

REVIEWING FISCAL DIFFICULTIES OF LOCAL GOVERNMENTS IN TAIWAN

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—Abstract—

This study attempts to discuss the local public finance problems of Taiwan based upon the viewpoints of fiscal sociology. Fiscal sociology basically states that government is a place where public finance resources are competing and that fiscal difficulties of local government represent a social problem.

In summary, this research intends to discuss the fiscal difficulties of local government with the view of society as a whole. Moreover, I will analyze the issue —i.e., how changes in social relations between people influence the distribution of tax sources and the division of authority between the different levels of government— with the perspective of social structure.

Key Words: *Fiscal Difficulties, Fiscal Sociology, Local Government*

JEL Classification: H72

1. PREFACE

The fiscal position of Taiwan's local government presents the following situation approximately. First, the local government's own-source financial resources are not enough to cope with the burden of the task of funding required. Second, the fiscal deficit is thus widening, and local government's debt burden is in turn increasing. Third, because regional developments are imbalanced, an uneven distribution of tax sources exists among local governments. Fourth, the proportion of personnel expenditures as a percentage of own-source financial resources is high, which leads to a rigid expenditure structure.

In the face of fiscal difficulties of local governments, local governments in Taiwan have proposed a variety of strategies based on the decentralization

theorem (Oates, 1972), the Tiebout model (Tiebout, 1956), and the principal-agent model (Levaggi, 2002 ; Tommasi, 2007). However, these strategies cannot be effective. The financial difficulty of the local government still exists.

2. THE LOCAL PUBLIC FINANCE ISSUES BASED ON THE STAND POINT OF FISCAL SOCIOLOGY

Fiscal Sociology regards government as a square for fiscal activities and competitions, and local fiscal difficulties as a social issue (Goldscheid, 1967). Hence, we know that the fiscal and political systems and the social structural factors formulating these systems must be taken into considerations for the investigation of fiscal difficulties of local government. In other words, the issues of local fiscal difficulties must be understood based on the factors of social structure rather than the division of authority between central and local government according to pure economic standpoint of Decentralization Theorem. It is also wrong to assume the local fiscal difficulties can be solved simply by raising the own-source revenues of local governments.

2.1. Consider the central and local government's finances at the same time

Fiscal Sociology emphasizes the investigation of local public finance issues based on the standpoint of the entire society. Both central government and local government are only the square for numerous participants to pursue different objectives and to interact with each other. The participants of these two kinds of square may be overlapping with mutual interaction and constraints. Therefore, the fiscal difficulties of local government cannot be solved by local government alone. The government expenditures and tax revenues under social structural change are inseparably composed by central and local governments based on common social foundation. Therefore, only the central government with sound fiscal condition will lead to healthy local public finance.

2.2. Consider the efficiency and equity at the same time

Fiscal Sociology has emphasized social relationships regarding resources allocation among people in the entire society. Under the social structure with imbalanced regional development, the gaps between economic resources allocated for each local government resident has been too big leading to the inequality of "economic power" among all local government residents. And this inequality of economic power will be extended to the political and social aspects in the democratic capitalism system leading to inequalities of "political power" and

“social power”. This will result in unreasonable classification of sources of tax revenues and division of authorities between central and local governments, and between local governments. As a further result, unfair wealth allocations will be generated among residents of all local governments. Since efficiency is based on fair and reasonable distribution of wealth, there will be no efficiency without fair distribution. (Chang, 2008: 50) Therefore, the Decentralization Theorem with the only emphasis on efficiency objective is not suitable under the social structure with imbalanced regional development. The efficiency of resources allocation can only be achieved by reasonable distribution of resources with respect to residents of all local governments.

2.3. Consider the sources of tax revenue distribution and the division of authority simultaneously

Fiscal Sociology emphasizes multi-facet, holistic point of view where things of reality and specific existence shall not be constrained by unilateral regulations. Therefore, factors of revenues and expenditures of local governments must be simultaneously taken into considerations for the investigation on local fiscal difficulties. Fiscal difficulties are the comprehensive results of government revenues and expenditures, thus the crux of the issue will not be understood by unilateral discussion of either financial resources or the division of authority. In other words, the sources of tax revenue distribution and the division of authority among governments of different levels should be simultaneously taken into considerations, while the distribution of sources of tax revenue should depend on the responsibility undertaken by local government.

2.4. Consider social relation between local government expenditures and tax collection

Fiscal Sociology considers local public finance phenomenon as the presentation of social relationships among people, and as the interdependence among fiscal matters, economic balance, and social balance. In other words, the revenues and expenditures of local governments can be regarded as the presentation of social relationships among people. From the fiscal revenues and expenditures of local governments we can see the existence of all kinds of economical and social issues in the society at that time, while the social influences of different organizations will determine the distribution of revenues and expenditures of local governments.

Therefore, the investigation on the social relationships of expenditures and tax revenues of local governments is the starting point for understanding fiscal difficulties of local governments. If we can understand the variations of social relationships among residents of governments of all levels caused by social structural change with respect to variation of production technology, we will be able to figure out the reason behind fiscal difficulties of local governments.

2.5. Consider the quasi-fiscal agencies

In terms of research method for local public finance issues, the methodological basis of pluralism and derived dual has been adopted by Fiscal Sociology. The mechanism of resources allocation is not dualism (market and government). In other words, in addition to market and government (including central and local government), nationwide organizations composed by occupation or identity with membership fees as the financial resources (generally known as the quasi-fiscal agencies) can be one kind of resources distribution mechanism. Therefore, the influences of quasi-fiscal agencies on residents of all local governments and on distribution of sources of tax revenues and the division of authority among governments of all levels must be all taken into considerations simultaneously while dealing with local fiscal difficulties.

3. THE INFLUENCE OF SOCIAL STRUCTURAL CHANGE ON THE LOCAL PUBLIC FINANCE OF TAIWAN

From aforementioned theorem of Fiscal Sociology we know that the fiscal difficulties of local governments must be investigated from the standpoint of the entire society. And we should analyze from the perspective of social structure how the variation of social relationships among people affects distribution of sources of tax revenues and the division of authority among governments of all levels under social structural change.

3.1. The influences on financial status of governments of all levels

Under post-industrial society, the unique historical heritage of Taiwan, social structure and political system, the change of the basic lifestyle and the transition of social organizational structure, the following scenarios of the ten trends (Perkin, 1996) will be presented including the enhancement of the living standard; professional elites (professional managers of cross-border companies and government officials) place at the top of social class controlling the economy of the whole society, distributing income and arranging social relationship; conflicts

of economic interests between professional elites and the public; biased meritocracy brings about effects of factors (income, in particular) other than capabilities on the formation of professional elites; enhancement of female education and labor force participation rate; governmental control power over the whole economic resources appearing to be on the increase, however, declining in recent years; robust, but yet adequate, social security system; gradual increase in the number of persons receiving higher education; and steadily growing effects of professional elites from large or multi-national companies on the government. Of course, the most important is that Taiwan society organized and controlled by the increasing number of professional elites (most of whom are company managers and government officials).

In other words, in the post-industrial society of Taiwan, government officials and company managers are the most important people who control the distribution of social resources. Besides, professional hierarchies insist the ideology of free market, thereby leading to a laissez-faire market. Emergence of larger-sized enterprises and economic globalization has weakened governmental functions. All these enable government officials and company managers to extract social resources excessively to satisfy themselves while leaving the costs to the public. As a result, most economic resources are private; tax base is eroded and lost; social security expenditures are insufficient, basic labors and the middle class shoulder the responsibility of economic recession and the problem of unemployment. There are reflected on government expenditures and revenues ultimately, while government fiscal deficits are one of the symptoms. (Chang, 2008: 100-103)

3.2. The influences on the distribution of financial resources and the division of authority among governments of all levels

The influence of social structural change on the distribution of financial resources and the division of authority among governments of all levels is the trend of fiscal centralization. The so-called “fiscal centralization” is referring to the trend of the distribution of financial resources and the division of authority among governments of all levels centralized in central government or government of higher level. Usually the degree of centralization will be evaluated by the proportion of total expenditures (total revenues) of governments of all levels accounted for by the expenditures (revenues) of Federal (Central) government (Maior, 2009).

In other words, the cause of fiscal centralization is the social structural change (change of social relationship among people) under post-industrial society leading to the distribution of financial resources and the division of authority among governments of all levels centralized in central government or government of higher level.

3.2.1 Allocation of financial resources

The impact of trend of post-industrial society on financial resources allocations among governments of all levels in Taiwan has lead to accelerated flow of sources of tax revenues, and the excess burden and tax competition of local taxes.

In the post-industrial society, the transportation system and mass communication system have been greatly improved by the development of information electronics technologies and the utilization of new intellectual technologies. The greatly enhanced standards of living for residents of all areas have led to greatly improved mobility of individuals between local governments. In addition to enhanced mobility of individuals, the mobility of production factors has also been greatly enhanced under the emergence of larger-sized enterprises and influences of economic globalization. Under such social structure change, the flow of sources of tax revenue has been accelerated, the scope of cost-sharing and benefit distribution of public goods has been expanded, and the spillover effects across local government jurisdictions can be generated easily. From the perspective of efficiency, the local tax which can be levied by local government alone has become less and less.

In other words, with the social structure change in the post-industrial society leading to enhanced flow of sources of tax revenue, the local tax levied by local government alone cannot become a rich source of tax revenue. The unclear relegation of sources of tax revenue will easily lead to tax exporting and tax competition. Moreover, the imbalanced developments between urban and rural areas caused by urbanization development will worsen the gap of distribution of sources of tax revenue among all local governments. Therefore, with the principle of taxation as the pursuit of efficiency and fairness, the allocation of financial resources should be focused on central government.

3.2.2 The division of authority

The impact of trend of post-industrial society on the division of authority among governments of all levels in Taiwan has lead to consistent needs for public goods

or labor services among people and more intensive responsibility undertaken by central government, such that the division of authority is concentrated in central government.

In terms of the needs for public goods or labor services in post-industrial society, residents in different local government jurisdictions tend to request for public goods or labor services of the same level due to extended higher education, popularity of national education, and expansion of the concept of citizenship. In addition, due to enhanced mobility of individual and production factors, the relative dependences among all local governments will also be increased. With the preferences of residents in different local government jurisdictions gradually reaching consistency, there will be request for public goods or labor services of consistent quantity and quality.

Under the social structure change, people will demand central government to undertake more tasks such that the control over the entire social and economical resources will be enhanced, and the division of authority will be concentrated in central government.

First of all, central government should be responsible for the formulation of economical policies. Under the emergence of larger-sized enterprises and influences of economic globalization, the entire economic system is facing a more intensive challenge such that the issues of sustainable economic growth, low inflation and low unemployment rate have become very important tasks. The governments of higher level should be responsible for formulating policies in response to such challenging tasks. In this case the tasks for central government will naturally be enhanced such that the division of authority will be concentrated in central government.

Secondly, central government needs to bear the costs of technology development. The post-industrial society is based on the third social revolution of technology allowing a small number of people to produce consumer goods and foods for the majority of people. These people released for other works are mainly in the service industry, but it is not just the progress of production technology (production mode). Technology cannot create, install and maintain itself. It will take special experts to create, install and maintain technology, and complicated configuration is required for its operation. Technology is created by professional experts, and managed and organized by bureaucracy. Therefore, central government is directly involved in the formulation of policies of technology and

higher education. Central government is responsible for the expenses of R&D and management of scientific technologies, while the higher education for developing talents of scientific technologies will also be controlled by central government. The influences of these social structure changes all lead to the division of authority concentrated in central government.

Finally, central government needs to undertake the task of formulating social policies. The increasing competition for financial resources in the post-industrial society is the conflict of economic interests between professional hierarchies and between professional and non-professional hierarchies. The conflicts of economic interests in Taiwan have led to the following results:

- (1) Conflicts of economic interests for distribution of economic resources between individual and collective

Under the post-industrial society of Taiwan, resources such as labor, land and capital are distributed between individual and collective, shrinking resources of the nation. Most economic resources are private; such unreasonable distribution of economic resources results in unfair competition and leads to irrational distribution of output.

- (2) Conflicts of economic interests for distribution of tax burden

Due to the gradual erosion of tax base and gradual decline of tax rate, the fund raising capability of government has been getting challenged. With government's finance principle of "revenue according to expenditure", governments' tax revenues can no longer afford the provisions of public goods and labor services needed by general public, such that they have begun to rely on the issue of bonds.

- (3) Conflicts of economic interests for government expenditures

With professional elites ignoring the positive influence of expenditures for social welfare on overall economic growth and competitiveness of this country and considering expenditures for social welfare will only lead to expelling effect on expenditure of economic development, as a result there is a lack of expenditures for social welfare. Obviously there is a huge room for improvement on how government should maintain the functions of basic living rights of nationals.

- (4) Conflicts of economic interests for distribution of corporate profits

Due to the prevalence of free market ideology, working class and middle class have taken the responsibility for economic regression, while enterprises are

hoping government can be heading toward loosen and open labor market such that the protection of rights-to-work of labors has been getting worse every day.

All above scenarios under the social structure of expanded concept of citizenship have led to general public demanding central government to be responsible for formulating social policies such that the division of authority is concentrated in central government.

By summarizing all aforementioned discussions regarding financial resources allocation and the division of authority, we know that in post-industrial society the financial resources allocation and the division of authority are centralized in central government due to the factors of social structure change including the enhancement of the living standard, the fight for resources between professional classes and between professional and non-professional classes, the enhanced control over economic resources in the society by government, promotion of the concept of civil rights, expansion of higher education, emergence of larger-sized enterprises, and influences of economic globalization.

Therefore, in response to local fiscal difficulties, we need to get rid of the concept of the past where local government was recognized as an independent individual with independent sources of tax revenues. In a post-industrial society, central and local governments are based on the same social relationship foundation. In other words, the development of fiscal relationships between central and local governments must be heading toward the system of mutual assistance and cooperation. The strategies in response to local fiscal difficulties should be the allocation of sources of tax revenues based on the responsibilities undertaken by local governments instead of blindly setting the objective as raising the own-source revenues of local government. Therefore, for the perspective of fiscal system, the design of a distribution system for sources of tax revenues based on the division of authority is the most crucial issue for dealing with local fiscal difficulties.

4. CONCLUSION

Facing the constraints of current strategy, in this article we introduce the concept of Fiscal Sociology for investigation on fiscal difficulties of local government. We explain how the change of social relationships in post-industrial society is going to affect the distribution of sources of tax revenue and the division of authority among governments of all levels. In this article we provide following institutional

suggestions with respect to fiscal difficulties of local government considering current trend of fiscal centralization: the fiscal integrity of central government is the foundation for improving local fiscal difficulties, the authorities of central and local governments must be clearly divided, central government must compliment the insufficient financial resources for local government, there should be uniform and objective standard for the proportion of allocation of centrally-funded tax revenues among municipalities and all counties (cities), all tasks undertaken by local governments must be taken into considerations for determination of allocation of centrally-funded tax revenues, grant in aid system among governments of the same level can be considered for dealing with horizontal fiscal imbalance among governments of all levels.

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