Research on the Problems and Countermeasures of Local Government Bonds Issuance

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Abstract: Local government bonds issuance not only is an essential fiscal policy but also plays an important role in promoting the development of the local economy. However, the issuance of it is relatively prominent at present, which has increasingly attracted extensive attention from the theoretical and practical circles. Combining with the current situation of local government bonds issuance, this paper systematically elaborates on the necessity of local government bonds issuance, and sort out the main problems existing in the actual issuance process. Finally, effective countermeasures are put forward, aiming to provide useful references for future bond issuance and management.

Keywords: local government, bond issuance, supporting legal system, issuance and circulation system

1. Introduction

The issuance of local government bonds (hereinafter referred to as "local bonds") has a powerful driving effect on local economic development. Although the positive spillover effect of local bonds is significant, there are still problems such as imperfect pricing mechanisms and lack of supervision in the actual operation. To solve the above problems, it is necessary to build a complete bond supporting legal system integrating the actual situation of current bond issuance, select bond issuers prudently, and strengthen strict supervision over the use of local bond funds. Besides, the problems existing in the issuance process must be promptly corrected, to better play the role of local bonds in alleviating the pressure on grassroots finances and stabilizing the economy.

2. The necessity of local government bonds issuance

2.1 Help to accelerate the process of urbanization

With the rapid development of society and economy, local governments strive to improve the level of public services and strengthen infrastructure construction to meet people's demand for a high-quality life. To a certain extent, increasing the issuance of the local debt will help to accelerate the process of urbanization. The increase in the rate of urbanization and the expansion of the scale of cities have put tremendous pressure on urban construction investment and increased the economic burden on local finances. The local governments regard the issuance of bonds as the top priority of their current work, starting from their actual development level, which will help ease the pressure on project financing. At the same time, the issuance of the local bonds plays a significant role in preventing the occurrence of "unfinished projects", and promoting the sustainable development of the local economy.

2.2 Help to resolve debt risks

Issuing local government bonds is beneficial to standardize local government debt financing channels, resolve debt risks and curb systemic financial risks so that the government debt financing behavior will develop in a standardized and institutionalized direction. As the transformation of the socio-economic structure accelerates, the local government’s demand for financing is also increasing. The financing methods of relying on local investment and financing platforms make the implicit debt of local governments expand rapidly, which disrupt the smooth operation of the financing market. Under the dual factors of downward pressure on the economy increased and the novel coronavirus pneumonia epidemic, there are some effective choices to resolve the risk of local government debt, such as increasing the issuance of local bonds, improving the efficiency of the use of financial funds,
and regulating financing channels. Besides, it is imperative to strengthen local government budget management, conduct real-time supervision of the flow of fiscal funds, and solve problems in the process of debt financing.

2.3 Help to the perfect of financial markets

Not only does the issuance of local government bonds help to regulate the financial market to a certain extent, but it is also the key to ensuring the stable operation of the capital market. The local bonds have become an important part of the financial bond market as the scale of it increases day by day. It is widely acknowledged that the safety of local government bonds is higher than that of financial bonds, and the yield is significantly higher than that of ordinary treasury bonds. Currently, the social competition gradually intensifies and the investment demand also increases. For meeting the needs of social development, the investment needs should be optimized following the actual needs of current social development. Also, the issuance of local government bonds and the national debt should be organically integrated, which will be extremely important for the central government to implement macro-control and ensure the stable operation of the national economy.

3. Problems in the issuance of local government bonds

3.1 The relevant laws and regulations are imperfect

Commonly, the laws and regulations are imperfect in the issuance of local government bonds. In the process of bond issuance, the pricing of bond issuance is largely affected by non-market-oriented factors. In the actual operation process, because the relevant policies and regulations lack completeness, the regulation of the bond market is relatively limited, then the irregular operations occur from time to time. Additionally, because of the serious absence of specialized management agencies, investors cannot effectively protect their legitimate rights and interests during the investment process. Therefore, all aspects of bond issuance, rating, and circulation must be incorporated into laws and regulations for ensuring the smooth progress of bond issuance.

3.2 The issuance operation mechanism is unsound

The management method of local government in the bond issuance process is relatively traditional. The relevant management does not understand the relevant knowledge of bond issuance, so they cannot proceed from the actual situation of the current market economy development to conform to the development needs of the market discipline. Hence the unreasonable market behavior occurs occasionally. While optimizing the supporting investment projects of local governments, there are some uncertainties in their returns, and the responsibilities of relevant management departments are not clear. When assessing the returns of supporting investment projects, the assessment criterion is single, and the risk prevention mechanism has not been optimized according to the actual situation of the current government bond issuance market. Therefore, the operational risks are increasing during the bond issuance process. Furthermore, the investment pressure on investors will be huge, and their legitimate rights and interests cannot be effectively protected. Consequently, to comply with the current bond market issuance laws, a sound and complete supporting market operation mechanism must be established during the bond circulation process, and the development principle of market development laws are supposed to be upheld to ensure the smooth progress of government bond issuance.

3.3 The interest rate pricing mechanism is imperfect

The imperfect interest rate pricing mechanism is one of the problems in the development of government bonds. There are some differences in the transaction conditions between the primary market and the secondary market. In the actual pricing process, there is too much preference given to the primary market, so that the ratio between the two is not coordinated. In the process of bond pricing by local governments, the pricing mechanism is unsound. Meanwhile, the design of their interest rates lacking rationality, the investment interest from investors is difficult to increase. For example, when calculating the return on investment of local government bonds, it is not hard to see that if the bidding positions of government bonds are restricted, the average return on repayment bonds will fluctuate slightly within the specified time, at about 15%. More than this, the return on investment is gradually in a downward trend. When it comes to the credit ratings of local government bonds and national bonds,
the former is lower than the latter, thus it is unable to give full play to its advantages in the secondary market. Due to differences in the level of economic development between regions, different credit levels in regions have little impact on returns. Therefore, it is of importance to ensure the design of interest rates, and perfect the pricing mechanism following the actual development of the current bond market. Besides, governments are supposed to learn from excellent pricing experience actively, take the essence and discard the dregs to ensure that the issuance of local government bonds develops in a standardized direction.

4. Effective countermeasures to solve the problems in the issuance of local government bonds

4.1 Establish a sound and complete bond supporting legal system

Aiming at solving the problems in local bonds issuance, the primary task is to establish a sound and complete bond supporting legal system. There are several aspects mainly included in this legal system, such as reforming the budget law and optimizing the rights of local bonds issuance. There is one point that needs attention that the formulation of bond laws must be based on the actual conditions of local economic development.

To start with, the central government must focus on reforming the budget law and granting local governments the legal right to issue bonds to provide a legal basis for the smooth issuance of bonds. In the process of budget management, the supervision function of the budget is extremely important. In the actual operation process, it will be helpful to promote the stable operation of the economy by effectively integrating with the national macro-control to ensure the standardization of distribution. In addition, the new "Budget Law" promulgated in 2014 meets the actual needs of the legalization process of government financial management, but still existing a certain gap with the actual situation of current social development. At the same time, the promulgation of the regulations also has certain advantages and plays an active role in the prevention and control of local fiscal risks. For clearing away the obstacles on the road to local bonds issuance, the related departments require to perfect relevant regulations and optimize the budget law.

Secondly, it is of significance to establish a special system of laws and regulations for regulating local government bond issuance. In the process of bond issuance, some relevant bond management regulations can no longer meet the needs of current bond management work, also the lack and imperfections of relevant regulations have restricted the smooth implementation of bond issuance. It is necessary to consider the bond issuance comprehensively so that the development of the bond market is stable and healthy. Certainly, the difficulties and doubts in the bond issuance process must be dealt with in time and effectively, which will promote the development of local government bonds issuance in a standardized and institutionalized direction. The fund approvals, the scope of use, and risk control need to be incorporated into the laws and regulations by local governments to establish a sound legal system for local bonds so that the bond issuance operates gradually. Optimizing the functions of the local government and improving the transfer payment system are of vital importance in the process of establishing a sound legal system for bonds. The establishment of the legal system requires to scientifically distinguish the functions between the central and local governments while ensuring the rationality of the division, and focus on controlling the scale of local government debt. What’s more, governments should master the key expenditure investment projects and grant certain funding subsidies to areas with large funding gaps, to give full play to the advantages of public welfare investment projects. Besides, it will help to ensure the coordinated development of local government bond issuance that governments clarify their debt repayment responsibilities and powers. Finally, it must be emphasized that all the methods are always supposed to follow the market development laws.

4.2 Establish a sound and perfect bond issuance and circulation system

During the issuance of local bonds, a sound bond issuance and circulation system are supposed to be established to help to ensure the integrity of bond issuance. This mainly includes scientifically confirming bond issuers and bond interest rates, as well as focusing on expanding the scope of investment participants.

Firstly, during selecting bond issuers, the government must control the scale of bond issuance proceeding from the current market development laws and take advantage of the central approval system to regulate the issuance of local government bonds nationwide. The premise of the above measures is sure to uphold the scientific principles. Additionally, the uncoordinated links in the actual
management process shall be managed as a whole, the scope of bond issuance shall be defined, and the relevant behaviors of local government bonds issuance shall be verified by professional departments. Besides, the scale of bond issuance should be controlled and the local governments should effectively combine the fiscal revenues and expenditures with risk prevention.

Furthermore, it is the center of the work that determines the interest rate level and issuance period of local bonds. It is worth noting that the investors’ returns must be confirmed firstly, and the formulation of interest rate level must be fully integrated with the financial bonds and central government bonds, to ensure that the level is between the two. For this reason, we can analyze the needs of investors in the design of interest rate varieties. For example, the interest rates can be divided into fixed interest rates and floating interest rates, at this time, the risk appetite of investors can be divided into two types: risk aversion and risk preference. The former is more applicable to fixed-rate bonds, while the latter is more suitable for floating-rate bonds.

Finally, cultivating various forms of investment participants must be focused on. Governments ought to take advantage of institutional investors and the power of personal investment to regulate the secondary trading market, as well as do a good job in guiding and educating investors, which will help to regulate investors’ trading behavior and improve their anti-risk ability. Furthermore, governments require to take advantage of insurance companies to attract institutional investors to participate, and focus on the construction of local bond investment funds, which are managed by professional departments to accurately estimate investors’ returns. The institutional investment takes a large proportion in the process of local government bonds issuance, therefore, the relative department needs to start from the actual development of the current government bond market and carry out different forms of exchange forums concerning the main problems faced in the actual bond issuance to ensure the smooth progress of follow-up bonds issuance work.

4.3 Establish a sound and complete bond risk prevention system

A perfect bond risk prevention system ought to be established in the process of local bonds issuance, aiming at ensuring that local government bonds issuance develops in a healthy direction. The system mainly includes the establishment of a debt repayment mechanism, a credit rating mechanism, and an information disclosure mechanism.

First of all, a complete debt repayment mechanism should be established. It will be mainly divided into three phases. At first, in the initial stage of bond issuance, the fund-raising channels are supervised to ensure the rationality of the use of funds, and they are managed in a unified way. The income of a company is handed over to the department for budgeting, and the irregularities in the use of its funds are dealt with seriously. Secondly, the funds should be repaid timely. The establishment of sinking funds must fully consider the solvency of local governments and ensure their legitimacy. The final phase is focusing on strengthening communication and collaboration among departments, clarifying their responsibilities and powers, and planning a reasonable division of the responsibility system between the central and local governments.

Second of all, a complete credit rating mechanism is supposed to be established. Economic, legal, financial, and other relevant elements should be incorporated into the credit rating system. Local governments are supposed to formulate effective policies and regulations to correct irregularities in government bond management in time and conduct a real-time review of the behavior of credit rating agencies to prevent illegal operations. The relevant departments need to formulate strict industry quality standards for credit rating and optimize the rating process. Meanwhile, the entire process of bond issuance should be supervised in real-time, and bond ratings are supposed to be regularly disclosed so that investors' right to know could be ensured.

Last but not least, a complete information disclosure mechanism ought to be established. To a certain extent, it is the key to improving the transparency of local government debt. And this process needs the support of relevant policies and regulations to centralize and integrate the publicically disclosed information. The financial information and non-financial information ought to be divided reasonably, for avoiding the phenomenon of disclosing false information. The government and relevant departments should arrange for professionals to analyze the information disclosed and propose effective countermeasures. To effectively protect the legitimate rights and interests of investors, governments require to use the civil liability mechanism to rectify the disclosure. It is of vital significance to formulate a sound local debt repayment and crisis resolution mechanism, the bond issuer and the direct debt repayment subject must be clarified. In the actual operation link, the
mechanism scientifically calculates the fiscal tax revenue and the use of fund projects in the region, and the funds are supervised by professional departments. Fully integrating the actual situation of the current financial market development, governments are supposed to use the advantages of the crisis resolution mechanism to respond to emergencies, effectively safeguard the legitimate rights and interests of bond investors, and ensure the smooth progress of bond issuance.

5. Conclusion

There are diversified ways to solve the problems in the issuance of local government bonds. The first is to establish a sound and complete local government bond system. The next is to optimize the monitoring and early warning mechanism of local bond risks to gradually improve the level of local bond supervision. And the last is to enhance the transparency of government finances, on the one hand, establish a special information disclosure mechanism, on the other hand, improve the credit rating agencies, which will help to ensure the smooth implementation of local government bonds issuance.

References