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Hardening Budget Constraints: A Cross-National Study of Fiscal Sustainability and Subnational Debt

Heidi Jane Smith, Sanghee Park & Liguang Liu

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ABSTRACT

This study explores the financial sustainability of subnational governments in four different countries. Scholars argue that subnational fiscal capacity helps local governments deliver better public services and provide public goods, which in turn helps to promote economic growth. While administrative control by the central governments contributes to reducing moral hazard from the soft budget constraints, bottom-up strategies to manage fiscal profligacy also need attention. The study first provides understanding about the characteristics of central-local governance and management of subnational government debt of each country. Then, we test our hypotheses regarding local fiscal capacity and administrative control, including political-economic factors that may affect debt spending by local governments. Our findings show that subnational fiscal sustainability improves when the central

governments have clear rules to intergovernmental transfers in place and more (market) liberal policies, meanwhile when subnational governments have a more fiscal capacity and less intergovernmental transfers they are able to manage their debt more soundly.

KEYWORDS:

Subnational government debt | fiscal capacity | administrative control | financial management

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