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Municipal financial strategy responses to fiscal austerity: The case of Taiwan

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Introduction

Sima Guang, a historian of the Northern Song Dynasty, once admonished his son: 'It is easy for the frugal to become extravagant, but very difficult to reverse the process.' Centuries later, the context for considering the virtues of frugality has grown from 'regulating the family' to 'governing the country'. In the interests of providing social security and income redistribution, welfare spending—for example, on social assistance, unemployment insurance and medical insurance—has increased exponentially and has substantially extended the role of governments. The beginnings of local government autonomy in Taiwan could be characterised as a type of state guardianship, because local governments lacked independent authority and money. Since 1999, the central government has launched a series of financial system reforms to enhance the role of local government. The *Local Government Act 1999* provided a substantial increase in power for local governments and the *Act Governing the Allocation of Government Revenues and Expenditures* was revised in the same year to improve the financial resources of local government. A series of institutional reforms was launched, including increasing general grants and empowering local

governments to levy new taxes. However, these failed to significantly increase local revenue or allow revenue to keep pace with expenditure. Local finances have been constantly in deficit in Taiwan, with little sign of improvement over the past decade (Table 12.1).

The challenge for municipalities has been how to address a surge in expenditure at a time of revenue stagnation. The response has involved an excessive dependence on the centralised system of taxes and grants. Of the five municipalities in Taiwan studied here—New Taipei, Taipei, Taichung, Tainan and Kaohsiung—Tainan City has the highest financial dependence on the centralised system, receiving 38.88 per cent of its average annual expenditure from grants (Table 12.2). Over the years, personnel expenses have absorbed an increasing proportion of revenue, which, combined with substantial growth in welfare spending, has led to structural rigidities in local fiscal expenditure and increasing local debt. In summary, the large gap between revenue and expenditure has resulted in a major debt burden. Municipalities have had to deliver public services to meet citizen demands despite this continuing fiscal imbalance.

Table 12.1 Revenue, expenses and balance at all levels of government (NT\$100 million)

Year	Central government			Local government		
	Revenue	Expense	Balance	Revenue	Expense	Balance
2005	16,164	14,542	1,622	6,017	8,378	-2,361
2006	15,909	13,930	1,979	5,861	8,212	-2,351
2007	16,361	14,425	1,936	6,087	8,477	-2,390
2008	16,488	14,368	2,120	5,828	9,068	-3,240
2009	15,666	16,911	-1,245	5,470	9,798	-4,328
2010	15,005	15,799	-794	6,150	9,869	-3,719
2011	16,729	15,575	1,154	6,333	10,555	-4,222
2012	16,617	16,228	389	6,595	10,551	-3,956
2013	17,451	16,246	1,205	7,125	10,406	-3,281
2014	17,069	16,048	1,021	7,606	11,766	-4,160

Note: The numbers for 2005–13 are actual (settlement) amounts for those years; the numbers for 2014 are from the budget.

Source: Ministry of Finance (MoF 2014: 18–20).

Table 12.2 Ratio of five municipalities' revenue and dependence on grants (per cent)

Year	New Taipei		Taipei		Taichung		Tainan		Kaohsiung	
	A ¹	B ²	A	B	A	B	A	B	A	B
2005	63.91	25.76	62.19	3.93	53.44	29.53	45.48	34.33	39.79	37.19
2006	59.81	24.71	62.02	3.26	55.82	28.91	42.84	37.67	42.40	30.95
2007	60.57	23.38	61.79	3.20	55.13	29.54	42.11	38.42	46.68	20.39
2008	44.37	20.36	57.76	17.15	47.90	37.38	33.61	46.09	44.49	30.34
2009	43.85	24.02	59.75	15.88	50.75	33.53	35.62	43.18	38.78	39.26
2010	53.22	14.98	62.37	16.59	50.97	36.45	35.84	44.80	41.57	36.46
2011	51.88	31.44	59.45	19.58	48.37	29.25	33.35	41.54	43.28	33.98
2012	58.01	21.05	58.88	18.45	54.01	23.75	42.01	34.42	48.10	24.98
2013	62.47	17.98	62.59	15.26	58.46	20.40	46.25	29.51	53.25	21.41
Average	55.34	22.63	60.76	12.59	52.76	29.86	39.68	38.88	44.26	30.55

¹ Ratio of municipality's revenue (A): (revenue – grants – allocation of income)/revenue × 100.

² Ratio of dependence on grants (B): (grants/revenue) × 100.

Source: DGBAS (2014).

In 2014, Taiwan's Ministry of Finance (MoF) announced its Local Fiscal Consolidation Project to promote local fiscal autonomy and control debt. Its practical strategies for local government included increasing resources for self-financing, reducing expenditure and debt and providing financial counselling. Local governments were encouraged to accept greater autonomy despite still being highly dependent on central government fiscal resources. To understand the strategies and measures the five Taiwanese municipalities under study adopted in response to fiscal austerity, this research addresses the following questions: 1) How did the municipalities respond to the Local Fiscal Consolidation Project? 2) What types of strategies and measures did the municipalities adopt to increase their revenue? 3) How did they control their expenditure? 4) How did they manage their debt?

The following sections consist of a brief literature review of local government strategies when facing financial difficulties, a discussion of the MoF's strategies in its Local Fiscal Consolidation Project, a description of the design and methodology of this research, a discussion of local governments' financial management strategies in response to fiscal austerity and a conclusion.

Municipal financial strategies in fiscal retrenchment

Pollitt (2010: 17–18) noted that many governments worldwide are facing a new era of 'public spending cutbacks and austerity'. In other words, governments are facing an unprecedented challenge generated by a conflict between public spending cutbacks in light of revenue limitations and increasing demands for public services (Pandey 2010; Overmans and Noordegraaf 2014: 99).

During times of fiscal austerity, when revenue is under severe pressure and governments face significant debt, a government's financial management strategy may be called 'cutback management' or 'austerity management'. In the field of public administration, Levine (1978) pioneered the study of cutback management, which he defined as 'managing organizational change toward lower levels of resource consumption and organizational activity' (Levine 1979: 180). It is difficult to determine which programs should be terminated during the process of

cutback management, as there can be many problems that are difficult to solve and the people affected might not accept such changes. The public sector might also face challenges from professional norms and procedures, veterans' needs, affirmative action commitments and collective bargaining agreements. In addition, there could be problems related to morale and job satisfaction.

Raudla et al. (2013) conducted a systematic review of the literature on cutback management, noting the diversity of recent research. They found that some researchers have focused on the long-term relationship between cuts, reforms and some responsibilities of governments during periods of fiscal austerity (e.g. Dabrowski 2009; Thynne 2011; Gieve and Provost 2012). Other studies have focused on citizens' declining trust in government coupled with heightened expectations (e.g. Massey 2011; Posner and Blöndal 2012; Van de Walle and Jilke 2012; Kattel and Raudla 2013). Some have argued that the diversity of researchers' conclusions demonstrates a lack of consensus and also reflects the fact that various countries have pursued different strategies in response to financial difficulties (e.g. Pollitt 2010; Verick and Islam 2010; Bideleux 2011; Peters 2011; Peters et al. 2011; Kickert 2012; Lodge and Hood 2012; Raudla et al. 2013: 4).

Cutback management strategies differ by country, and the question of their effectiveness is highly controversial. Whether cutback management succeeds depends on the specific strategy utilised: expenditure cutting, revenue enhancement or management improvement. Each category has a range of specific measures and tactics often associated with it (Table 12.3).

Expenditure cutting strategies include curbing public services or access to them, deferral of maintenance and capital improvements, reduction in administrative expenses, suspension of public service projects, wage reductions and hiring freezes. Walzer et al. (1992) observed that there are two main characteristics of expenditure cutting strategies. One is that governments always cut the least important service programs. The other is that the effectiveness of the cutbacks depends on the nature of the cut. For example, if governments cut capital investment projects, the effect will be short term (Krueathep 2013).

Table 12.3 Strategies for cutback management

Expenditure cutting strategies	Revenue enhancement strategies	Management improvement strategies
<ol style="list-style-type: none"> 1. Reduction in miscellaneous administrative expenses—e.g. overtime, travel, supplies 2. Hiring freeze 3. Across-the-board cuts in service programs 4. Cuts in least important service programs 5. Reductions in core services 6. Deferral of maintenance and capital improvement 7. Cuts in capital investment projects 	<ol style="list-style-type: none"> 1. Increasing tax rates or bases 2. Levying additional user fees or charges 3. Spending control through stringent tax and revenue targets 4. Drawing down fiscal reserves 	<ol style="list-style-type: none"> 1. Undertaking public expenditure reviews 2. Work process redesign 3. Medium-term spending cut and budgetary balance targets 4. Delegating services to other organisations (e.g. contracting out)

Source: Krueathep (2013: 455).

Revenue enhancement strategies include levying additional user fees, increasing tax rates or bases and drawing down fiscal reserves. According to empirical research, governments in the United States and Europe prefer to levy additional user fees because the concept of ‘user pays’ is readily accepted by their citizens (Pammer 1990; Walzer et al. 1992). Increasing tax rates or bases is an option for increasing revenue, but the political costs are very high and citizens have a strong antipathy towards taxation increases. More politically palatable are indirect increases in taxes by not adjusting thresholds for movements in prices and incomes. Drawing down fiscal reserves is another option, but it can only be used when governments have a budget surplus. Generally, government officials prefer to use revenue enhancement strategies, as these raise the most revenue with ongoing desirable effects. However, such strategies are very often not politically palatable.

Finally, governments can implement management improvement strategies to provide sufficient or improved public services with limited resources. This type of strategy includes delegating services to other organisations, redesigning work processes, medium-term spending cuts, setting targets to balance budgets and undertaking public expenditure reviews. Some researchers have noted that contracting out might enhance efficiency through competition and motivating the private sector to pursue profit maximisation (Borcherding et al. 1982; Daft 2007). Redesigning work processes can enhance efficiency and reduce the cost of public services. Setting medium-term targets to balance budgets and performing

expenditure reviews can enable reallocation of public resources over time, promoting increased productivity, economic growth and stability (Schick 1998).

In Taiwan, many scholars have expressed concern about the financial difficulties faced by local governments. Since the 1990s, they have analysed the revenue structure of local governments and problems of insufficient financial resources, and have provided practical advice such as to increase taxes, broaden the concept of user pays and examine other options aimed at increasing revenue (Shan 1996). Some scholars have found that many local governments in Taiwan rely on a single source of revenue, which might adversely affect revenue stability. They have suggested that local governments should increase self-financing resources and enhance revenue diversification (Liu and Kuo 2012). Additionally, some scholars have emphasised the importance of oversight by, and the coordination mechanisms of, the central government. They have been concerned about the capacity of local government, in the absence of central government support, to handle increased fiscal responsibilities, promote fiscal autonomy, develop and use local financial information, impose local financial discipline and enhance cooperation with other local governments (Liao and Wu 2005; Hsu and Zheng 2011).

To address the fact that local governments in Taiwan are still facing fiscal imbalances, in February 2014, the MoF proposed its Local Fiscal Consolidation Project. This reform was aimed at integrating central and local governments' efforts to address fiscal imbalances. As the reform has been implemented for more than a year, the following section briefly reviews the initial results.

The Local Fiscal Consolidation Project in Taiwan

According to the MoF's National Treasury Administration, local governments in Taiwan now face four main fiscal challenges: insufficient self-financing resources, rigid revenue structures, fiscal imbalances and heavy debt burdens, and deficient financial discipline. The basic objectives of the reform package were promoting local governments' fiscal autonomy and controlling their debt, the target outcomes of which were to reduce their dependence on centrally allocated taxes and grants and to enhance their financial discipline and fiscal responsibility.

The Local Fiscal Consolidation Project has three main strategies for assisting local governments: increasing their self-financing resources, reducing their debt and providing them with financial counselling. The practical measures, each discussed below, can be divided into four main aspects: income source diversification, expenditure reduction, debt management and financial counselling (NTA 2014). The structure of the Local Fiscal Consolidation Project is presented in Table 12.4.

Table 12.4 Structure of the Local Fiscal Consolidation Project

Status quo	<ol style="list-style-type: none"> 1. Insufficient self-financing resources 2. Rigid revenue structures 3. Fiscal imbalances and heavy debt burdens 4. Deficiency of financial discipline 	
Objectives	<ol style="list-style-type: none"> 1. Promote local governments' fiscal autonomy 2. Control local government debt 	
Strategies	<ol style="list-style-type: none"> 1. Increase local governments' self-financing resources 2. Reduce local government debt 3. Provide local governments with financial counselling 	
Practical measures	Income source diversification	<ol style="list-style-type: none"> 1. Revenue from tax 2. Non-tax revenue 3. Promotion of private participation in infrastructure projects
	Expenditure reduction	<ol style="list-style-type: none"> 1. Change the use of land reserved for public infrastructure 2. Manage the number of personnel in municipalities 3. Organisational re-engineering 4. Review non-legal financial obligations 5. Reduce educational and personnel expenditure
	Debt management	<ol style="list-style-type: none"> 1. Prepare debt repayment budget 2. Debt early warning system 3. Establish public debt administration committee
	Financial counselling	<ol style="list-style-type: none"> 1. Strengthen the assessment of fiscal balance and debt 2. Benchmarking 3. Establish local financial appraisal index

Source: NTA (2014).

Income source diversification

To avoid excessive dependency on the central government, local governments need to increase their self-financing resources. The central government suggests this can be done from three sources: tax revenue, non-tax revenue and the promotion of private participation in infrastructure projects.

First, to increase tax revenue, local governments should review existing local tax credits and enhance the assessment of real estate values. Local tax credits include land value tax, housing tax exemptions and vehicle licensing tax exemptions for people with disabilities, and so on. Local governments could also review house and land valuations and, in particular, raise the tax rate on houses used for non-residential purposes.

Second, non-tax revenue could be increased by two methods: applying the user-pays model more widely and developing and activating public assets. Central and local governments could sign contracts with the private sector to activate real estate that is publicly owned but not required for public use. With private funding, such developments could be very successful. For instance, local governments could implement transit-oriented development initiatives, integrating transportation construction (e.g. mass rapid transit and railway systems) with land development. Local governments could benefit from such projects because the value of publicly owned real estate would likely increase (Chen 2012: 74).

The final measure to broaden sources of income is the promotion of private participation in infrastructure projects. Local governments could try different ways to attract private funds, such as build–operate–transfer (BOT) or operate–transfer (OT) project financing, relaxing investment barriers and holding investment conferences. Local governments could also encourage private finance initiatives.

Expenditure reduction

The means for reducing expenditure include changing the use of land reserved for public infrastructure, organisational re-engineering, managing the number of personnel, reviewing non-legal financial obligations and reducing expenditure on education and personnel. For instance, the Ministry of the Interior has offered subsidies to local governments to review and change the use of reserved land, the aim of which is to solve inefficiencies in the use of public land. Further, the central government assembled the Re-engineering Task Group to advise local governments on limiting their personnel expenses, promote downsizing measures, redesign the structure of organisations, and so on. Additionally, due to the falling birth rate in Taiwan, the number of new students has declined, providing an opportunity to review the distribution of education resources. According to the central government, local governments could also examine non-legal financial obligations to identify any unnecessary expenditure on social welfare.

Debt management

There are three practical measures in the MoF project concerning debt management. The first is budget control. Article 12 of the *Public Debt Act* (amended in 2013) states:

For the purpose of stepping up debt management, the central government and municipalities shall prepare their budgets with at least 5 percent of tax revenues of the current fiscal year, and the counties (and county-level cities) and townships (and township-level cities) shall allocate at least 1 percent of the forecasted amount of outstanding public debt for the preceding fiscal year, for repayment of principal on debt.

Thus, governments at all levels are required to not only meet the debt interest costs, but also take action to reduce debt. The second measure is the establishment by the central government and each municipality of a public debt administration committee, regulated by the MoF, to supervise debt management and schedule repayments. The final measure is to establish an early warning mechanism for debt. If the forecast amount of public debt with a maturity of one year or more reaches 90 per cent of the loan cap, the local government should propose a repayment plan. Furthermore, local governments should publish an overview of their annual debt online.

Strengthening financial counselling to local governments

To strengthen financial counselling, local governments could improve their assessment of their fiscal balance and debt by benchmarking as well as by establishing local financial appraisal indices. Initially, governments could assess their debts and then identify means to broaden sources of income, reduce expenditure and make new tax-raising efforts (particularly in the taxation of housing). Benchmarking enables local governments to share governing experiences with each other, enabling them to continue enhancing financial management. The MoF has provided support for benchmarking by identifying financial performance indicators to guide action to reduce expenditure and control the deficit, broaden sources of income and/or manage debt (see Table 12.5). The central government should, however, go further and help to establish an impartial local appraisal index. The establishment of such an index would enhance the fiscal transparency of local governments, provide valid comparisons of performance and motivate local governments to make progress.

Table 12.5 Local financial appraisal index indicators

Aspects	Indicators
Expenditure reduction and deficit control	<ol style="list-style-type: none"> 1. Annual revenue and annual expenditure: Comparing the rate of increase of annual revenue and annual expenditure 2. Size of annual expenditure: Last year's final determined expenditure minus the year before last year's final determined expenditure 3. Surplus or deficit change: Last year's final determined surplus or deficit minus the year before last year's final determined surplus or deficit
Income source diversification	<ol style="list-style-type: none"> 1. Increase or decrease in tax revenue: Last year's final determined tax revenue minus the year before last year's final determined tax revenue (centrally allocated tax and tobacco and alcohol tax excluded) 2. Increase or decrease in fee income: Last year's final determined fee income minus the year before last year's final determined fee income 3. Increase or decrease in self-financing resources: Last year's final determined self-financing resources minus the year before last year's final determined self-financing resources 4. The ratio of self-financing resources to annual revenue
Debt management	<ol style="list-style-type: none"> 1. The assessment of debt <ol style="list-style-type: none"> a) The ratio of debts to the loan cap b) Increase or decrease in the ratio of debts to the loan cap 2. The assessment of interest payments burden <ol style="list-style-type: none"> a) The ratio of interest payments to self-financing resources b) Increase or decrease in the ratio of interest payments to self-financing resources

Source: NTA (2014).

Research design and method

This research analyses municipalities' financial management strategies and explores their response to the Local Fiscal Consolidation Project. It addresses the likelihood that local fiscal action will be affected by each governor's concept of governance and fiscal responsibility and by the local political ecology. There are also differences and similarities among local governments—they may have differing degrees of self-responsibility, different business development situations and different sources of revenue, while facing similar rigid revenue structures and budget deficits. These differences and similarities may affect the influence the central government has in coordinating and consolidating local financial management.

The research used established statistical and qualitative analysis methods. The source of statistical data was the National Treasury Administration's local financial appraisal (NTA 2014). The research is also based on related acts, regulations and news reports. In addition, the differences and similarities among municipalities' strategies for managing financial distress were explored. In-depth interviews were conducted to collect qualitative data from respondents selected through a purposive sampling approach. Two accounting officers and seven financial officers were selected from across the five municipalities. The basic information provided by the respondents is presented in Table 12.6.

Table 12.6 In-depth interview respondents

Number	ID	Interview date	Title/institution
1	A	21 July 2014	Secretary-general/Finance Bureau
2	B	31 July 2014	Section chief/Finance Bureau
3	C	9 July 2014	Secretary-general/Budget, Accounting and Statistics Office
4	D	9 July 2014	Secretary-general/Finance Bureau
5	E	9 July 2014	Section chief/Finance Bureau
6	F	17 July 2014	Section chief/Finance Bureau
7	G	17 July 2014	Senior executive officer/Finance Bureau
8	H	16 July 2014	Section chief/Finance Bureau
9	I	16 July 2014	Section chief/Budget, Accounting and Statistics Office

Source: Author's work.

The in-depth interviews aimed to collect information about how bureaucrats in local governments respond to fiscal stress and the Local Fiscal Consolidation Project. Although local politicians might play a role, this research focused on administrative responsiveness and influences, so responses were invited from bureaucrats rather than politicians.

The interview outline is as follows:

1. The municipality you belong to uses what type of strategies or measures to increase revenue?
2. The municipality you belong to uses what type of strategies or measures to control expenditure?
3. The municipality you belong to uses what type of strategies or measures to manage debt?
4. What do you think of the Local Fiscal Consolidation Project? What is its impact on local finances?

Municipal financial strategies and responsiveness in Taiwan

The following section discusses income source diversification, expenditure reduction and debt management separately. In each instance, the manner in which municipalities have responded to the Local Fiscal Consolidation Project is discussed as well as their strategies and practical measures.

Income source diversification

To broaden sources of income, local governments could increase both tax revenue and non-tax revenue. Practical measures to increase tax revenue include reviewing credits for local taxes and enhancing the assessment of real estate values. Reviewing credits for local tax involves considering low tax rates for houses used for non-residential purposes, limiting landowners' eligibility for land tax exemptions, and so on. Real estate is valued regularly for the purposes of housing, land and land value increment taxes. In 2012, the Taiwanese Government introduced a requirement for registration of the sale price of real estate and, in 2014, it found that the average ratio of assessed land value to the trading price was 86.25 per cent. In May 2014, the *House Tax Act 2014* was amended so that land value assessments could more closely match the true market value (Department of Land Administration 2015). In 2015, every municipality and county adjusted its valuations¹ so that current assessed property values could match the true value, thereby enlarging the tax base for property taxes.

Practical measures for increasing non-tax revenue include user pays and developing and activating public assets. The concept of user pays may be accepted by most Taiwanese people and, according to the *Charges and Fees Act 2002*, local governments can charge fees that are affordable for citizens, but they should review the fees every three years. This offers considerable opportunity to increase charges to cover more of the costs of services. Furthermore, local governments could develop and activate real estate that is publicly owned but not required for public use. With the private sector's expertise and capital funds, local governments could create new

1 According to the Ministry of the Interior, in 2015 the ratio of assessed land value to trading price in municipalities and counties rose by: Penghu, 24.94 per cent; Kinmen, 17.91 per cent; Yilan, 16.57 per cent; New Taipei City and Kaohsiung, 15.17 per cent; Hsinchu City, 13.21 per cent; Pingtung, 12.92 per cent; Taoyuan, 12.56 per cent; Tainan City, 12.49 per cent; Taichung City, 11.06 per cent; and Taipei City, 10.63 per cent.

business opportunities and increase local revenue. Since 1997, Taipei City has used the BOT model for project financing, signing contracts with the private sector to develop and activate real estate that is publicly owned but not required for public use. In 2012, BOT projects in Xinyi and Shilin districts were successfully executed, generating NT\$27.1 billion (A\$1.14 billion) for the Taipei City Government (Lin 2012). Currently, Taipei City has the most BOT cases of the five municipalities considered in this study and its local government is seeking additional opportunities for generating income.

As identified in Table 12.5, indicators of local government income diversification include the change rates of tax revenue, fee income and self-financing resources and the ratio of self-financing resources to annual revenue. The results for 2013 are shown in Table 12.7. In that year, every municipality's tax revenue increased (the maximum was New Taipei City's, at 18.89 per cent, and the minimum was Taipei City's, at 5.17 per cent). Kaohsiung City and Taichung City exhibited a significant increase in self-financing resources (19.51 per cent and 16.58 per cent, respectively). Their ratios of self-financing resources to annual revenue were over 50 per cent. On this score, Taipei City and New Taipei City outperformed the other municipalities, with over 60 per cent of self-financing resources, whereas Tainan City lagged behind all other municipalities.

Table 12.7 Municipalities' performance in broadening sources of income, 2013 (per cent)

Items Municipality	Change in tax revenue ¹	Change in fee income ²	Change in self-financing resources ³	Ratio of self-financing resources to annual revenue
Taipei City	5.17	-1.19	5.67	62.59
New Taipei City	18.89	12.42	9.71	62.47
Taichung City	13.93	9.62	16.58	58.46
Tainan City	7.81	14.80	4.23	46.25
Kaohsiung City	10.59	6.34	19.51	53.25

¹ Change in tax revenue: The final determined tax revenue for 2013 minus that for 2012 (centrally allocated tax and tobacco and alcohol tax excluded).

² Change in fee income: The final determined fee income for 2013 minus that for 2012.

³ Change in self-financing resources: The final determined self-financing resources for 2013 minus those for 2012.

Source: NTA (2014).

Expenditure reduction

Although local governments need to control personnel expenses by themselves, the central government should respect local government autonomy and help them to find the means to do so. Direct supervision by the central government might not receive a positive response from local governments, which might undermine the goal of reducing expenditure. To help control social welfare expenditure, the central government provides general grants to local governments for specific items and decides future funding on the basis of local governments' previous performance. Therefore, local governments are encouraged to cooperate with the central government through their access to more grants.

It is common for local governments to change the use of land reserved for public infrastructure to reduce expenditure. Through zone expropriation and urban land consolidation, local governments can maximise revenue from their land. Furthermore, by changing the use of some of the land reserved for public infrastructure, local governments can reduce maintenance costs while keeping sufficient land for public infrastructure. Moreover, after urban land consolidation, current land values tend to rise, in which case local tax revenue increases. Taking Taichung City as an example, in the past 10 years, zone expropriation has created more than NT\$10.2 billion (A\$420.5 million) in revenue and the Phase VII Urban Land Consolidation program has created more than NT\$25.3 billion (A\$1.06 billion) in revenue and related expenditure savings. According to the Land Administration Bureau of Taichung City, this tactic saved the public almost NT\$14.6 billion (A\$614 million). Further, the ongoing Phases XIII and XIV of the Urban Land Consolidation Program could save NT\$57.7 billion (A\$2.4 billion) for the Taichung City Government.

As set out in Table 12.5, indicators of expenditure reduction include comparisons of annual revenue and expenditure growth, the size of annual expenditure relative to the previous year and the level of the surplus or deficit. These indicators for the five municipalities are set out in Table 12.8. In Taichung City and Tainan City, the increases in annual expenditure budgets are much higher than the increases in annual revenue (in Taichung City, it is about 12.7 per cent higher). Of the five municipalities studied here, all except Taichung City successfully controlled their expenditure (Tainan achieving actual expenditure savings despite budgeting for more growth in expenditure than in revenue). Generally, in 2013, New Taipei City and Kaohsiung City performed comparatively well, whereas Taichung City was the only municipality to exhibit a deficit increase.

Table 12.8 Municipalities' performance in reducing expenditure, 2013 (per cent)

Items Municipality	Annual expenditure budget growth rate compared with revenue budget growth rate ¹	Size of annual expenditure increase ²	Surplus or deficit ³	
			Change in surplus	Change in deficit
Taipei City	-6.15	-3.69	-	-2.96
New Taipei City	-0.25	-2.08	-	-3.62
Taichung City	12.70	9.67	-	1.70
Tainan City	7.82	-5.65	-	-0.33
Kaohsiung City	-1.39	-2.26	-	-8.68

¹ Annual revenue and annual expenditure budget growth rate: Annual expenditure budget increase compared with annual revenue budget increase in 2014.

² Relative size of annual expenditure increase: Final determined expenditure for 2013 minus that for 2012.

³ Surplus or deficit: Final determined surplus or deficit for 2013 minus that for 2012.

Source: NTA (2014).

Debt management

Because local governments could not balance their budgets, the Local Fiscal Consolidation Project established a mechanism for controlling debt. For example, the rules for forced budget repayment required every municipality to allocate at least 5 per cent of the current fiscal year's tax revenue for debt repayment and to establish a public debt administration committee before 2014; according to the National Treasury Administration, this requirement was met. The committees were established to supervise debt management and make repayment schedules.

Another mechanism for debt management is based on information transparency. With a debt early warning and control system, local governments can be held more responsible for debt management. If a local government's forecast amount of public debt with a maturity of one year or more reaches 90 per cent of the loan cap, the central government issues a public warning and forces it to make plans for repayment. Moreover, without public debt administration committee approval, a local government with poor debt management may not be able to borrow more money.

Local governments' performance in debt management is shown in Table 12.9. For 2013, the Tainan City Government tried to reduce its debt-to-loan cap ratio but still reached 94.5 per cent of its loan cap, which activated the early warning mechanism, requiring it to propose a debt management plan and schedule to repay the debt. It is worth mentioning that New Taipei City increased its debt-to-loan cap significantly (by 19.72 per cent), to 72.91 per cent, suggesting it could be heading for a quite high debt-to-loan cap ratio. At the same time, its ratio of interest payments to self-financing resources increased about 22.29 per cent, which is relatively high among the five municipalities.

Table 12.9 Municipalities' debt management performance, 2013 (per cent)

Items Municipality	Assessment of debt amount ¹		Assessment of interest payment burden ²	
	Ratio of debt amount to loan cap	Change in ratio of debt to loan cap	Ratio of interest payments to self-financing resources	Change in ratio of interest payments to self-financing resources
Taipei City	40.13	3.95	2.75	26.59
New Taipei City	72.91	19.72	0.65	22.29
Taichung City	71.43	-4.86	0.73	-3.95
Tainan City	94.50	-2.53	1.88	14.89
Kaohsiung City	70.64	2.21	1.89	-39.04

¹ The assessment of debt amount: a) The ratio of debt to loan cap in 2013; b) Change in ratio of debt amount to loan cap—the ratio of debt amount to loan cap for 2013 minus that for 2012.

² The assessment of interest payment burden: a) The ratio of interest payments to self-financing resources in 2013; b) Change in the ratio of interest payments to self-financing resources—the ratio of interest payments to self-financing resources for 2013 minus that for 2012.

Source: NTA (2014).

The aim of the central government's establishment of these local financial appraisal indices was to strengthen financial counselling of local governments to enhance their financial discipline and fiscal responsibility. But do these municipalities really follow the Local Fiscal Consolidation Project? How are they responding in practice?

Some interviews with local officials indicate that local governments have a negative attitude towards the Local Fiscal Consolidation Project and have little respect for it. In their view, it is a recycled initiative and has limited ability to improve their local financial situation. The problem is that most of the central government's remedies are ways to take money from citizens; consequently, local government leaders cannot or do not want to accept these remedies, primarily because of the effect they believe such measures would have on election outcomes. It is unsurprising, then, that local governments have demonstrated little interest in the Local Fiscal Consolidation Project.

Basically, I think the Local Fiscal Consolidation Project is not a novel idea. It could not solve any financial problem. It's just a matter of form, and it is no help on local finance. I think the most important thing is supervision and maybe there is the effect of benchmarking. (Respondent B)

I think it is of no use because the Local Fiscal Consolidation Project is just like a poor combination of old ideas. Most of the ideas already exist. (Respondent A)

Subjectively, local governments prefer approaches that do not adversely affect citizens, but, rather, attract their notice and support. In particular, local governments with land sites to develop prefer zone expropriation and urban land consolidation strategies. These measures can both reduce expenditure and broaden sources of income. Many local governments promote this idea and some have achieved significant fiscal outcomes.

I think zone expropriation and urban land consolidation contribute a lot to government revenue. It has great outcomes. (Respondent D)

The most successful policy is the urban land consolidation. After the urban land consolidation, our government could earn approximately NT\$30 billion [A\$1.3 billion]. Moreover, the land value would rise and the tax base of land value tax, house tax, and land value increment tax would also rise. (Respondent C)

Through zone expropriation and urban land consolidation, the city government does not need to spend money. It can make ends meet and even earn some more money. (Respondent F)

The process of urban land consolidation goes very fast. It can generate tax revenue from house tax or land value tax and enrich the city government. (Respondent H)

Local governments also favour private participation in infrastructure projects. In the case of financial difficulties, local governments have no choice but to cooperate with the private sector. The central government does help local governments find investors, decide what infrastructure to build and remove investment barriers. Local governments use different methods, such as BOT or OT, to finance infrastructure. Even if the public and private sectors could benefit from public–private partnerships (PPPs), governments need to strike a balance between public and private interests when they develop such partnerships.

Promotion of private participation in infrastructure projects could save money for governments. It is the government's responsibility to provide infrastructure. However, with the private sector's assistance local governments could save money and enhance efficiency. Take our city as an example, we develop 22 public–private partnerships and the private sector has invested more than NT\$20 billion [A\$842 million]. (Respondent F)

When local governments try to solve debt issues through the promotion of private participation, they need to consider carefully whether they are replacing direct loans (or debt) with indirect loans, particularly if the PPP deal involves the private partner being paid a fee by users. From a political perspective, there are likely to be limits to the extent to which new capital developments, whether through land consolidations or PPPs, can solve local financial problems. While local governments might not like the pressure from the central government to live within their means, it is understandable that the central government does not want to provide more grants and revenue transfers when local governments could accept more of the financial burden.

Conclusion

In a new era of governance, the role of local governments in Taiwan is changing. They face a dilemma in the need to make cutbacks as well as an expectation to provide more public services. After 2000, there was a series of fiscal decentralisation reforms aimed at responding to the call for fiscal autonomy. Unfortunately, these reforms seemed neither to increase local governments' revenue significantly nor to diminish their financial dependence on the central government. In the past 10 years, most local governments in Taiwan have had to fight for funding from

higher levels of government, while also looking to broaden revenue and reduce expenditure; local government politicians, however, have made commitments during election campaigns causing expenditure increases.

In 2014, the MoF launched the Local Fiscal Consolidation Project, which provided clearer strategies and measures for local governments to cope with fiscal imbalances. The project contains 27 practical measures under four main headings: income source diversification, expenditure reduction, debt management and financial counselling. In pursuing financial counselling, the central government wants to help lower-level governments to exercise fiscal autonomy and control their debt.

To broaden sources of income and improve fiscal autonomy, some practical measures were suggested, including reviewing credits for local taxes and enhancing the assessment of real estate values. These aim to increase revenue by means of broadening the local tax base. According to the National Treasury Administration, in 2013, every municipality's tax revenue increased (the maximum was New Taipei City's, at 18.89 per cent, and the minimum was Taipei City's, at 5.17 per cent). These measures seem effective, especially in larger cities such as New Taipei, Taichung and Kaohsiung City. The other measure was to increase non-tax revenue through user pays and developing and activating public assets. Comparatively speaking, these measures have been accepted because of their limited adverse effects, whereas broader revenue measures, such as increased tax rates, did not work because of political resistance.

Expenditure cutting measures suggested by the Local Fiscal Consolidation Project included managing personnel numbers in municipalities, re-engineering organisations, reviewing non-legal financial obligations and reducing educational and personnel expenditure. In 2013, Kaohsiung City and New Taipei City outperformed the other municipalities in reducing their expenditure—decreasing the level of deficit by 3.62 per cent and 8.68 per cent, respectively. Some successes were achieved via land development or where the central and local governments shared the expenditure burden and related political pain via financial grants. However, it is understandable that local governments were reluctant to initiate action to reduce services to the public, by adopting public service cuts in areas such as education and social welfare, and wanted the central government to take the lead in this area.

Finally, the Local Fiscal Consolidation Project attempted to establish an open information mechanism and accountability system to manage and control debt, including making rules for forced budget repayment and establishing public debt administration committees. Tainan City's debt reached 94.5 per cent of its loan cap in 2013, which activated the early warning mechanism, and the city was required to propose a debt management plan and repayment schedule for the following year. With the policy of information transparency, the public and the mass media are better positioned to provide oversight of their governments and to hold local government leaders accountable and prevent them from increasing debt.

To sum up, if the central government wants to be a financial counsellor or controller in cutback management, in Taiwan, as in many other countries, the difficulty is ensuring each level of government accepts responsibility for funding its functions. Politically, it is easier for local governments to blame the central government for insufficient grants and revenue shares and for the central government to push responsibility for functions to local governments without identifying the sources of funding.

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