

# Research on Local Government Debt from the Perspective of Land Finance

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## Abstract

**Local government debt is an important problem that has long plagued the healthy economic development of China since 1994, among which land finance and local government debt are inseparable, which is a key channel for local government financing. This paper analyzes the meaning and risks of land finance, summarizes and sorted out the changes of its development model in recent years, and thus gives policy suggestions on the resolution of local government debt problems from the perspective of land finance.**

## Keywords

**Land Finance; Local Government Debt; Land Transfer Fund; Financing Platform.**

## 1. Background and Research Significance of Local Government Debt Generation

Since 1994, China began to reform the tax system, the central and local governments have achieved decentralization in fiscal aspects, and the contradiction between the central and local governments also began to show. Subject to the limitation of the Budget Law, local governments shall not issue bonds for financing, but also under the financing pressure required by local economic development and the political promotion demand of local officials, local governments have a serious capital gap in financial aspects and must rely on financial institutions for loan financing. Funds are obtained through land mortgage, commercial bank loans, state-owned enterprise debt and other ways, thus forming a debt financing method based on land finance. Of the local government debt, the debts promised to pay from land transfer income have reached 40%, and 60% in some provinces. This is sufficient to reflect the important role that land resources play in local government financing. According to China Statistical Yearbook, the total revenue of state-owned land use rights in 2005 was 588.382 billion yuan, accounting for only 38.96% of local government fiscal revenue. In 2016, it reached 3563,3.969 billion yuan. In just 11 years, the income of land use right increased by more than 6 times. In the first half of 2018, the local government reached 2694.1 billion yuan, increasing by 43% year on year, in 2020, an increase of 15.9%. This is enough to show the development of land financial financing methods in our country.

The local government debt financing model based on land finance developed rapidly after the 2008 financial crisis, and increasingly highlighted the seriousness of the local government debt problem. With the help of financial institutions, local governments make the connection between land and finance increasingly closer, and the interest chain is getting longer and longer. Once problems occur in a certain link, it is easy to cause systemic financial risks and regional economic crisis. It is becoming increasingly important to deal with the relationship between land finance and local government debt well.

## 2. Meaning and Risks of Land Finance

Land finance refers to the fiscal revenue obtained by local governments through "operating land management", which belongs to the budget revenue of the fund. In essence, it relies on incremental land to create fiscal revenue. Specifically, it relies on non-tax revenue such as land transfer fee-land rent to meet financial demand and relieve financial pressure.

The dependence of local government debt financing on land finance and the inherent disadvantages of land finance financing are two important reasons for the risk problem of local government debt. On the one hand, the local finance relying on land transfer funds has led to the unhealthy development of the real estate market. As the only supplier of land, local governments determine the supply and price of land. Local governments will determine how many prices of land supply according to their own financing needs. The rise of land prices will lead to the rise of housing prices, affect residents' Life and bring certain social risks. On the other hand, the serious dependence of local government financing platforms on land transfer funds makes land finance linked with local government debt risks. With the continuous rising demand for economic construction and the consideration of local officials for their own political achievements, local governments will fully or even make excessive use of land finance to obtain funds. While promoting economic prosperity, they will also bury the local debt crisis, which poses a serious threat to the government's credit and solvency. Finally, the close combination of land finance and finance makes the local government debt financing increasingly financialized. Due to the local government "bypass financing" behavior, make financial institutions and financial financing mode some changes and development, financial institutions in financing for local governments also make their own funds and interests tied with state finance, coupled with the rising financial leverage ratio, once financial problems, easy to cause systemic financial risks, and endanger financial security.

## 3. Land Finance Operation Mode and Development Process

### 3.1. Operation Mode of Land Finance

For the needs of economic construction and the requirements of the government work objectives, the local governments need to finance the construction based on land finance. Under the current convenience conditions provided by financial decentralization and financial decentralization, as well as the constantly changing policies and measures of the central government, the land finance of local governments has mainly developed into two modes: land mortgage loan financing and land transfer fund financing. Land mortgage financing refers to the use of land as a fixed asset and relying on the financing platform as the medium. The financing platform relies on government credit guarantee and land capital to obtain bank loans or issue bonds, and finally passes through the land capital for capital support. Land transfer income refers to the local government through the land use right to obtain land transfer funds, and, the local government after the land transfer funds, can be based on the own funds to the proportion of fixed assets investment based on bank credit, obtain bank loans, and further increase the government financing funds, expand the government debt financing ability.

The Interim Regulations on the Assignment and Transfer of the Right to the Use of State-owned Land in Urban Areas promulgated by the State Council in 1990 have promoted the agreement, bidding and auction as the three methods of land transfer in China nationwide. In 2002, the Ministry of Land and Resources promulgated the Regulations on the Right of State-owned Land by Bidding, Auction and Listing, which restricted the transfer of commercial land, including only bidding, auction or listing. Since then, the land transfer fund financing model developed through bidding, auction or listing has developed vigorously in various parts of China. Table 1 shows the income from the transfer of domestic land use rights and its growth changes between 2015

and 2020. It can be seen from the table that the income from the transfer of domestic land use rights increased from 3254.7 billion yuan in 2015 to 8414.2 billion yuan in 2020, increasing by more than 500 billion yuan, nearly double. At the same time, the growth rate of land use right transfer income over the years is positive in all years, especially in 2017, increasing by 40.7%, and the transfer of land use right income is increasing.

**Table 1.** Income from domestic land use right transfer and its growth

	2015	2016	2017	2018	2019	2020
<b>Income from land use right (RMB 100 million yuan)</b>	32547	37547	52059	65096	74209	84142
<b>Year on-year growth (%)</b>	21.4	15.1	40.7	25	11.4	15.9

### 3.2. Land Finance Development Process

The development of land finance mainly depends on land assets for financing, and the changes in relevant policies will affect the development of land finance. In early 2014, according to the notice on stopping local government illegal financing, the National Development and Reform Commission according to the deployment of the financing platform company bonds guidance, at the same time, China interbank trading market association also according to the financing platform company easy tools, which clearly states that the financing platform does not have the function of land reserve, so land assets cannot be counted as company assets. The issuance and implementation of this policy became the time node for the development of land finance.

Before 2014, the local government mainly relied on land development through land finance. The specific process was: first, the government transferred the land to the financing platform company through "bidding and hanging", and obtained the land from the land, and then the financing platform company transformed the land into ripe and sold it to the market company. At the same time, the local government can acquire the financing platform company through its own land reserve department and give it to the market company to obtain the familiar transfer fee. To put it simply, local governments can use their own land capital to exchange raw land transfer funds to financing platform companies, or buy ripe land and transfer the mature land to market companies in exchange for ripe land transfer funds.

After 2014, the land reserve function of the financing platform companies was greatly limited, giving birth to a new model of land financial financing. The specific process is as follows: the local government entrust the land level development by A through the land reserve department, and pay the development cost and profits; the local government transfers the land transfer to the land transfer fund to achieve the financing purpose. To put it simply, the government uses development companies to convert raw land to mature land through entrusting and agency, and to exchange it for ripe land transfer fee to other companies.

With the strengthening of the central government supervision, and the evolution of financial instruments, land finance in the new era appeared the new model, such as using shantytown reconstruction financing, land finance and PPP financing, these financing mode hidden and higher and higher and higher, interest chain is longer and longer, put forward better requirements for capital supervision and risk control. In 2021, the Ministry of Finance, the Ministry of Natural Resources, the State Administration of Taxation, and the People's Bank of China were jointly released.

The Notice on the Transfer of Government Non-tax Income from the Transfer of State-owned Land Use Right, Special Income from Mineral Resources, Sea Area Use Gold, and Use of Residential Island, which may promote land finance to find a new breakthrough and innovate the local government financing mode.

#### 4. Discussion on Resolving the Disadvantages of Land Finance

In the final analysis, the land finance problem is still the local government debt financing problem, to solve the land finance problem, or we should start from the financing, and take regulatory measures while solving the local government financing. To solve the financing problem, we can basically start from two aspects: to meet the financing demand and to curb the financing demand. In terms of meeting financing needs, we can advocate diversified financing by local governments, from the previous combination of relying on land financial financing to relying on land, tax, and state-owned financing methods. At the same time, market access can be liberalized, and some construction projects that need financing can be transferred to the market companies for construction, which not only solves the financing needs, but also promotes the market-oriented construction. On the other hand, in terms of inhibiting financing demand, the central government should reduce the rigid local requirements and make appropriate policy adjustments according to the local actual situation; at the same time, we should improve the cadre selection and promotion standards, so that cadres can no longer carry out large-scale economic construction and loan financing for "political achievements".

Local government debt financing and financial institutions, easy to lead to high leverage ratio, capital to virtual, its own concealment and easy to breed corruption, in this regard, should strengthen the local government of the supervision of land capital and financial institutions, the central needs to closely monitor the flow of land capital and land transfer funds, to ensure that the land capital to the right field, and the land transfer income got reasonable use. In terms of financial supervision, financial institutions should be prevented from using local government land assets and government credit guarantees in exchange for highly leveraged loans to prevent systemic financial risks.

Local government use of land finance debt financing is mainly to promote local economic development, improve the life of residents, this is good, but through debt financing for economic construction, while the land finance and debt financing, harm the healthy development of the real estate market and financial market, ultimately damage the interests of the people. From this point of view, the land finance financing method of local governments is a kind of sacrificing the essentials, which is not conducive to the healthy development of the local government.

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