Taiwan's Fiscal Setback Mirrored by the U.S. Debt Crisis

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After U.S. bonds triggered a global financial crisis, fiscal problems have moved to center stage. The U.S. is in bad fiscal shape, Europe faces a sovereign debt crisis, and Taiwan saw its local currency sovereign credit rating downgraded by Fitch Ratings earlier this year. This article describes the government deficit and debt situation, while also pinpointing tax break goodies as the cause behind the structural imbalance of government finances and the rather low tax burden. On top of that ensuring a fair allocation of government expenditure is at the core of the fiscal problems. In the wake of the U.S. debt crisis we should earnestly consider how to establish a national fiscal system that serves the people.

Bad U.S. Finances Lead to Lower Credit Rating

When the U.S. bond crisis erupted in early August, it caused a global stock market meltdown. Since U.S. government debt has soared to US$14.29 trillion, nearly hitting the debt ceiling, Washington is at risk of not being able to repay its debt at maturity. Given that the U.S. was on the brink of defaulting on its debt, the nation's credit standing suffered. Eventually the political parties in the U.S. Congress struck a last minute compromise, raising the debt ceiling and agreeing on an initial package for deficit reduction.

But international ratings agency Standard & Poor's, which had previously cut Washington's credit outlook to "negative," on Aug. 5 nonetheless downgraded the credit rating of U.S. Treasury bonds from AAA to AA+. Aside from pointing to the bad fiscal situation and slamming the rise in the debt ceiling despite insufficient deficit reduction efforts, S & P cited as major reason for the downgrading a greater risk for the U.S. government to default on its debt because the political parties' selfish political wrangling during the debt crisis had weakened the effectiveness, stability, and predictability of American policymaking.

Taiwan Sees Credit Rating Cut over Bad Fiscal Shape

Similar to the U.S., Taiwan saw its local currency sovereign rating lowered by an international ratings agency in January this year due to its deteriorating government finances. In Oct. 2010 the Control Yuan had already proposed corrective measures to the Executive Yuan and the Ministry of Finance. At the time the Control Yuan argued that while central government debt had not yet reached the ceiling set in the Public Debt Act, statistics showed that government debt was still climbing, that hidden debt was huge, and that the fiscal deficit continued to deteriorate, posing a risk to national development and national security.

Public Debt Approaches Debt Ceiling

In the three years since the government of President Ma Ying-jeou took power in 2008 the shortfall between central government revenue and expenditure has widened year by year, markedly pushing up the budget deficit. With new debt issued worth more than NT$400 billion every year, a total of NT$1.339 trillion in new debt has been raised in the past three years, not counting the NT$125.5 billion in debt issued in fiscal year 2008. Debt has increased at an astonishing pace with no slowdown in sight.

The main reason for the debt is a severe imbalance between government revenue and spending. In the 2011 central government general budget proposal the fiscal gap between revenue and expenditure reached NT$159 billion. When the NT$204 billion shortfall from special budgets is factored in, the combined shortfall amounts to 18.21 percent of total general budget and supplementary budget spending.

When expenditures outpace revenue a mountain of debt will naturally pile up. As of the end of 2011 outstanding debt will total NT$4.9213 trillion, etching close to the debt ceiling stipulated in the Public Debt Act, which says that central government debt shall not exceed 40 percent of the average gross national product of the previous three years. After the transfer of government in 2012 the new government will face the conundrum that it won't have any room for raising new debt unless it amends the law to raise the debt ceiling.

Rampant Tax Cuts Cause for Fiscal Imbalance

The widening fiscal deficit and the continued rise in outstanding debt show that the government is unable to effectively rein in expenditures. On the revenue side the excessive granting of tax breaks has led to a structural imbalance. The rampant use of tax cuts and tax exemptions has already undermined fiscal stability. The reduction of the inheritance tax and gift tax constitutes tax cuts for the rich. The lowering of the profit-seeking enterprise tax rate from 25 percent to 17 percent amounts to a tax reduction for corporate groups. Due to the rather low tax burden, tax fairness has been thrown into doubt. In FY2010 the tax burden (tax revenue as percentage of GDP) fell to just 11.9 percent.

Unequal Distribution of Government Spending Crux of the Problem

At the back of the U.S. debt crisis the Republican Party and the Democratic Party were for a long time unable to reach consensus on how to cut the fiscal deficit. The Democrats insisted on maintaining social welfare spending, while scrapping corporate tax breaks to balance the budget. The Republicans for their part hoped to maintain the corporate tax incentives and wanted to cut government spending and scale down the government instead to achieve a balanced budget. The two political parties held on to their respective stances regarding the distribution of government finances, as to who should

Issuance of Central Government Debt

Unit: NT$ million; %

FY	Debt Issue Amount			Annual Expenditure	Debt Issue Amount/ Annual Expenditure
	Debt included in the annual debt limit	Debt excluded from the annual debt limit	Total	(Before 2001 called total expenditure)	
2nd half of 1999 plus 2000	387,920	80,000	467,920	2,538,699	15.28%
2001	277,000	78,075	355,075	1,709,755	16.20%
2002	245,000	0	245,000	1,578,560	15.52%
2003	237,900	83,900	321,800	1,635,646	14.54%
2004	230,000	63,500	293,500	1,627,619	14.13%
2005	144,400	107,053	251,453	1,627,654	8.87%
2006	64,025	74,000	138,025	1,593,296	4.02%
2007	0	101,729	101,729	1,628,351	0.00%
2008	0	125,546	125,546	1,711,717	0.00%
2009	165,000	248,819	413,819	1,809,667	9.12%
2010	224,700	255,041	479,741	1,714,956	13.10%
2011	205,301	240,234	445,535	1,788,422	11.48%

Notes: 1. Up to FY2010: Final Audit Accounts of the Central Government, FY2011: Budget of the Central Government (including supplementary budgets)
2. The debt issue amount and debt issue amount/total expenditure exclude debt repayment and new debt issues from the Central Government Debt Service Fund

Central Government Debt as Percentage of GDP
(lists only debt outstanding more than one year)

Unit: NT$ million; %

FY	Outstanding Debt	GDP	Outstanding Debt/GDP
2nd half of 1999 plus 2000	2,450,138	10,187,394	24.05%
2001	2,759,121	9,930,387	27.78%
2002	2,849,272	10,411,639	27.37%
2003	3,124,741	10,696,257	29.21%
2004	3,362,141	11,365,292	29.58%
2005	3,549,926	11,740,279	30.24%
2006	3,622,951	12,243,471	29.59%
2007	3,718,681	12,910,511	28.80%
2008	3,779,227	12,620,150	29.95%
2009	4,128,045	12,477,182	33.08%
2010	4,541,782	13,603,477	33.39%
2011	4,921,317	14,009,437	35.13%

Notes: 1. External debt is not included.
2. FY1989-2010: Final Audit Accounts of the Central Government, FY2011: Budget of the Central Government
Source: National Treasury Agency, Ministry of Finance

benefit from government expenditure and who should shoulder the tax burden. Both sides hoped to adjust the allocation of government finances to curry favor with their respective voters, and erode the other side's voter support base.

In Taiwan the misallocation of fiscal resources and the rigidity of the budget have lead to an uneven distribution, which actually is the fundamental core of our fiscal problems. But the core problem of uneven distribution is little discussed. Although the budget deficit is widening and the fiscal situation is tight, the government keeps handing out inheritance and gift tax cuts to high income earners, grants salary rises to military officers, civil servants, and teachers, and subsidizes the 18 percent interest paid on their preferential savings accounts with NT$700 million to NT$800 million per year. The government also sponsored the Taipei International Flora Expo with a huge amount, and issued shopping coupons worth NT$80 million, all by issuing new debt, padding budgets for public infrastructure projects, and compiling supplementary budgets. Such improper government expenditures cause fiscal straits and raise people's doubts over the fairness of the government's spending practices.

The root of our fiscal problems lies in the government, which despite controlling huge economic resources from levying taxes and borrowing large amounts, is not only unable to solve the various crises that our people face – be it the economy, society or even the loss of national sovereignty – but also causes a widening of the wealth gap due to the unfairness of the tax system. Due to the fiscal difficulties the right to survival of economically disadvantaged groups is in jeopardy, which naturally causes a correspondingly strong sense of deprivation and great harm to people's dignity.

Establishing National Finances for the People

As the U.S. debt crisis gradually abates, we need to squarely look at our current fiscal problems. Aside from cultivating basic fiscal management capabilities that can give the public confidence, the government should consider at the fiscal policymaking level how fiscal resources can be replenished to support government administration. At the top level the question must be asked how sustainable state finances can be established that are based on the national economy. Only then can state finances embody national sovereignty and safeguard people's livelihood and well-being. Internationally we must guarantee the integrity of national sovereignty and protect national dignity. Domestically we need to deepen the roots of industrial development and lay the foundations for a humane, sustainable national economic development. We must make it our mission to guarantee a life in dignity for the economically disadvantaged through a sound social security net. The big task for our national development vision is to establish state finances that serve the people and realize fairness in government spending.