

## *2011 Budget Proposal Under Review*

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The central government's general budget proposal for fiscal year 2011 has been sent to the legislature for review. The government has earmarked NT\$1.7896 trillion in expenditure and NT\$1.6306 trillion in revenue, which amounts to a budget deficit of NT\$159 billion or 8.88 % of expenditure. Together with a special budget of NT\$204 billion, the combined budget gap totals NT\$363 billion, which amounts to 18.21% of overall expenditure under the general budget and the special budget, and 2.62% of GDP, as forecast for 2011 by the Directorate-General of Budget, Accounting and Statistics (DGBAS) under the Executive Yuan. In order to finance the budget deficit and debt principal repayment the government will need to issue bonds worth NT\$429 billion, the second highest amount ever following new borrowing of NT\$493 billion in 2010.

### *Structural Deficit Evident*

The severe budget deficit shows that the government finances have lost their structural balance so that we no longer face a recession-related cyclical deficit, but a structural deficit. Outstanding government debt has rapidly

accumulated since the constantly widening budget hole was largely financed through the issuance of bonds. The total amount of outstanding government bonds with a maturity of more than one year continuously rose from NT\$3.720 trillion at the end of 2007 and is expected to hit NT\$4.962 trillion at the end of 2011. This would amount to 37.5% of average gross national product (GNP) of the previous three years, close to the 40 percent public debt ceiling stipulated in the Public Debt Act.

### *How Government Reveals Public Debt Level Violates International Rules*

Article 4, Paragraph 1, of the Public Debt Act stipulates that the forecast public debt extending more than one year as taken out by the central government on the general budget, special budgets, and in the form of extraordinary fund budgets beyond the operating funds and trust funds, shall not exceed forty percent of the average nominal gross national product (GNP) of the previous three years as forecast by DGBAS. Therefore if the Ministry of Finance (MOF),

when calculating the caps on public debt accumulated in the past and on new debt, excludes self-redeeming public debt with a maturity of more than one year, debt loans, treasury bill issues, and short-term loans from the sum of outstanding public debt, then the figures are no longer able to reflect the government's actual debt burden and also violate international rules for government debt statistics issued by the International Monetary Fund (IMF). The MOF's refusal to make debt service from self-financing resources the criterion in setting national debt limits does not only differs from the approach used in developed countries, but also deliberately covers up a possible worsening of government finances.

### Sovereign Ratings Outlook Turns Negative Due to Deficit

International ratings agencies have voiced concern over Taiwan's fiscal situation for several years in a row, noting that the worsening finances are likely to negatively affect Taiwan's local currency rating. Fitch Ratings said in a press release in late September: "Taiwan's weak fiscal outlook and economic prospects may weigh on its sovereign rating-even as a global recovery has spurred a rebound in the country's

exports and financial markets." It quoted Vincent Ho, associate director in Fitch's Asia-Pacific sovereign ratings team as saying that "Taiwan's rising government debt amid weak fiscal and tax revenue suggests fiscal consolidation in the medium term may not be credible." The agency expects that Taiwan's general government debt/GDP ratio will rise to 48% by end-2010 and its fiscal deficit will substantially widen to more than 4% of GDP in 2010-2012 from an average of 1.5% in 2003-2009.

### Don't Let Up on Deficit Cutting Measures

Not only international credit rating agencies have been sounding a warning over Taiwan's fiscal straits. In its audit of the central government's financial report for fiscal year 2009 the National Audit Office pointed out that the government expanded expenditures seemingly uncontrollably, while invariably cutting taxes. As a result the budget gap in 2009 reached NT\$387.7 billion so that the government's fiscal structure severely lost balance, also because tax reforms made only limited progress. On October 6 the Control Yuan slapped the Executive Yuan and the finance ministry with a corrective measure, while also pointing out that even though

government debt had not yet reached the limit set in the Public Debt Act, it kept climbing higher and there was a huge amount of hidden liabilities. The government watchdog concluded that the continuously worsening fiscal deficit constituted a threat to national development and national security.

When Premier Wu Den-yih was asked in a questioning session during the review of the 2011 central government budget in the legislature what the heavily indebted government would do once its borrowing exceeded the Public Debt Act limit, he said he thought the government had only two options, namely giving up infrastructure construction or asking the Legislative Yuan to relax the ceiling on public debt. Similarly the finance ministry does not only fail to squarely face the worsening government finances, it even declared repeatedly toward the outside world that “the finances of the Republic of China are the best of the world.”

Aside from the premier who, wringing his hands, professes that the situation can't be helped, the government should actually try to come up with a solution to the structural fiscal imbalance more eagerly. Britain and other advanced nations, for instance, have already proposed measures to actively reduce the wasteful use of fiscal resources and slash their budget deficits. On the contrary, our

cabinet agencies have earmarked almost NT\$100 million in the general budget proposal for overseas travel expenses on top of NT\$121.2 million earmarked under the budget item “expenses for trips to the mainland area.” This budget item has more than doubled compared to the NT\$55.8 million earmarked in 2009, which is not only clearly against the principle of reining in expenditure and wasting less money, but cries for further discussion or even deletion from the budget proposal. As everyone can see the government is not powerless when it comes to addressing our fiscal problems such as the structural deficit and huge debt. The key is rather whether those in power respect fiscal discipline. **BT**