so that government debt will not

be over-inflated.

6. Policy Recommendations

6.1. From the Perspective of Principal and Agent

Reasonable division of central and local rights and expenditure responsibilities. China has always had the problem of unclear financial and administrative rights between the central and local governments, and clarifying the responsibilities of the two is an issue that must be standardized in the current context. A good division of responsibilities between the two and their implementation is conducive to the overall situation of the government, and can well meet the new requirements of the modern financial and tax system. Although more autonomy to local governments can stimulate the vitality and enthusiasm of local governments, but give too much is more harm than good, China does not exist in the central and local checks and balances each other, the central government should be the right leadership, committed to solving the local economy in the emergence of new problems, new contradictions. For the local debt problem is not reasonable and standardized, not only can not protect the legitimate rights and interests of citizens, but also not conducive to the local government to effectively fulfill their responsibilities. Therefore, it is necessary to reasonably divide the central and local authority and expenditure responsibility.

6.2. From the Perspective of Budget Constraint

Regulate the debt raising behavior of local governments. From the point of view of local governments, local governments often borrowing is not very reasonable, to make the corresponding control and assessment of solvency, standardize the local government debt management mechanism to determine the size of local borrowable debt. Within the scope of the loan, to maximize the financing behavior of the local economic development to promote the role. Local governments should not be allowed to raise debt at will, but should establish a local standardized debt financing mechanism, and promote the rationalization and legalization of local financing.

Improve the transfer payment behavior of the central government. From the central government's point of view, the central government should avoid continuing to local debt underwriting, change and reduce the local transfer payments, should improve the efficiency of the use of funds, improve the payment structure, improve the transparency of the transfer payments, so that the use of each of the funds have a root cause can be traced. For local illegal debt, relevant documents and laws should be introduced, and appropriate punishment mechanisms should be adopted to curb the large and unreasonable debt of local governments, curb the scale of local debt, and prevent systemic risks.

6.3. From the Perspective of Financial Transparency

Improve government information disclosure regulations. In recent years, in order to protect the rights and status of citizens to be the master of their own house, the government has been paying more and more attention to the issue of information disclosure, and citizens also want to know more about matters concerning their own interests. Therefore, the government must be more proactive in disclosing information, expanding

the scope of disclosure, refining the disclosure regulations, and enhancing the transparency of all aspects of local affairs. Especially in finance, a large part of the local revenue sources are from citizens' taxes, which are taken from the people and must also be used for the people, and relevant laws and regulations should be improved to ensure that the people's right to know is effectively guaranteed, which also facilitates the people's supervision of the local government, thus making the finance more efficient.

Improve the local debt disclosure mechanism. Local debt was only published once in 2013 by the Audit Office, which shows that the transparency in this area is very low. The debt issue, as a controversial topic that has been in the limelight, is very necessary to be disclosed in a timely manner from the perspective of the attitude of the whole society. To further improve the local debt disclosure mechanism, the Ministry of Finance also put forward proposals on related issues in 2020, not only to promote the disclosure of local debt, but also to make a detailed plan on the scope of disclosure and so on. This behavior is important for the sustainability of local debt, and is conducive to solid investment and financing, driving local economic development. At the present stage, in order to curb the uncontrollable growth of local debt, it is necessary to publicize matters related to local debt and accept public supervision.

Strengthen the level and intensity of supervision. Improve the transparency of local finance can effectively improve the local control, improve the consciousness of the local government, so as to inhibit the impulse of large-scale debt, so as to reduce the scale of debt. But most of the local government financing for various reasons, including corruption, etc. may not be put into practice, so strengthen the supervision of local governments cannot be delayed, we must improve the construction of the relevant positions, increase the supervision of the strength and level, and strive to enhance the supervision of the work of the target, and effectively enhance the supervision of the work of the effectiveness.

In the central region, should improve the standardization and integrity of government supervision, strengthen their assessment and supervision, promote the adjustment of the structure of financial resource allocation and efficiency enhancement, so that financial transparency can effectively improve the quality of local government debt expenditure, to provide good public services for the development of innovative activities.

7. Research Shortcomings and Prospects

First, one of the shortcomings of this paper is not put forward innovation, basically in the scholars on the basis of the research again, the contribution is not great; Secondly, the data of this paper to find there may be insufficient, the conclusion of the regression is not persuasive enough, and control variables and the actual experience of the theory of some inconsistency.

Second, there are many factors affecting local debt, some important theories, including the theory of fiscal decentralization, as well as promotion incentives, internal and external factors are worth the further depth of the follow-up study, as well as the future policy to promote the relationship between the size of the debt and the fiscal transparency will

change this kind of financial issues need to continue to follow up.

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