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Research on the Public Director System of Local Financing Platforms

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Abstract: Behind the local financing platform, there are huge financial and financial risks, facing the problems of capital use deviating from the public purpose, corporate decision-making ignoring long-term development and insufficient market-oriented transformation. The public director system emphasizes attention to the public interest in corporate governance, which is an innovation of the internal governance structure of the company. Introducing the public director system into the resolution of the internal operational risks of China's local financing platforms will help to correct the development concept of local financing platforms, fill internal governance deficiencies, and achieve the maintenance of social and public interests. The public directors in the local financing platform will break the 'inner circles' inherent in the company's decision-making through the exercise of various functions and powers, reconcile the conflicts of interest inside and outside the local financing platform, release the internal operation risk of the local financing platform from the root, and boost the development vitality of the local financing platform. By giving special veto rights to public directors of local financing platforms, special meeting convening rights and supervision rights to management, it ensures that the authority has sufficient 'penetration'; on the basis of the internal supervision of the public directors of the local financing platform, the public supervision committee is set up as the external supervision institution of the public director system of the local financing platform, forming a dual maintenance of the social and public interests. Finally, settle down to the localization of the public director system of local financing platform in China, combine the excellent experience of foreign countries with the current situation of local financing platform, follow the three key points of framework construction, efficiency stimulation and risk prevention, get out of the dilemma of internal governance of local financing platform in China, and realize the vision of safeguarding social and public interests.
Keywords: Local Financing Platform; Public Director System; Corporate Governance; Risk Resolution

1 Foreword

China's local financing platforms are a unique product created by governments to bridge traditional fiscal channels with financial markets. Since 2010, regulatory oversight has intensified at the central level, with a growing focus on hidden government debt caused by local financing activities (Ren, 2024). Since 2021, local governments have undergone multiple rounds of debt resolution. At the 12th Session of the Standing Committee of the 14th National

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People's Congress held in November 2024, a resolution was passed approving the State Council's proposal to increase local government debt limits for replacing existing hidden debts. Starting from 2024,800 billion yuan in special bonds will be allocated annually for debt reduction over five consecutive years, adding 10 trillion yuan in total resources for debt resolution (Jiang, 2024).

Local financing platforms are tasked with infrastructure development and public service provision, yet they function as independent corporate entities representing a unique "embedded" relationship between market forces and government oversight (Zhou, 2003). Nowadays, a series of policies and guidelines require local financing platforms to be separated from the function of financing for the government, emphasizing that local financing platforms should be treated as a key area for systematic risk governance, including market-oriented debt disposal and the establishment of regular financial supervision (Financial Stability Analysis Group of the People's Bank of China, 2024). This paper explores multiple dimensions, including the reorganization of government-financing platform relationships. Departing from conventional approaches, it focuses on reforming the internal governance structures of local financing platforms. By examining the governance potential of foreign public director systems in addressing internal risk management, this study initiates theoretical exploration through the lens of trusteeship responsibilities and managerial opportunistic behaviors within these platforms. Through localized institutional design, we aim to address existing governance deficiencies, enhance market competitiveness, safeguard public interests, and fundamentally promote the healthy, stable, and sustainable development of local financing platforms.

2 The inherent risks of local financing platforms

2.1 The use of funds deviates from public purposes

Following the 1994 tax-sharing reform, local governments faced a mismatch between fiscal authority and operational responsibilities. Under the explicit prohibition against government borrowing stipulated in the then-revised Budget Law, this situation gave rise to local financing vehicles (LFVs). By adopting market-oriented approaches to secure project funding, these entities offered greater flexibility compared to traditional financing methods, effectively addressing funding gaps for infrastructure development and public service provision (Xu & Mao, 2024).

As government financing vehicles, local financing platforms have increasingly exposed hidden debt issues during operations, with their fund utilization deviating further from public objectives. For instance, the Ministry of Finance's Supervision and Evaluation Bureau highlighted in its "Notice on Typical Accountability Cases of Illegal Financing by Financing Platform Companies and New Local Government Hidden Debts" that a county-level financing platform in central China. In Anhui Province, illegally obtained 500 million yuan in loans from Bank of Communications Co., Ltd., Chizhou Branch by pledging 780 million yuan in accounts receivable stipulated in government-purchased service agreements (Bureau of Supervision and Evaluation, 2022). People's Government of the Autonomous Region (2023) "2022 Audit Report on Budget Execution and Fiscal Revenues/Expenditures" also documented two counties using 287 million yuan of local funds through financing platforms to continue four non-revenue-generating public welfare projects, while three county governments' financing platforms risked losses by lending out 135 million yuan externally.

The mismanagement of local financing platforms in fund utilization and administration is deeply rooted in their inherent operational characteristics. While these entities are nominally corporate structures, they have been governmentcontrolled since inception, borrowing under corporate names while essentially relying on state credit (Yang & Zhang, 2012). These complex factors make it easy for funds to deviate from public purposes, resulting in issues such as funding non-public welfare projects, opaque capital flows, and excessive investments. Such malpractices erode the operational foundations of local financing platforms and ultimately harm societal interests.

2.2 The company's decision-making ignores long-term development

Local financing platforms have developed intricate ties with governments over time, yet their internal systems lack rigorous performance evaluation mechanisms. The difficulty in quantifying operational costs and efficiency has created vulnerabilities for short-sighted corporate decisions (Li, 2016). Many platforms operate with vague strategic objectives, failing to cultivate core competencies or implement sustainable business planning. This leaves them vulnerable to market competition, undermining long-term growth and profitability (Wang, 2024). When addressing debt crises, these platforms often resort to "borrowing new to pay off old" tactics. While this may temporarily alleviate immediate pressures, it actually fuels the accumulation of broader debt risks. Such practices not only disrupt normal operations and public welfare projects but also risk spilling over into financial systems, heightening systemic risks (Feng, 2021).

Misallocation of capital remains a critical challenge threatening the sustainable development of local financing platforms. These entities 'decision-makers frequently prioritize personal gains and short-term profits over public welfare, further entangled in information asymmetry and incentive misalignment within the principal-agent chain between government and enterprise schemes. This institutional flaw drives massive capital into projects with flashy returns but poor long-term viability. A glaring example is Hunan Province's practice of using platform loans to fund public-sector construction projects with short-term visibility but limited long-term returns, exposing their shortsightedness in strategic planning and market competitiveness (Hunan Provincial Audit Office, 2023). Such malpractice not only squanders resources but also jeopardizes the platforms' long-term growth, ultimately undermining public interests.

2.3 Insufficient impetus for market-oriented transformation

From the perspective of corporate governance, local financing platforms should be classified as state-owned enterprises. However, considering their fiscal system background and operational models, these platforms differ significantly from conventional SOEs in that they maintain close ties with government credit and policy directives across various dimensions (Mao & Xu, 2021). Precisely because they rely on government credit and operate within a "risk-sharing community" with the authorities, long-term operations have revealed issues such as insufficient market competition in business activities, limited financing channels, and inadequate operating income.

In recent years, a series of policy documents have demonstrated the heightened attention to local government debt issues from both central authorities and society at large, making the market-oriented transformation of local financing platforms an urgent imperative. From the National Development and Reform Commission's 2021 release of "Accelerating the Market-Oriented Transformation of Local Government Investment and Financing Platforms" (Macroeconomic Research Institute, 2021) to the State Council's 2020 document "Opinions on Further Revitalizing Existing Assets and Expanding Effective Investment" (General Office of the State Counci, 2022) and the 2024 emphasis in the Government Work Report calling for categorized advancement of local financing platform reforms (Policy Research Office, 2024), all these initiatives clearly indicate that orderly and effective market-oriented transformation of local financing platforms has become a crucial task of our era.

Currently, many local financing platforms face challenges in their market-oriented transformation due to overlapping market credibility with government credit. This stems from the confusion between public welfare and commercial project funding sources, as well as unclear ownership distinctions between public welfare and operational assets. The resulting ambiguity makes it difficult to accurately separate public welfare assets, hindering the transition (Zhao, He & Li, 2022). Given the varying conditions across regions, a one-size-fits-all approach for market-oriented transformation proves impractical. Some local financing platforms, already grappling with weak financial foundations and chaotic management, face even greater challenges in enhancing competitiveness. Moreover, their long-standing close ties with governments have eroded internal growth momentum. The lack of corporate governance talent capable of market-driven operations and competition, coupled with an absence of clear core business development priorities, collectively creates significant obstacles in achieving market-oriented transformation (Pan, Cheng & Wu, 2019).

3 The solution of the internal operational risk of the local financing platform: the introduction of a public director system

In the “Report of the State Council on the 2023 Central Government Final Accounts,” Finance Minister Lan Fuan emphasized the need to “systematically advance the reform and transformation of financing platform companies, accelerate the reduction of their numbers and hidden debt scale,” once again sounding the alarm bell for resolving operational risks in local financing platforms. The operation of these platforms has generated fiscal and financial risks, exacerbated the financial burden on local governments, and hindered China’s sustainable economic development. After analyzing the inherent operational risks of local financing platforms, this section introduces the public director system from other jurisdictions as a new approach to addressing these issues. Starting from this premise, we will define and characterize the public director system for local financing platforms, while examining its value in eliminating internal governance flaws within these institutions.

It should be clarified here that our discussion focuses exclusively on non-operational local financing platforms, including those platform companies undertaking purely public welfare and quasi-operational project financing tasks. This category of local financing platforms operates in close alignment with social public interests, necessitating a return to the fundamental nature of “public welfare” and aligning with the values of the public director system (Hu, 2012).

3.1 The basic meaning of the public director system of local financing platforms

“The more explicit the legal provisions, the easier it is to implement their substantive content.” (Hegel, 1961) When establishing the public director system for local financing platforms, we must first clearly define its core principles, identify key characteristics, and outline the essential framework of these directors. This clarity will ensure the authority and effectiveness of the subsequent implementation of the public director system in local financing platforms.

3.1.1 Definition of the public director system for local financing platforms

When the concept of public director systems was first introduced, it demonstrated a strong commitment to social welfare, consumer protection, environmental issues, and other public interests (Hegel, 1961). Originating from international practices, this institutional framework initially aimed to resolve conflicts between corporate decision-making processes and societal benefits, thereby maximizing public welfare protection. The system also emphasized optimizing directors' obligations and responsibilities, marking a significant innovation in corporate governance.

Given China's fiscal system and the current state of local financing platforms, the public director system was established to address corporate governance rigidity. By assigning "penetrative" responsibilities to these directors, it ensures that decision-making processes, operational management, and managerial actions align with public interests. This framework not only mitigates operational risks but also transforms external oversight into structural reforms within platform governance. Fundamentally, it resolves internal-external interest conflicts, revitalizes development momentum, and ultimately enhances social welfare.

3.1.2 Characteristics of the public director system of local financing platforms

The introduction of the public director system to address local financing platform issues represents an innovative attempt. With over half a century of research on public director systems abroad, we have distilled valuable lessons and identified the following characteristics that China's local financing platform public director system should possess:

The primary orientation lies in public interest. The establishment of a public director system within local financing platforms primarily aims to empower these directors as representatives and watchdogs of societal welfare. They conduct prudent oversight on corporate decisions, financial management, and project planning to ensure compliance with external social interests, while correcting improper corporate conduct through the fulfillment of their duties (Blumberg, 1973). Furthermore, the allocation of authority for public directors and the creation of public supervision committees are all designed from the perspective of safeguarding collective social interests.

The second aspect is the high caliber of public directors. As representatives of public interests, these directors must possess both professional expertise in corporate operations and rich management experience, along with strong ethical principles, to effectively represent and articulate public welfare demands. These dual-role directors—combining professional competence with social responsibility—are pivotal in driving management philosophy transformation, addressing corporate governance deficiencies, and ensuring financing platforms fulfill their social obligations while safeguarding public interests (Jones & Goldberg, 1982).

Finally, the independence of public directors is crucial. Public directors within local financing platforms must independently and prudently assess whether corporate decisions and operations harm public welfare (Tu, 2015). This requires maintaining independence from both the platform's management and the platform itself to prevent conflicts of interest. Additionally, given the historical context of China's local financing platforms, establishing their governance framework necessitates clarifying government relations regarding director selection, oversight, and authority exercise. This prevents improper administrative interference.

3.2 The value of the public director system for local financing platforms

Public directors should act as "whistleblowers" for local financing platforms, promptly identifying and correcting misconduct by both the platforms and their management (Alford, 2002). The establishment of a public director system in local financing platforms aims to address internal governance challenges, eliminate decision-making cliques, mitigate negative externalities caused by platform operations, and ensure that the development orientation of these platforms aligns with public interests.

3.2.1 Get rid of the "circle culture" in corporate decision-making

During corporate operations, executives, directors, and external advisors may form internal "inner circles" that exert substantial influence on decision-making and development plans through tight-knit group dynamics. These circles typically center around the CEO, extending outward to include senior management, board members, external service providers, controlling shareholders, and key employees. Under the influence of groupthink and social identification, insiders often overlook collective errors while prioritizing personal interests. Through resource dependencies and corporate culture, these groups develop cohesive actions (Fanto, 2004). This phenomenon not only distorts corporate governance structures by marginalizing external stakeholders' concerns but also harms the interests of shareholders, other stakeholders, and the public. Although the U.S. enacted the Sarbanes-Oxley Act in 2002 to curb corporate fraud and strengthen public oversight, it has yet to effectively dismantle this entrenched decision-making circle structure (Sarbanes-Oxley Act of 2002).

As an innovative solution to these challenges, public directors will exercise oversight through veto power and supervisory authority to effectively regulate corporate decisions and management practices. This mechanism enhances corporate governance transparency while addressing the historical deficiency of insufficient consideration for public interests in decision-making processes. Confronting the entrenched "clique culture" accumulated during the long-term development of local financing platforms, public directors will adopt a distinct role positioning. Guided by the public welfare nature of these entities, they must actively fulfill their duties to influence corporate conduct and managerial decisions, advocating for the broader public interest to dismantle outdated "cliques" within the system. To ensure this institutional force aligns with social welfare objectives, it is essential to establish requirements for public directors 'social responsibility and business acumen, coupled with appropriate term limits and performance evaluation mechanisms. These measures will guarantee the optimal effectiveness of China's public director system in local financing platforms.

3.2.2 Reconcile internal and external conflicts of interest in local financing platforms

China's local financing platforms face particularly complex governance challenges. These entities originated from the government's need for off-budget financing, resulting in corporate governance practices heavily influenced by administrative control. The government's extensive resource allocation and operational interference have created blurred lines between public and private sectors, with unclear responsibilities. This environment has fostered rent-seeking behaviors, where approval processes and risk controls have proven insufficient (Tong, Zhao & Li, 2024). Such circumstances not only expose these platforms to "insider culture" but also create irreconcilable conflicts of interest. Without timely resolution, these platforms risk straying further from their original mission of serving public welfare.

The inherent conflicts of interest within local financing platforms manifest not only in the tension between individual decision-makers 'personal gains and the platform's collective development, but also in the clash between commercial interests and public welfare (Conard, 1977). As independent entities in the market economy, these platforms must prioritize economic efficiency while fulfilling their unique public service responsibilities, making such conflicts unavoidable. Whether through domestic court rulings or international precedents, determining whether corporate decisions align with public welfare and sustainable growth primarily depends on professional judgment by directors and executives (Luo, 2007). Serving as a powerful instrument to address internal governance issues, public directors aim to mediate multi-stakeholder conflicts, maximize social benefits, and stimulate organic development momentum—achieving this balance requires expertise in platform operations, business acumen, and strong social accountability. To enhance governance effectiveness, public directors must consider broader public interests, holistically evaluate social and economic benefits during decision-making, and proactively mitigate risks by steering the platform's development path.

4 The power allocation of public directors of local financing platforms

Corporate directors generally bear fiduciary duties to avoid intentional harm to corporate interests and diligence obligations to promote wealth growth (Shi, 2018). Public directors in local financing platforms, building upon these responsibilities, shoulder the special mission of mitigating operational risks and safeguarding public welfare. By tracing the theoretical origins of foreign public director systems and exploring their governance value for China's local financing platform issues, we aim to establish a more comprehensive framework. This includes systematically addressing the allocation of authority and supervisory mechanisms for public directors in local financing platforms, thereby filling internal governance gaps and revitalizing these financial entities.

4.1 Selection of public directors of local financing platforms

Public directors of local financing platforms hold a position of independence from shareholders and other board members, making them the most suitable entities to implement corporate social responsibility and serve as core players in safeguarding public interests (Lei, 2008). The selection criteria, appointment mechanisms, and specific tenure regulations for public directors of local financing platforms are crucial factors that determine whether this system can truly and effectively function, thereby improving the current governance status of these platforms.

4.1.1 Selection of public directors of local financing platforms

As public directors of local financing platforms, essential qualifications include professional expertise, public administration experience, business acumen, and a commitment to safeguarding public interests. Given their inherent dual nature as both market entities and government-affiliated institutions, China's local financing platforms require more stringent selection criteria for public directors compared to general board members. A key responsibility of these directors is to prevent corporate misconduct from harming public welfare through proactive prevention and corrective measures. This necessitates two fundamental qualities: first, proven public management experience and a strong sense of social responsibility; second, while emphasizing the platform's public service mission, we must not overlook its independent legal status in the market. "The sole objective of an enterprise is to maximize profits within legal boundaries." (Stiner & Stiner, 2002) Therefore, public directors must also possess domain-specific knowledge relevant to the platform's operations and demonstrate sound business judgment. While protecting public interests, they should simultaneously build sustainable development capabilities for the platform (Lorsch & Young, 1990).

Regarding the Selection of public directors, some overseas state-owned enterprises have appointed public directors from government departments, such as St. Lawrence Seaway Development Corporation and San Francisco Presidio Trust (Jiang, 2014). Considering China's fiscal system background, shaped by local financing platforms, the Selection of public directors for these platforms should also originate from government officials. Although China's local financing platforms are essentially state-owned enterprises, we emphasize that during their transformation process, it is crucial to clarify their relationship with the government. However, guided by the goal of "public welfare," government officials can better represent public interests and fulfill the public functions of local financing platforms. Public servants inherently possess experience in public administration and awareness of public interests. Additionally, maintaining a relatively independent status from local financing platforms allows them to effectively balance individual and corporate interests, making decisions that combine commercial value with public welfare. Therefore, this group of individuals fully possesses the four qualities discussed above.

4.1.2 Selection of public directors of local financing platforms

The selection mechanism of public directors of local financing platforms, including nomination, qualification examination, election and formal appointment, needs to meet the requirements of fairness and publicness in the whole process, so as to elect public directors who can truly represent the interests of the public and update the governance pattern of local financing platforms.

The nomination process for public directors of local financing platforms begins with identifying qualified candidates from government service personnel who demonstrate the four core competencies mentioned earlier: professional expertise, public administration experience, business acumen, and commitment to public welfare. This phase involves extensive public consultation, with local governments encouraged to establish dedicated nomination committees that regularly update candidate lists.

Secondly, after the nomination of public directors of local financing platforms, the qualification review stage is carried out. This part mainly examines the basic quality of the nominated personnel and checks whether any circumstances may affect their normal performance of duties, such as holding directorships of other companies.

The appointment phase serves as the core of the entire process, typically conducted by the shareholders 'meeting of local financing platforms. After obtaining a list of qualified candidates (which usually requires the board to add explanatory notes for each candidate), the shareholders' meeting will make decisions on public director appointments in the same manner as electing other directors. If no effective decision is reached, the board must update the candidate list and convene an extraordinary meeting to finalize the decision (Del. Code Ann. tit. 8, § 223, 2003). The number of public directors appointed should be determined based on the platform's specific scale and management team size, ensuring that public directors are neither left isolated nor overstaffed (Grutter V. Bollinger, 2003).

Following the completion of the selection process, the formal appointment of public directors for local financing platforms takes place. This phase not only involves internal procedures within the platforms themselves, but also requires public disclosure of both the selection outcomes and basic information about the appointees. This ensures full transparency throughout the process, allowing for active public oversight.

4.2 The functions and powers of the public directors of local financing platforms

The dynamic interplay of various interests within local financing platforms directly determines the overall quality and efficiency of public goods provision (Deaking & Hughes, 1997). As mediators of conflicts of interest and representatives of public welfare, the effectiveness of public directors in influencing corporate conduct fundamentally depends on their exercise of authority. Therefore, defining the specific types of authority and operational mechanisms for public directors constitutes a crucial issue in establishing a robust governance framework for these platforms.

4.2.1 Special veto power of public directors of local financing platforms

The validity of corporate resolutions is determined by their alignment with the company's rational autonomy, particularly when such resolutions contribute to its survival and sustainable development. If they fail to serve this purpose, the resolutions lack legitimacy and should be invalidated (Liu, 2022). Local financing platforms exhibit unique characteristics distinct from ordinary corporate entities, as their operations significantly impact public interests.

Therefore, the authority of public directors must possess substantial efficacy to effectively "overcome" decisions within these platforms that jeopardize social welfare.

In standard corporate governance frameworks, boards typically operate under the "one person, one vote" principle. To ensure public directors in local financing platforms maintain effective oversight and prevent their marginalization due to numerical constraints (Friedman, 1973), we grant them special veto power. When platform decisions involve matters, processes, or outcomes that could harm public interests, these directors can directly block such decisions through their veto authority, thereby preventing adverse consequences. Critical decision-making areas include major investments, asset disposals, and resolutions affecting public welfare. To prevent abuse of this special veto power, two measures are essential: first, establishing clear boundaries for its application, and second, implementing external oversight mechanisms to ensure proper exercise of this authority. These aspects will be elaborated on in subsequent sections.

4.2.2 The right to convene special meetings of public directors of local financing platforms

While potential conflicts with public interests may arise during decision-making, local financing platforms may also encounter various emergencies affecting social welfare in their daily operations. This necessitates granting public directors of these platforms the authority to convene special meetings for focused discussions on critical matters. The sustainable development path for local financing platforms lies in balancing commercial efficiency with public service functions, harmonizing the dual objectives of "commercial viability" and "public welfare" (Chen, 2019). To prevent misjudgments caused by public directors' limitations in professional expertise or business acumen, major decisions should not rely solely on their opinions but require collective deliberation through special meetings.

The authority to convene extraordinary meetings of public directors at local financing platforms fundamentally serves the broader public interest. This power should be exercised when: significant risks emerge that may affect the general public, past decisions are found to be inappropriate, or management actions or corporate conduct harm public welfare. While resolutions passed at extraordinary meetings follow the same procedures as regular meetings, public directors retain oversight over their implementation. Additionally, the convening process, proceedings, and outcomes of these extraordinary meetings must be publicly disclosed to facilitate societal supervision.

5 Supervision mechanism for public directors of local financing platforms

"Power must be monitored; otherwise, it will be abused." (Montesquieu, 2020) After establishing the authority allocation for public directors of local financing platforms, it is crucial to refine their oversight mechanisms and build a comprehensive institutional framework. By detailing internal supervision responsibilities, these directors can effectively promote social welfare in key infrastructure projects, major pillar industries, and critical livelihood security sectors (Zhang & Shi, 2015). Implementing external oversight through public supervision committees that oversee director selection, performance evaluation, and appointment processes ensures dual safeguards for public interests.

5.1 Internal supervision of public directors of local financing platforms: adherence to public purposes

The introduction of public directors into local financing platforms can address the homogenization of corporate governance thinking, enhance cognitive diversity (Forbes & Milliken, 1999) and increase the emphasis on social public interests. This approach ensures that platform operations better align with public objectives. The supervision by public directors will focus on three key aspects: improving the quality and efficiency of public interest-related decisions, monitoring the supply of public goods, and reviewing management strategies.

5.1.1 Improve the quality and efficiency of financing platforms involving public interest decisions

As providers of public goods, the internal decision-making processes of local financing platforms directly impact the realization of public interests. Serving as key guardians of social welfare, public directors of these platforms will exercise special veto rights, convene extraordinary meetings, and oversee management teams to eliminate entrenched "clique culture" and groupthink limitations. This enhances corporate decisions' alignment with societal priorities, ensuring platform policies serve public objectives. Specifically, public directors can implement measures like information gathering, benefit assessment, and risk monitoring to conduct rigorous oversight of public-related decisions and their follow-up processes. These actions improve the quality and effectiveness of public-interest decisions while upholding the fundamental principle of maintaining the non-profit nature of local financing platforms.

5.1.2 Monitor the supply of public goods by local financing platforms

Another crucial responsibility of public directors in local financing platforms is to monitor the supply of public goods. As discussed earlier, these platforms were established with the mission to address China's public goods shortages, improve service efficiency, and enhance social welfare (Hu, 2017). However, their operations have accumulated massive hidden debts, continuously releasing red flags while compromising operational sustainability and deviating from public objectives (Zhu & Yang, 2024). To mitigate internal risks, we implement a governance system for public directors that corrects systemic issues, reinforcing their commitment to safeguarding public interests.

Public directors of local financing platforms must establish clear parameters for the quantity, scope, and delivery methods of public goods from the outset. They should ensure that these public goods meet national and local mandatory standards throughout implementation, rigorously control quality and safety compliance, and address systemic failures in government-provided public goods (Hu, 2012). Furthermore, these directors must conduct comprehensive evaluations of public goods supply, regularly collect public feedback, and translate this internal oversight into concrete actions that genuinely safeguard public interests.

5.2 External supervision of public directors of local financing platforms: public supervision committee

Establishing external oversight for public directors of local financing platforms, by incorporating their authority exercise, corporate decision-making, and strategic planning into public supervision, aligns with modern corporate governance principles (Yuan, 2010). As an extension of the public director system, the Public Supervision Committee will serve as an external supervisory body to effectively check and balance the powers of these directors, thereby strengthening protection for public interests.

5.2.1 Establishment of a public supervision committee

The Public Supervision Committee was established to strengthen safeguards for public interests, ensuring the independence, professionalism, and impartiality of public directors in local financing platforms. As an external oversight body, this committee oversees the Selection, training, and evaluation of public directors, thereby maintaining rational internal governance structures and preventing management from reverting to “internal circle” practices. Notably, while all public directors are government officials, the committee composition should incorporate a representative number of citizens to enhance external oversight effectiveness. This is because “only those who have vested interests can truly feel the visceral pain of being harmed,” ensuring effective public representation (Zhang, 2009). Additionally, government officials are included to guarantee the committee’s operational efficacy.

5.2.2 Functions of the Public Supervision Committee

In order to enhance the effect of supervision, it is necessary to refine the functions of the public supervision committee of local financing platforms, establish a comprehensive external restraint mechanism for the performance of public directors, and maintain the independence and impartiality of the public supervision committee itself (Bratton, 2003).

During the selection process for public directors, the Public Supervision Committee of local financing platforms is responsible for vetting candidate lists to ensure candidates possess essential qualifications, including professional expertise, commitment to public welfare, business acumen, and public administration experience. Additionally, the committee oversees the entire selection process to prevent improper conduct by platform management, thereby maintaining fairness throughout the appointment procedures.

In the performance of public directors, the Public Supervision Committee within local financing platforms is responsible for rigorous oversight of their core responsibilities (Fanto, 2004). The committee establishes corresponding evaluation mechanisms to implement daily quantitative management of directors ‘performance, while progressively developing incentive and penalty systems for public directors in these platforms. To enhance directors’ professional competence and ensure their swift adaptation to platform operations, regular training programs certified by the Public Supervision Committee are mandatory, improving their effectiveness during limited tenure periods. Furthermore, the committee uniformly regulates compensation standards and payment methods for public directors, preventing conflicts of interest between directors and platform management that might compromise public interests.

6 The construction of the public director system of local financing platforms in China

Risk management of local financing platforms presents a unique challenge in China. To resolve the governance dilemma, developing a Chinese-style solution remains fundamental (Zhang, 2022). By drawing on international best practices and considering China’s specific conditions, we have identified the significant value of public director systems in optimizing governance structures and mitigating operational risks. After establishing preliminary frameworks for designing public director systems, the focus should shift to localized implementation. This requires three key principles: building institutional frameworks, enhancing operational efficiency, and preventing systemic risks. Only through these measures can China’s public director systems truly fulfill their mission of safeguarding public interests.

6.1 Establish the framework of the public director system for local financing platforms

6.1.1 Clarify the scope of performance of public directors of local financing platforms

To address the vision limitations of “circle culture” within local financing platforms and reconcile internal-external interest conflicts, we have introduced a public director system. This innovative mechanism enhances decision-making quality and efficiency while safeguarding the public welfare nature of these platforms (Volkema & Gorman, 1998). The board structure now comprises two distinct categories: “commercial directors” focused on financial performance and “public directors” dedicated to social responsibility. These roles differ in appointment methods, term limits, compensation packages, and functional priorities: commercial directors prioritize economic growth and operational vitality, whereas public directors ensure compliance with public interest standards (Jiang, 2023).

When establishing the framework for public director systems in local financing platforms, it is crucial to define the boundaries of public directors’ authority in decision-making, strategic planning, and project operations, while clarifying their specific responsibilities. Specifically, public directors must participate in major decisions involving public interests, investment and financing resolutions, and operational strategy planning. They should monitor key projects throughout their lifecycle, oversee daily management activities, and mediate conflicts between management, financing platforms, and stakeholders. Additionally, public directors must disclose critical information and major matters affecting public welfare within the platform to the public, while collecting feedback and opinions from citizens. Ultimately, the establishment of public directors aims to prevent the distortion of “public welfare” in local financing platforms. Therefore, their scope of duties should be strictly limited to considerations of “public interest,” avoiding excessive interference in normal corporate operations. Discussing the maintenance of public interests without considering the economic foundation of local financing platforms is unrealistic and could undermine their market-oriented operational capabilities (Li, 2010).

6.1.2 Standardize the exercise of authority by public directors of local financing platforms

China’s local financing platforms are tasked with delivering public services and enhancing social welfare. Compared to direct government provision of public goods, their market-oriented operations and commitment to public service principles can significantly improve overall supply efficiency (Dai, 2013). The introduction of the public director system aims to standardize governance practices in these platforms and further strengthen their positive contributions.

After clarifying the scope of responsibilities for public directors in local financing platforms, it is essential to establish standardized guidelines for their authority exercise to prevent power abuse. Public directors must not only comply with general corporate governance requirements, fulfill fiduciary duties, avoid abuse of power for personal gain, and adhere to company articles of association and relevant corporate law provisions, but also consistently prioritize public interests as a key consideration. They should conduct comprehensive evaluations of economic and social benefits during decision-making processes to prevent risk spillover that could endanger public welfare. To ensure proper implementation of special veto rights, extraordinary meeting convening authority, and management oversight powers, an External Supervision Committee should be established. This committee will oversee daily supervision, training, and performance evaluation of public directors, thereby enhancing the overall governance effectiveness of the public director system in local financing platforms.

6.2 Stimulate the effectiveness of the public director system of local financing platforms

According to the 2024 “Local Financing Platform Manual”, China’s urban investment platforms total 3,567 (with an outstanding bond balance of 9.46 trillion yuan), of which only 201 have announced market-oriented operations (as defined by Wind data). The existing number and debt volume of local financing platforms remain substantial, with systemic risks not yet fully resolved. Addressing operational risks within these platforms has become urgent, requiring the full utilization of public director systems.

6.2.1 Clean up the relationship between public directors of local financing platforms and the government

In recent years, national policies have increasingly emphasized the debt issues and financial risks arising from local financing platforms. Authorities have stressed that these platforms must divest their government financing functions to eliminate long-standing problems of blurred lines between public administration and corporate operations in decision-making and management. For financing platforms undertaking public welfare projects with stable operating revenues, it is crucial to improve internal governance structures and enhance their development momentum (Wu, 2013).

As pivotal guardians of public interests, public directors in local financing platforms must uphold independence, professionalism, and impartiality in their duties. This principle applies not only to their relationship with corporate management but also to their interactions with the government. While serving as government officials, these directors must avoid improper administrative interference during their tenure. When handling decision-making and operational matters, they should maintain clear separation from governmental influence, exercise oversight authority prudently, and make independent judgments. Building on this foundation, we can fundamentally reform the relationship between local financing platforms and the government, establishing a modern governance structure for these entities (Yang & Meng, 2015).

6.2.2 Set up an evaluation mechanism for public directors of local financing platforms

As an external oversight body, the Public Supervision Committee is responsible for daily monitoring of public directors in local financing platforms and conducting regular performance evaluations. The assessment process may include peer reviews, shareholder feedback, and self-evaluations by public directors to ensure diversified evaluation sources and enhance fairness and comprehensiveness (The Business Roundtable, 2004). Evaluation results must be publicly disclosed to guarantee transparency, while public supervision incentivizes prudent performance by public directors. The Public Supervision Committee of local financing platforms determines specific implementation details for other aspects of the evaluation mechanism. The evaluation framework for public directors should adhere to three core principles: establishing scientific assessment indicators, adopting diverse evaluation methods, and creating effective incentive mechanisms. These measures aim to maximize the value of the public director system in local financing platforms and strengthen public confidence in their commitment to safeguarding social interests.

6.3 Preventing the risks of the public director system of local financing platforms

“All established systems inevitably face inherent flaws.” The public director system for local financing platforms represents an innovative approach to mitigate operational risks in China’s regional financial institutions. To ensure its smooth implementation, robust safeguards must be established around this framework.

6.3.1 Improve the important information disclosure mechanism of local financing platforms

Information asymmetry is the logical starting point of the corporate information disclosure system. From the perspective of social public interest, it is particularly important to establish the information disclosure mechanism of local financing platforms, which is related to the public’s knowledge and effective supervision over the implementation of public interests by local financing platforms.

One of the key responsibilities of public directors at local financing platforms is to oversee major decision-making processes, ensuring transparency in critical matters such as project implementation progress, external guarantees, and fund utilization (Xu, 2017). To prevent public directors from engaging in “backroom dealings” that could severely compromise public interests, it is essential to standardize the scope, criteria, and methods of information disclosure. This requires proactive disclosure of significant decisions and crucial operational details affecting public welfare during platform operations. Such measures will enhance governance transparency, ensure public awareness of matters directly impacting individual rights, and reduce potential risks associated with the public director system in local financing platforms.

6.3.2 Promote public supervision over the operation of the public director system

Over the years, China’s local financing platforms have accumulated fiscal and financial risks due to systemic issues, including flawed governance structures, misdirected capital allocation, and operational opacity caused by blurred government-enterprise boundaries. These challenges have sounded the alarm for their categorized transformation (Li, 2015). The introduction of public director systems aims to steer these platforms back to their core mission of “public welfare”, thereby enhancing the efficiency of public service provision and safeguarding societal interests.

To prevent decision-making errors and misconduct by public directors, it is essential to simultaneously enhance public oversight of the public director system in local financing platforms. This ensures that all decisions made by these platforms gain public understanding (Wang, 2014). By synergizing the performance of public directors with public supervision, we can establish risk control mechanisms for this system and maximize its value. Specifically, building upon improved information disclosure mechanisms for local financing platforms, multiple channels for public participation should be established. These include incorporating public input into the Selection and appointment of public directors, as well as daily operational decisions. Public hearings and press conferences can be organized to facilitate supervision of public directors’ duties. This approach not only encourages prudent exercise of authority by public directors but also ensures comprehensive consideration of public interests during platform operations. Ultimately, this achieves a balance between the “economic agent” identity pursuing profit maximization and the “responsible” commitment to safeguarding social welfare in local financing platforms (Yuan, 2020).

7 Conclusion

China’s local financing platforms, born from unique national conditions, represent a strategic blend of market mechanisms and public service functions, fiscal governance and financial operations (Wang & Huang, 2009). While they have played a positive role in delivering public goods and restructuring economic frameworks, their operational risks have gradually surfaced over time. These include misdirected fund allocation, corporate decisions that neglect long-term development, and insufficient momentum for market-oriented reforms. To address these challenges, introducing foreign public director systems provides a targeted solution. By establishing such governance structures within local financing platforms, we can optimize internal governance frameworks and reconcile conflicts between internal stakeholders and external interests in their daily operations. This approach aims to mitigate institutional risks while maximizing the effectiveness of the public director system, thereby eliminating inherent governance flaws and ensuring comprehensive protection of social welfare.

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