Chapter 7
Subnational Finance in Australia and China:
The Case for Municipal Bond Banks

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ABSTRACT

The political and economic benefits of decentralization have been cogently represented, to the extent that decentralization and devolution comprise identifiable programs of reform across a range of polities. However, the public policy question of finance following function – and the oversight of this process – is less resolved. Further, concerns over the financial sustainability of sub-national governments continue across a range of polities. Against the backdrop of reforms to municipal finance in both Australia and China, this chapter provides an account of the formation and functioning of two successful sub-national financial institutions, the Local Government Finance Authority of South Australia (LGFA) and the Municipal Finance Authority of British Colombia. The case studies suggest that sub-national finance may not be the thorn in the side of decentralization it sometimes appears to be. The broader introduction of such financial instruments is considered.

INTRODUCTION

Scholars of local government are adept at debating the putative benefits of systems of political economy wherein advantages are accrued based upon "finance" following "function" (Robotti & Dollery, 2009; Shah & Shah, 2006). Similarly, in many jurisdictions public policies designed to pursue these theoretical advantages can be the source of significant debate. This is arguably the case in both the contemporary

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Australian and Chinese contexts. While some might point to recent reforms to intergovernmental relations in Australia as signifying a degree of administrative decentralization (see, for example, O'Loughlin, 2013), viewed from the perspective of finance, the story of the Australian federation can still be told as one of the increasing dominance of federal government (see, for example, Dollery, 2002). In the case of China, concerns around increasing levels of government debt generally and sub-national debt in particular have constituted a focus for central government and observers alike, with recent reforms to municipal self-finance attracting intense scrutiny both domestically and internationally (Ma, 2013; PDO, 2014). Otherwise stated, the observation by Podger and Yan (2013, p. 202) that "the various challenges facing the government systems in both countries are generating similar types of response", while generally correct, has to concede that in the case of municipal finance the two polities are at different points in addressing this crucial question in maximizing the theoretical benefits of decentralization.

Despite what we have asserted is *prima facie* the incomparability of the two systems of political economy, our central concern in this chapter is to demonstrate that the policy option for introducing municipal bonds as a mechanism to assist in achieving the goal of finance following function is both theoretically defensible and practically viable, notwithstanding the institutional complexities of any particular set of circumstances. A second aim of our discussion here – and one that we trust is achieved in the pursuit of the first – is to provide an account of the operation of municipal bond banks. In so doing we move from a conceptually stylized or ideal-type account, through to an examination of two examples of successful, long-standing municipal financial institutions, before asserting the relevance of the type to disparate contexts wherein the broad policy goal of finance following function might be pursued. We as authors freely admit that we are *not* financially trained; nevertheless this ought not proscribe us from both understanding options for municipal finance and conveying this understanding, as rudimentary as it may be, lest there be other souls similarly positioned and subject to the overview of our more learned colleagues. Any reasonable interpretation of the Global Financial Crisis (GFC) of 2008 and ensuing events ought surely to recognize that the division of labor that pervades the understanding of what was once political economy can render opaque many processes that ought to be understood by more people, both inside and outside universities.

Our discussion here proceeds from a brief account of the contemporary situation of municipal finance in both countries. With regard to public policy in Australia, we examine the current appetite for reform represented in the [then] Abbott Government's announcement of the White Paper on the Reform of the Federation (PM, 2014), a process which continues to unfold. With regard to public policy in China, we document the vexatious issue of local government bonds. Following this, we move to our ideal-type account of the operation of municipal bond banks before examining the workings of two sub-national municipal bond banks, the Local Government Finance Authority of South Australia (LGFA) and the Municipal Finance Authority of British Colombia (MFABC) (Dollery, Kortt, & Grant, 2013). We argue that these examples point to a potential direction for reform in the Australian context and shed an alternative light on China's reforms to subnational finance. We canvass future research directions with respect to the functions of bond banks generally and in the specific, path-dependent contexts of Australia and China.

MUNICIPAL FINANCE IN AUSTRALIA

Local government finance in Australia has several main features. First, despite its diversity across the federation, Australia's 560 local governments are largely self-funded with own-source revenue compris-

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