A Historical Overview of the Development of China's Fiscal Theory and Debt Governance

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Abstract. In the global economic landscape of the 21st century, China has become a striking focus with its rapid economic growth and unique development model. With the vigorous development of the economy, the way of China's economic development and the series of problems caused by it have become important research topics for academics and policymakers. This article focuses on the development of China's domestic fiscal theory and debt governance, and we sorted out how China's domestic fiscal theory affects China's debt governance, especially implicit debt caused by at all levels local governments in China. Through extensive reading of relevant domestic literature in China, this article conducts an in-depth historical review of the evolution of China's fiscal theory, the development of implicit debt and its governance strategies, refine the original contributions of Chinese scholars and summarize the theoretical system constructed by Chinese research, and provide new perspectives and profound insights for overseas scholars to understand China's fiscal and debt outside of China.

Keywords: China's fiscal, China's local government debt, implicit debt, China's debt resolution

1 Introduction

The development of Chinese fiscal theory is naturally inseparable from government debt. Government debt is an important tool for regulating the macroeconomy. Since the Reform and Opening up decided by China government, China's government debt has mainly been raised by the central government, known as national debt. However, since China's Tax-Sharing System Reform in 1994, local governments have established financing platforms by selling land①, which has promoted the rapid development of my

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① Accurately speaking, government sales the using rights of the land, because China is a socialist country where all land is owned by the whole nation.

country's economy while also giving rise to the rapid growth of research and development of local government fiscal theory in my country[1]. Since 2005, the initial research on Chinese fiscal theory has gradually shifted from the discussion of intergovernmental relations to the analysis of more complex fiscal phenomena such as soft budget constraints and political incentive mechanisms (Zhou Feizhou 2005, Zhou Xueguang 2006, Zhou Lian'an 2007). The introduction of this series of theories not only reveals the unique role of local governments in promoting economic development, but also exposes a series of fiscal problems caused by this, such as the expansion of extra-budgetary revenues, the mismatch between urbanization and public service expenditures, etc[2]. In 2008, in response to the international financial crisis, China's credit environment continued to be loose, and financing platforms grew rapidly, becoming an important assistant for governments at all levels to make up for the financial gap and ensure economic growth, but debt risks also accumulated rapidly. Due to the huge amount of debt of financing platforms, the diverse debt-raising methods and the complex risk associations, the debt of financing platforms has become a major risk hidden danger affecting China's economic and social development[3]. These debts often lack unified management and the risk prevention mechanism is not sound, posing a potential threat to financial stability and economic development. Therefore, since 2014, the Chinese government has taken a series of measures to deal with the long-accumulated hidden debt problem, showing China's innovation and practice in fiscal governance[4].

Therefore, this article will approach the topic from the perspective of the development of China's fiscal theory, summarizing the characteristics of fiscal development at various stages since the 21st century, and highlighting how the theory of each stage has influenced the Chinese government's debt management. First, in the second part, it sorts out the research context and summarizes the research views of China's domestic fiscal theory in various periods, and points out that China's debt sorting since 2014 is actually based on the understanding of China's actual situation by these studies. Then in the third part, we have integrated a large number of documents and policy materials from official websites. Table 1 lists all important official documents. Starting from the notice issued by the State Council in 2010, the Chinese government has gradually established a top-level design for debt management and promoted the process of debt governance through the continuous improvement of laws and policies.

Table 1. Related documents on China's local debt.

Policy Year	The Institution of issuing the law	Document in English	Document in Chinese
2010.06	General Office of the State Council	"Notice of the State Council on Strengthening the Management of Local Government Financing Platform Companies"	《国务院关于加强地方政府融资平台公司管理有关问题的通知》
2014.09	General Office of the State Council	Opinions of the State Council on Strengthening the Management of Local Government Debt	《国务院关于加强地方政府性债务的管理意见》

2014.10	Ministry of Finance	Methods for clearing and screening local government debt into budget management	《地方政府存量债务纳入预算管理清理甄别方法》
2015.12	Ministry of Finance	"Ministry of Finance's Implementation Opinions on Limiting the Management of Local Government Debt"	《财政部关于对地方政府债务实行限额管理的实施意见》
2017.05	Ministry of Finance	"Notice on Further Regulating Local Government Debt Financing Behavior"	《关于进一步规范地方政府举债融资行为的通知》
2017.06	Ministry of Finance	"Notice on resolutely stopping local governments from illegally and irregularly raising funds through government procurement of services and public opinion"	《关于坚决制止地方以政府购买服务民意违法违规融资的通知》
2018.09	CPC Central Committee② & General Office of the State Council	Guiding Opinions on Strengthening Asset-Liability Constraints of State-Owned Enterprises	《关于加强国有企业资产负债约束的指导意见》
2018.10	General Office of the State Council	Guiding Opinions on Maintaining Efforts to Make Up for Shortcomings in the Infrastructure Sector	《关于保持基础设施领域补短板力度的指导意见》
2018.10	CPC Central Committee	Opinions on Preventing and Resolving Hidden Debt Risks of Local Governments	《关于防范化解地方政府隐性债务风险的意见》
2018.10	CPC Central Committee	Measures for Accountability of Local Government Hidden Debts	《地方政府隐性债务问责办法》
2019.03	Ministry of Finance	"Implementation Opinions on Promoting the Standardized Development of Government-Social Capital Cooperation"	《关于推进政府和社会资本合作规范发展的实施意见》
2019.06	General Office of the State Council	Opinions on Preventing and Resolving the Risks of the Existing Local Government Hidden Debts of Financing Platform Companies	《关于防范化解融资平台公司到期存量地方政府隐性债务风险的意见》
2021.07	China Banking and Insurance Regulatory Commission③	Guiding Opinions on Banking and Insurance Institutions to Further Prevent and Resolve Local Government Hidden Debt Risks	《银行保险机构进一步做好地方政府隐性债务风险防范化解工作的指导意见》

The documents listed in Table 1 successively facilitated the Chinese government's three attempts at debt resolution. China's local fiscal has established clear boundaries for government debt, formulated standardized debt management strategies, clarified the debt responsibilities between the government and enterprises; and pilot and implement

② Refers to the document issued by the General Office of the CPC Central Committee.

③ In 2023, the Chinese government will abolish the China Banking and Insurance Regulatory Commission and establish the State Financial Supervision and Administration Bureau.

measures to resolve implicit debts, reduced debt risks in vulnerable areas, and achieved zero implicit debts in high-quality areas. Therefore, this article will review the development of China's fiscal theory through systematic analysis, explore the formation mechanism of implicit debts and their theoretical research on the economy. On the other hand, we combine the history of theory with the Chinese government's debt governance process and draws the following Fig. 1, so that later fellows can better understand the process of China's local debt governance and provide a good historical combing.

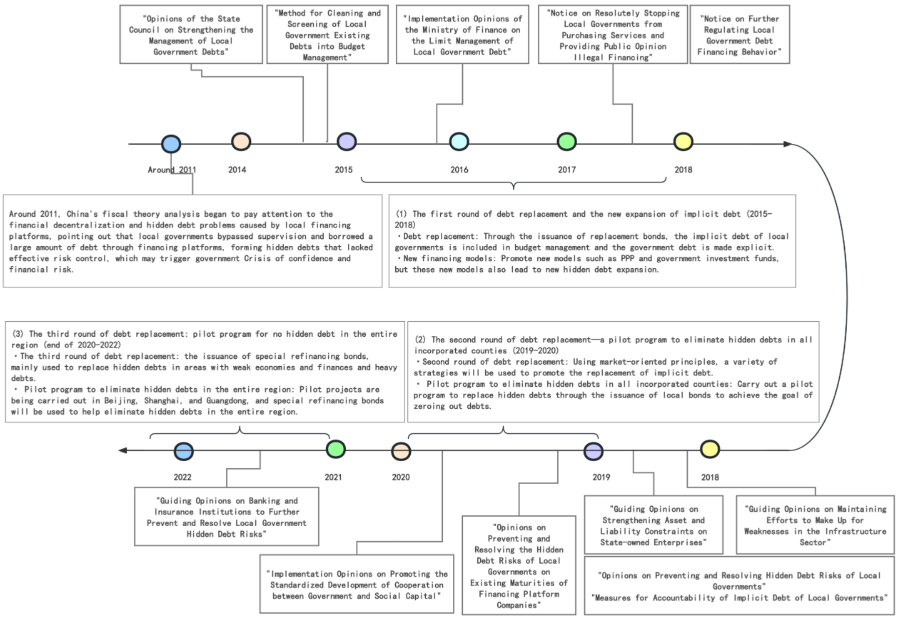

Fig. 1. China’s fiscal theory and subsequent debt resolution process.

2 Development and Maturity of China’s Fiscal Theory

2.1 Early Research Stage – Studies from the Perspective of Intergovernmental Relations (Around 2005)

From 2001 to 2009, as China established a market economy system and joined WTO, the way of China economic development shifted to one centered on land development and urban construction. This model, known in China as the "Land-Based Fiscal Model", generally refers to the practice in mainland China where, due to state ownership of land, local governments sell land use rights to generate off-budget fiscal revenue[④], which is

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④ It is important to note that, prior to 2014, all local governments in China, except the central government, were not allowed to issue bonds. As a result, local governments established investment platforms (commonly referred to as urban investment companies, see below), and the revenue obtained from the sale of land was considered off-budget income.

then used to attract investment and drive large-scale infrastructure construction, thereby promoting regional economic development[5].

Currently, scholars in China generally agree that the operation of land finance primarily consists of four key components: first, selling land to obtain land transfer income; second, selling industrial land at low prices to attract investment and stimulate economic growth; third, conducting urban construction to drive up land prices and generate income, thereby promoting urban development; and finally, using land as collateral to obtain bank loans for infrastructure investment and municipal construction. Such institutional arrangements bind economic development to fiscal revenue, which in turn drives governments to pursue high profits and regional growth, causing them to behave more like market participants rather than market facilitators[6].

Therefore, during this period, China's fiscal theory was primarily analyzed from the perspectives of intergovernmental relations, centralized budgeting, decentralized off-budget funds (mismatched responsibilities and fiscal powers of local governments⑤), and transfer payments. Chinese domestic scholars mainly focused on the fiscal relationships between provinces and between the central and provincial governments. This is rooted in China's graded budget system, which has been in place since the reform and opening-up period, with the principle of "one government, one budget," leading to relatively independent fiscal systems across different levels of government. For example, Chinese scholar discussed the issue of fiscal decentralization and its bias in China's expenditure structure, pointing out that fiscal decentralization in China has led to competitive growth at the expense of fiscal discipline[7]. Empirical research shows that China's fiscal decentralization, combined with performance evaluations driving intergovernmental competition, has resulted in local governments prioritizing basic infrastructure over human capital investment and public services, causing a significant distortion in the public expenditure structure. Some scholars observed that fiscal decentralization in China is partial and incomplete, as local governments do not have independent taxing authority but instead have limited discretion over certain public functions. This decentralized model incentivizes local governments to promote or protect markets, facilitating rapid local economic growth[8].

Thus, during this period, research on China's fiscal decentralization mainly highlighted problems under the Land-Based Fiscal Model, such as how off-budget revenue expands the size of local governments, increasing the burden on local residents and farmers; how the marginal effect of local government off-budget expenditures diminishes; and how urbanization levels negatively correlate with local government expenditures on urban maintenance, indicating a misalignment between China's industrialization and urbanization processes.

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⑤ To put it simply, the proportion of fiscal revenue is divided step by step from the central government to local provinces, cities and counties. However, large-scale grassroots affairs are carried out by grassroots governments. Local governments have lower fiscal revenue but are responsible for various matters. It is called the mismatch between the administrative power and financial power of local government.

Specific reference: Lan, X. (2024) How China works: An introduction to China's state-led economic development. Singapore: Palgrave Macmillan.

Beyond discussions about the central-local government relationship, the non-standard nature of the fiscal transfer payment system was also a focal point for scholars during this phase. A prominent example pointed out that China's centralized budget leads to greater difficulty for lower-level governments in accessing earmarked funds from higher levels of government[9]. He further noted that, in the process of fiscal system reforms, grassroots governments that historically relied on collecting fees from rural areas are now becoming dependent on transfer payments from higher levels. This shift has altered the behavior of grassroots governments, with a general trend from "seeking money" and "seeking grain" to "asking for funds" and "incurring debt". In this context, grassroots governments have evolved from extractive entities to more detached "floating" entities in their relationships with farmers[10]. At the same time, while responsibilities are being decentralized, transfer payments remain non-standardized. Although grassroots governments lack sufficient fiscal capacity, they are still mandated to shoulder significant responsibilities under rigid institutional arrangements.

2.2 Theoretical Development and Maturation Phase (2005-2010)

Between 2005 and 2010, systematic theories by Chinese scholars gradually began to emerge. Among these, the soft budget constraint theory and studies on political incentives gained prominence.

According to our review of the timeline, Justin Yifu Lin and his collaborators were among the first to introduce the issue of fiscal exogeneity into the analysis of soft budget constraints. They argued that the root of soft budget constraints prevalent in socialist planned economies, transitional economies, and many developing countries lies in the fact that these enterprises bear certain external targets (i.e., "policy burdens") that lead to policy-induced losses[11]. Subsequently, in 2007, China academic started to discuss the phenomenon of "reverse soft budget constraints" in intergovernmental behavior, where in government officials pursuing short-term performance outcomes exceed budgetary limits to seize resources. This behavior results from the collusion of common interests between officials at different levels of government, which undermines top-down constraints. This phenomenon is widespread among grassroots governments and is closely linked to, information asymmetry, and competition among officials at the same level[12]. Thus, this was later incorporated by scholars into analyses of land finance, where the unreasonable fiscal decentralization system was linked to strong incentives for local economic development and soft budget constraints[13].

In 2007, Zhou Li'an proposed the "promotion tournament" incentive model, which became a widely recognized concept in China's academic circles. It was argued that the success of China's economic transition is closely tied to its unique governance structure, which combines political centralization with economic decentralization. The "promotion tournament" theory, a result of this combination, explains an incentive mechanism that ties the promotion of local officials to economic growth. By granting local officials administrative power and discretionary authority, it offers a governance model unique to China, which incentivizes local officials to promote economic development. This model also highlighted the need for complementary reforms, such as administrative and fiscal decentralization, to realize its full potential[14]. However, Zhou also pointed out the costs associated with this model, such as distorted incentives for officials, conflicts between the promotion tournament and government functional transformation, and the need for changes in China's economic growth model.

By 2010, as China's debt situation continued to evolve, various domestic theories matured in response, allowing scholars to take a more comprehensive view of the issue through established theoretical lenses. Some scholars explored the relationship between local government officials' promotion incentives, economic responsibility audits, and local government financing platform debt. Their research found that stronger promotion incentives for local government officials led to a greater motivation to borrow, resulting in faster growth of local government financing platform debt and heightened debt risk[15]. In 2012, fiscal decentralization, promotion incentives, and soft budget constraints were examined, arguing that China's fiscal decentralization is not the sole incentive driving local governments to establish financing platforms and incur substantial debt. The dual role of governments as "economic participants" and "political participants," as well as the widespread existence of soft budget constraints in China's banking sector, are key factors contributing to the excessive debt incurred by local government financing platforms[16]. A 2015 study examined the relationship between fiscal decentralization, promotion incentives, and local government debt financing behavior. Using provincial panel data, the study provided empirical evidence that both fiscal decentralization and promotion incentives significantly contributed to the increase in the size of municipal investment bonds across China[17].

3 Development of Fiscal Decentralization and Implicit Debt Theory

Around 2011, the analysis of fiscal theory in China gradually began to focus on local government financing platforms. Some researchers found that local financing platforms provided local governments with financing channels that allowed them to by pass central government oversight, thus realizing a form of fiscal decentralization. Local governments used financing platforms to borrow heavily, resulting in implicit debts[18]. These debts lacked unified management, effective risk prevention mechanisms, and were being transformed into financial risks through the banking system. This not only risked undermining government credibility but also posed a significant potential threat to China's economic development [19]. At same time, some discussion focus on the impact of government debt expansion on financial stability, arguing that the expansion of government debt poses risks to financial stability and that a comprehensive government debt constraint framework and risk resolution mechanisms are needed[20]. However, due to the contingent, non-standard, and opaque nature of local government implicit debt, a unified measurement standard has yet to be established. Nevertheless, the scale of implicit debt continues to rise.

As the research on financing platforms progressed, Chinese scholars emphasized the concepts of fiscal decentralization and implicit debt. In Chinese domestic research, fiscal decentralization refers to the division of power between central and local governments in areas such as financial regulation, financial stability, financial resource allocation, and financial corporate governance. This stems from China's 1994 tax-sharing reform, which saw the central government retract fiscal power, leaving local governments financially strained. To compensate, the central government granted local governments more tax authority and flexibility, allowing them to use financial means to allocate resources for local government needs. Implicit debt arises from local governments, under the tacit approval of the central government, using government credit guarantees to generate off-budget debt. Ba Shusong (2009) noted that since 2006, various local financial institutions have emerged, supported by policy, and a number of local financial holding groups have been established. To better serve small and medium-sized enterprises and address regulatory gaps caused by information asymmetry and insufficient regulatory capacity, the central government gradually devolved regulatory authority over non-deposit quasi-financial institutions such as microloan companies, pawnshops, and financing guarantee companies to local governments[21]. In 2013, the central government further devolved debt pre-approval authority to local governments, intensifying local governments' enthusiasm for financial development. However, as previously mentioned, the expansion of local financial authority also accelerated the growth of local debt. In 2017, the evolution, characteristics, and conceptual implications of China's fiscal decentralization were discussed, constructing a basic model to preliminarily explain the evolution of fiscal decentralization in China from an economic growth perspective[22]. Further research in 2017 showed that both fiscal decentralization and implicit fiscal decentralization contribute to local debt growth, with the latter enhancing the positive impact of the former on local debt growth[23].

Therefore, as research on China's fiscal decentralization continued to develop, the issue of implicit debt garnered widespread attention from Chinese academia. By 2013, here is a discussion pointed out that under the current system, government debt, particularly implicit government debt, had grown to a massive scale with highly concealed characteristics. Due to conflicts of interest and institutional issues, the use of implicit debt was marked by low transparency, poor professionalism, and administrative interference. Furthermore, regulatory inconsistencies, a lack of statistical data, and decentralized management made it impossible to routinely monitor, assess, or control government debt, thus hindering a comprehensive understanding of the true situation regarding government debt[24].

With China placing increasing emphasis on debt issues and its debt resolution process, academic research on implicit fiscal decentralization also intensified around 2018. Some researchers explored the impact of explicit fiscal centralization and implicit fiscal decentralization on local government debt efficiency, using a dynamic spatial panel model for empirical analysis. The study found that both explicit fiscal centralization and implicit fiscal decentralization significantly affect local government debt efficiency, with implicit fiscal decentralization having a positive impact, while explicit fiscal centralization has a negative impact[25]. Implicit fiscal decentralization refers to a series of non-standard, implicit institutional arrangements by local governments, made outside the central government's formal regulatory framework, aimed at promoting long-term economic growth through autonomous control over financial resources and their allocation between different levels of government

4 Development of China's Fiscal Theory and the Practice of Debt Resolution in China

In the third part, we outlined the historical evolution of China's fiscal theory. From early research on the Land-Based Fiscal Model, to the establishment of comprehensive theories such as the "promotion tournament" theory, and then to studies on financing platforms, fiscal decentralization, and implicit debt, China's research has matured, providing important policy guidance for subsequent economic development. Under the leadership of the central government, China has undergone three rounds of debt resolution, with fiscal theory paving the way, followed by debt resolution practices. In this process, China has focused on advancing government budget management, improving debt mechanisms, investigating implicit debt, and implementing debt swaps, effectively addressing the challenges posed by local government implicit debt.[26]

4.1 First Round of Debt Swaps and the New Expansion of Implicit Debt (2015-2018)

In the first section of the third part, we noted that around 2010, research on China's fiscal theory began to concentrate on financing platforms, as the central government recognized the urgency of managing local government financing platforms. In 2010, the State Council issued the "Notice on Strengthening the Management of Local Government Financing Platform Companies" (State Council Document No. 19, 2010⑥). This document placed three key restrictions on local governments: 1) Local governments must fully fund financing platform companies and may not inject public welfare assets into them; 2) Local governments are prohibited from providing illegal guarantees; 3) Local governments must fulfill their responsibility for repaying existing debt[27]. While Document No. 19 was the first to regulate local debt and financing platforms, it did not effectively curb illegal borrowing practices. Instead, its primary political significance was to signal to local governments and the market that the central government would adjust its approach to local borrowing and financing platform management.

In 2014, China's National People's Congress passed the revised Budget Law, officially marking the beginning of comprehensive central government management of local finances. The new Budget Law granted local governments the legal authority to issue bonds⑦. In the same year, the State Council's "Opinions on Strengthening the

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⑥ "Notice of the State Council on Issues Concerning Strengthening the Management of Local Government Financing Platform Companies" Guofa [2010] No. 19, here in after referred to as Document No. 19 https://www.gov.cn/zwgk/2010-06/13/content_1627195.htm

⑦ In the new "Budget Law", the central government clarified that local governments have the right to borrow debt. The main body of borrowing is provincial government. The type of debt is local government bonds. The debt limit is determined by the State Council. It also stipulates basic debt purposes, debt repayment, and debt supervision. The overall model is self-repayment of local government bonds under budget constraints.

Management of Local Government Debt" (State Council Document No. 43, 2014⑧) called for the control of local government debt through size limits and budget management. The opinion mentioned that for the existing local government debts that have been included in the budget management after screening, each region can apply to issue local government bonds for replacement. Specifically, it can be classified from two aspects:

- According to the purpose of funds, it is divided into new bonds and bond swap. New bonds are used for project construction expenditures, and bond swap are used to repay debts in the form of non-government bonds that are identified as government debts.
- According to project income, it is divided into general bonds and special bonds, which are included in the general budget and government fund budget respectively. Public welfare undertakings with income are financed by local governments issuing general bonds, and are mainly repaid with general public budget revenue. The development of public welfare undertakings with certain income is financed by local governments through the issuance of special bonds, and repaid with corresponding government fund revenue or special revenue.

The 2010 Document No. 19 and the 2014 Document No. 43 together established China's top-level debt management framework. Document No. 43 introduced a unified "borrowing, using, managing, and repaying" mechanism for local government debt, with a key focus on stripping financing platform companies of their government financing function. The issuance of bond swap helped bring local government implicit debt into the budget management system, a process described by China's Ministry of Finance as "opening the front door and closing up the back door." However, this approach primarily tightened control over local government borrowing through financing platforms without addressing the fundamental need for local government financing to support economic development[28]. Consequently, local governments resorted to PPP (Public-Private Partnerships) and other tools supported by the State Council to create long-term financial commitments, thus generating new implicit debts. These measures allowed implicit debt to expand in a more concealed form.

Thus, it is evident that the primary strategy of this round of debt resolution was to "make government debt explicit." Through the 2014 Document No. 43 and the 2010 Document No. 19, the Chinese government completed the top-level design of its debt management framework, encompassing both bond issuance and financing platform management. The issuance of bond swap to swap out local governments' implicit debt and include it in the budget management of local government debt stock was referred to by the Ministry of Finance as "opening the front door while blocking the back door." However, in essence, this approach merely tightened control over the previous practice of local governments using urban investment platforms and other financing platforms for borrowing. It did not address the fundamental need for local governments to raise

⑧ "Opinions of the State Council on Strengthening the Management of Local Government Debts" Guofa [2014] No. 43, here in after referred to as Document No. 43 https://www.gov.cn/zhengce/content/2014-10/02/content_9111.htm funds to support economic development[29]. Consequently, local governments, leveraging Public-Private Partnerships (PPPs), government procurement services, and other long-term financial commitments supported by the State Council, began to accumulate new implicit debt through long-term expenditure commitments related to government services. This practice led to the further expansion of implicit debt, albeit in a more concealed manner.

4.2 Second Round of Bond Swaps—Pilot Projects for "No Implicit Debt" in County-Level Regions (2019-2020)

The release of the 2010 "Document No. 19" and the revised Budget Law in 2014 laid the legal foundation for China's debt management strategy of "opening the front door and blocking the back door." Meanwhile, new financing methods (such as PPPs and government investment funds) were promoted, and local financing platforms leveraged transitional policies to engage in non-standard or even illegal borrowing. As a result, from 2015 to 2017, implicit debt expanded rapidly, especially in the form of shadow banking.

Li Wenzhe (2019) introduced the ways in which local governments expanded implicit debt during this period. First, commercial banks transferred funds off their balance sheets by issuing wealth management products, which were then channeled through various partnerships between banks, trusts, securities firms, and financial holding companies to provide loans to local financing platforms. Later, local governments further involved non-financial institutions, which strengthened the shadow banking system, expanding local governments' implicit debt financing options. Non-financial enterprises became natural participants in the shadow banking credit chain by purchasing bank wealth management products, trust products, and securities firms' wealth management products, acting as credit intermediaries between credit creators and lenders. This system of private lending and entrustment triggered systemic financial risks.

In response, in 2019, six ministries, including the Ministry of Finance, National Development and Reform Commission, The People's Bank of China, National Audit Office, China Banking and Insurance Regulatory Commission, and China Securities Regulatory Commission, issued Document No. 40⑨, launching the second round of implicit debt swaps. Unlike the first round, this round was driven primarily by policy banks and commercial banks under market-based principles. In essence, local governments were encouraged to adopt flexible strategies for resolving implicit debt based on their actual debt structure. These strategies included selling government equity and operational assets, utilizing surplus funds from other projects, reallocating operating income, activating dormant funds, and disposing of idle government assets. At the same time, Document No. 27 (2018)⑩ required provinces to eliminate implicit debt by 2028. To achieve

⑨ "Opinions on Preventing and Resolving the Hidden Debt Risks of Local Governments on Existing Maturities of Financing Platform Companies" (Guohanban [2019] No. 40, the specific content has not yet been made public.

⑩ "Opinions on Preventing and Resolving Hidden Debt Risks of Local Governments" Zhongfa [2018] No. 27, the specific content has not yet been made public.

this, the Ministry of Finance initiated two waves of pilot projects aimed at resolving implicit debt in county-level regions, alongside a third wave of pilot projects designed to achieve "no implicit debt" in specific regions. In all three waves, local governments were allowed to issue a limited number of local bonds to replace implicit debt, issuing a total of 1.34 trillion yuan in local bonds, which had a limited impact.

4.3 Third Round of Debt Swaps: Pilot Projects for "No Implicit Debt" Across Entire Regions (Late 2020-2022)

The second round of debt swaps, based on the final issuance results, saw the issuance of nearly 160 billion yuan in bond swap in 2019, a relatively small amount. Beginning in 2020, the monthly bulletins of the Ministry of Finance no longer listed bond swap, but instead introduced a new type of bond called refinancing bonds. These refinancing bonds were used to extend the term of local government debt that could not be repaid on time and had already been issued as government bonds.

Starting in December 2020, some of the new refinancing bonds shifted their purpose to “repaying existing government debt.” After this change in purpose, refinancing bond funds were allowed to be used to resolve implicit debt, and this form of bond became known in China as "special refinancing bonds." These special refinancing bonds were mainly used to replace implicit debt in county-level regions that were financially weak. Their purpose was to support the pilot projects aimed at eliminating implicit debt in county-level regions and across entire regions. The special refinancing bonds were rolled out in two stages:

- First Stage: County-Level Debt Resolution Pilots (December 2020 to September 2021). Building on the first wave of county-level debt resolution pilots in 2019, the second wave began in December 2020, with 26 provinces and cities, including Liaoning, Chongqing, Tianjin, Ningxia, and Qinghai, issuing 612.8 billion yuan in special refinancing bonds to repay existing government debt. During this stage, some special refinancing bonds were also used to repay debts at the municipal level, expanding the scale and participation of provinces and administrative levels.
- Second Stage: Full-Scale "No Implicit Debt" Pilot (October 2021 to June 2022). In October 2021, with approval from the Central Committee and the State Council, Beijing, Shanghai, and Guangdong began pilot projects for "no implicit debt" across entire regions. These three regions issued a total of 504.18 billion yuan in special refinancing bonds. With the support of these bonds, Guangdong and Beijing achieved full elimination of implicit debt in early 2022 and early 2023, respectively. While Shanghai did not officially announce that it had achieved this goal, several districts within the city, such as Pudong, Fengxian, and Chongming, declared in 2022 that they had reached full implicit debt elimination.

The third round of debt swaps, which was large in scale and geographically concentrated, effectively alleviated the debt burden in some regions, particularly those with weak economic and fiscal conditions and heavy debt loads. This round not only reduced the short-term debt repayment pressures in these regions but also lowered the credit risk associated with urban investment. After three rounds of debt resolution, China’s fiscal system achieved three significant milestones: first, it clarified the boundaries of government debt, establishing standardized debt management strategies and delineating the responsibilities of governments and enterprises; second, it piloted and promoted implicit debt resolution, both mitigating debt risks in weaker regions and achieving debt elimination in stronger regions; and third, it completed a comprehensive audit of implicit debt, laying a solid foundation for future targeted policy making.

5 Summarize

We provides a comprehensive review of the development of China's fiscal theory and the governance of implicit debt. Through an in-depth historical analysis, we explored how China's fiscal policies have evolved, particularly since the 1994 tax-sharing reform, which significantly impacted the fiscal dynamics between central and local governments. The resulting Land-Based Fiscal Model and the creation of local government financing platforms have played a crucial role in China's rapid economic growth but have also led to the accumulation of significant implicit debts.

China's debt management framework has undergone substantial changes, especially after 2010, when the government recognized the risks associated with unchecked local government borrowing. Key policy initiatives, such as the 2014 Budget Law, paved the way for more regulated debt issuance through local government bonds and the incorporation of implicit debt into formal budget management. The three rounds of debt swaps and refinancing bonds have been instrumental in reducing implicit debt, particularly in financially weaker regions, while establishing clearer boundaries for local government debt.

The process of fiscal decentralization and implicit debt governance has revealed important lessons for China's economic stability. The central government's strategic approach to managing debt risks—balancing local governments' need for development financing with fiscal responsibility—has allowed for gradual improvement in debt management and financial sustainability. Future efforts will require continued innovation in fiscal governance, particularly in addressing the underlying causes of implicit debt accumulation and ensuring a more balanced economic development model.

In conclusion, the evolution of China's fiscal theory and debt governance highlights both the achievements and ongoing challenges in managing local government debt. The lessons learned from China's experience can offer valuable insights for other developing economies facing similar fiscal decentralization and debt management issues.

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