AJPA Australian Journal OF PUBLIC ADMINISTRATION

Institute of Public Administration Australia

Australian Journal of Public Administration, vol. 72, no. 3, pp. 330–343 doi:10.1111/1467-8500.12032

RESEARCH AND EVALUATION

Pursuing Revenue Autonomy or Playing Politics? Fiscal Behaviour of Local Governments in Taiwan

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This paper critically accounts for why fiscal decentralization does not necessarily enhance revenue autonomy in the experience of Taiwan, as local governments do not pursue it. This experience is especially relevant to unitary countries that are undergoing both democratization and fiscal decentralization. This paper shows that, with inter-jurisdictional competition, democratically elected local governments are inclined to pursue tax harmonization and have little incentive to maximize taxing powers even though doing so increases own-source revenues. The local governments in Taiwan take a 'mini-max' fiscal strategy, which involves minimizing changes to own-source revenues while maximizing local expenditures. To finance increasing expenditures as a response to the demands of constituencies, local governments tend to press the central government to increase local government's tax bases, and to try to gain a greater share of intergovernmental transfers by having their administrative status upgraded. In summary, revenue autonomy is not being pursued by local governments because of political considerations. In a decentralized fiscal system, local governments can be fiscally accountable, but still irresponsible.

Key words: *revenue autonomy*, *unitary state*, *tax competition*, *democratization*, *Taiwan*

It is often suggested that local governments should exercise full fiscal decision-making authority and accept full accountability for their areas of responsibility as an ideal approach to fiscal decentralization (Bird and Vaillancourt 1998). Conventional wisdom holds that inter-jurisdictional competition is the key to this ideal (Tiebout 1956; Oates 1972; Brennan and Buchanan 1980), despite the side effects it may cause (Oates 2001). By contrast, democracy may encourage revenue maximizing behaviour by governments, as suggested by the Leviathan hypothesis (Brennan and Buchanan 1980). Democratization with a centralized national government is often to blame for the fiscal weakness of subnational governments as the central government maximises its revenue while devolving responsibility for service delivery (Weingast 2009). To counter these tendencies, fiscal decentralization involving inter-jurisdictional competition between local governments, and strong local democratic processes is thought likely to enhance fiscal accountability, economic prosperity, and allocative efficiency as people and businesses may vote with their feet as well as at the ballot box.

Is this setting of fiscal decentralization free of adverse effects? No. The facts are that considerable taxing powers granted by fiscal decentralization often remain unused by local governments (Blöchliger and Rabesona 2009), and a high dependency on intergovernmental transfers (IGTs) among decentralized local governments of unitary states remains (Bahl and Linn 1994; Bardhan and Mookherjee 2006; Dillinger 1995). Democracy matters, despite the Leviathan hypothesis which turns a blind eye to the 'vote-maximizing behaviour' of politicians suggested by public choice theory (Downs 1957). This paper substantiates this point by examining Taiwan's development of revenue autonomy after recent fiscal decentralization reform associated with democratization.

The experience of Taiwan shows that, despite fiscal decentralization reform over the last decade, local governments have not been motivated to exercise their taxing power to exploit their own-source revenues. A rule-based intergovernmental fiscal system was set up in newly democratized Taiwan. The rules imposed fiscal discipline and restrained the imposition of predatory taxes, but it also discouraged the development of own-source revenues from mobile tax bases because of local politicians' preoccupation with elections and awareness of the democratic limits to their powers. Consistent with the fiscal behaviour of pursuing tax harmonization while competing for expenditures which Rounds (1992) found in some federal countries, this paper finds that local governments in Taiwan are tempted to adopt opposing strategies in revenue-raising and public spending by using a 'mini-max strategy': minimizing increases in their own-source revenues and maximizing the level of local expenditure. Even in a setting where competition between local governments is encouraged, 'market-preserving federalism' is not present because local governments lack the capacity to pursue their own industrial policies to promote economic growth and thereby to develop 'niche tax bases'.

Pursuing revenue autonomy is a means rather than an end for local elected officials. It can be abandoned if other means, especially political ones, are available to promote the soundness of local finances. In the first decade of the 21st century, Taiwan experienced not only weak local tax effort under fiscal devolution but also a political campaign by local governments to upgrade their administrative status in order to capture an increased share of IGTs. This reflects local governments' proclivity for more revenue dependency rather than autonomy, driven by reliance on a 'common pool' in the centrally regulated fiscal system. Enhancing fiscal dependency places the political burden for raising taxes onto the central government, and elected local governments prefer to play this political card. This paper argues that fiscal decentralization with inter-jurisdictional competition and strong local democracy may enhance local governments' accountability in the sense of answerability and responsiveness, but not their fiscal responsibility in the sense of revenue self-reliance.

The following section presents a literature review of the fiscal incentives of decentralized local governments in a democratic unitary state. In the subsequent sections, the points raised in the review are explored by using Taiwan's experience.

Fiscal Incentives of Decentralized Local Governments Constrained by Inter-jurisdictional Competition and Democracy

Fiscal decentralization has been a significant institutional reform that tries to align government policies with citizens' preferences, delivering tailor-made public services and building up fiscal accountability of decentralized local governments directly to citizens (Besley and Coate 1997; Oates 1972). The advantages of such decentralization are further justified from a political economy perspective. Tiebout (1956) suggested that breaking the government into a number of smaller entities spurs inter-jurisdictional tax competition. Brennan and Buchanan (1980) further hypothesized that market-like decentralization can break up the monopoly of the revenue-maximizing Leviathan, containing growth in the size of government. Weingast (2009) provided a model of 'market-preserving federalism', which argues that inter-jurisdictional competition is a boon for local market-enhancing policymaking and facilitates the production of both a healthy local economy and valuable tax revenue.

However, many empirical studies question the claim that decentralization constrains the growth of government (Forbes and Zampelli 1989; Chen 2004; Faguet 2004; Sagbas et al. 2005). This is because of the 'common pool' problem where expenditure by decentralized governments is mainly funded by revenue-sharing schemes and intergovernmental transfers or centrally regulated sub-national taxations, especially in unitary states (Rodden 2003; Rodden and Eskeland 2003). This phenomenon belies Brennan and Buchanan's 'Leviathan hypothesis' of tax competition in terms of the growth of expenditure. However, the hypothesis may be still valid in terms of the growth of revenue if many taxing powers remain unused.

The political economy viewpoint emphasizes the positive impact of market-like competition amongst local governments rather than the impact of electoral democracy on local fiscal behaviour. Brennan and Buchanan's (1980) revenue maximizing Leviathan is based on the assumption of an unconstrained post-election government. The model of 'market-preserving federalism' is not necessarily based on the condition of democracy: Montinola, Qian and Weingast (1995) indicated that China also fits this model because of its well-performing decentralization policies. Weingast (2009) also found that elected centralized national governments in developing countries tend to abuse their fiscal transfer powers to control localities. On the other hand, building democracy starting from the grass-roots level can reduce risks and increase the responsiveness of public services to citizens' demands.

However, a strong local democracy may exhibit some negative effects on local public finance management. The Leviathan hypothesis underestimates the constraints of democratic processes other than elections, especially the checking powers of legislatures and the constant pressure generated by public opinion, even though public choice theory has long highlighted that politicians always keep their eye on elections (Downs 1957). The joint impact of inter-jurisdictional competition and democracy needs to be considered when analysing the fiscal behaviour of local officials under decentralization. A gap may exist between the taxing powers granted by a central government and the actual use of the powers by subnational governments. Revenue autonomy can appear less than we expect from the institutional design, and subnational governments may sometimes choose to be less autonomous (Foster et al. 1980; Smith 1985; Bird 1992). This phenomenon needs to be explored further.

Tax competition is not unanimously supported. Bird and Vaillancourt (1998) and Schiavo-Campo and Sundaram (2000) suggested that inter-jurisdictional tax competition should not be encouraged in the design of fiscal decentralization. They recommended that mobile tax bases be assigned to the central government, and relatively immobile taxes form the local revenue base to allow varying tax rates between localities without undermining the overall tax base. This tax assignment makes particular sense for those subnational governments that lack the authority and capacity to regulate or manage all economic functions in their jurisdiction (i.e., the capacity to encourage local economic prosperity and thereby increase tax revenue from their own 'niche tax bases'). To achieve 'market-preserving federalism', therefore, subnational governments must have primary authority over public goods and service provision for the local economy. This essential condition does not apply in many countries (Weingast 2009), including Taiwan.

In practice, inter-jurisdictional tax competition is not necessarily induced by a competitive setting in any case. This is especially true for countries in which a high degree of tax harmonization (i.e., converging of tax systems of local governments) is already operating (Rounds 1992). In this situation, it is politically or fiscally imprudent for local governments to either raise or reduce their taxes to depart from the harmonized tax scheme. An increase incurs a political cost, whereas a reduction incurs a financial cost. Hence, inter-jurisdictional tax competition in a democratic setting may undercut local tax efforts, reinforcing revenue dependency on the central government. The result may reinforce tax harmonization, instead of competition, and increase pressure for horizontal coordination of local governments.

In short, a local government weighs the benefits of expenditure expansion against the costs involved in tax financing. If the effort is costly, tapping local revenue sources is unattractive, regardless of the potential revenue from the sources.

Taiwan's Intergovernmental Fiscal Relations under Democratization

Although the first local election was launched in 1950, democracy and local autonomy only emerged in Taiwan in the 1990s. Under the rule of martial law imposed by the Kuomintang (KMT) regime from 1949, local governments were accountable to the KMT leadership rather than to the public, not only because local personnel were controlled but local fiscal needs were subordinate to the interests and decisions of the central party-state (Cheng and Haggard 1992; Tan 2000).

Taiwan maintained a four-tier governmental system, established during the KMT rule in mainland China before 1949. Below the central government are the provincial and special municipal governments, the county level governments, and the township governments.[1] Provincial governments took command of considerable fiscal resources, and directly regulated and managed the finance of lower-level governments before its administration was withdrawn in 1998. After that year, special municipal governments (two before 2010) and county level governments (23 before 2010) became the two major local political entities. Local governments in this article refer to special municipal and county level governments. The special municipal government is one level higher than the county level government in terms of administrative status, but both are geographically and administratively independent from each other. Special municipal governments and county level governments now enjoy similar taxing and spending powers. Township governments still exist after the 1998 reform, but they are not the focus in this paper.

Toward Democracy and Decentralization

The establishment of the first opposition party, the Democratic Progressive Party (DPP), in 1986 and the lifting of martial law in 1987 marked the starting point of democratization in Taiwan. The ensuing direct elections for the governor of Taiwan Province and the mayors of two special municipalities in 1994, as well as for the president in 1996, accelerated democratization and contributed to decentralization. During this period, local autonomy was gradually legislated. In 1994, the Legislative Yuan (the national legislature) passed the *Province and County Autonomy Law* and the *Special Municipality Autonomy Law*, which devolved some personnel, spending, and revenue powers to local governments as part of the democratization process (Tan 2000). In the local election of 1997, the DPP secured 12 magistrates and mayors from 23 counties and cities, leading to a greater demand for local autonomy. Meanwhile, a constitutional reform in 1997 resolved to slash the provincial-level administration, as previously noted.

In response to the new political situation, two important pieces of legislation were enacted in 1999: the *Local Autonomy Law* and the amendment of the *Law Governing the Allocation of Government Revenues and Expenditures* (hereafter referred to as the *Allocation Law*). The *Local Autonomy Law* stipulates the scope of local autonomy and the relationship between central and local governments. The 1999 amendment of the *Allocation Law* reassigned the expenditure responsibilities and revenue authorities of each level of government. After this amendment, the fiscal revenues originally held by the provincial government were divided between the central government and local governments (see Table 1). These legislative changes put into effect fiscal decentralization in Taiwan.

Examination of the Enhancement of Local Revenue Autonomy

The withdrawal of the provincial administration was intended to reduce central control and create a more decentralized structure of expenditure and revenue at the county level

Table 1. Taiwan's Tax Structure

1981–1999	2000–Present
National Tax	**National Tax**
Customs	Customs
Income Tax	Income Tax
Legacy and Gift Tax	Legacy and Gift Tax
Excise Tax	Excise Tax
Securities Transaction Tax	Securities Transaction Tax
Mining Lot Tax	Mining Lot Tax
Municipal and Provincial Tax	Sales Tax[a]
	Tobacco and Alcohol Tax
Sales Tax	Capital Gains Tax
Stamp Tax	**Municipal and County/ City Tax**
Vehicle License Tax	
Selective Excise Tax	Stamp Tax[a]
County /City Tax	Vehicle License Tax[a]
Agricultural Land Tax	Agricultural Land Tax
Land Value Tax	Land Value Tax
Land Vale Increment Tax	Land Value Increment Tax
House Tax	House Tax
Slaughter Tax	Amusement Tax
Amusement Tax	Deed Tax
Deed Tax	

Source: Fang (2001) rearranged and translated by the authors.
[a]The tax item shifted from the Provincial Government

governments. However, the result has not been entirely consistent with this expectation.

(1) Expenditure

As shown in Table 2, local expenditures averaged approximately NT$502 billion (2011 prices) from 1987 to 1999, whereas the average from 2000 to 2011 was approximately NT$789 billion, or 57 percent more following decentralisation. In particular, county and city expenditure showed rapid growth from $279 billion (average from 1987–1999) to $524 billion (average from 2000–2011). Decentralization of expenditure did occur in the 2000s, although the expenditure of the central government still accounted for the majority.

(2) Revenue

Local governments' revenue with intergovernmental grants excluded only increased around 19 percent, from an average of approximately NT$436 billion from 1987 to 1999 to an average of approximately NT$518 billion from 2000 to 2011. If we only look at the change of revenue at the county level government, revenue grew about 30 percent from 1987–1999 to 2000–2011. Local executives complained that the shift of responsibilities from the provincial to county level governments was not paralleled by congruent revenue transfers. In contrast, the central government's revenue averaged approximately NT$1.0 trillion between 1987 and 1999, and it grew over 63 percent to an average of approximately NT$1.7 trillion between 2000 and 2011. This was caused mainly by the shift of the sales tax from the provincial and special municipal to the central government (see Table 1). Although 40 percent of the sales tax was reallocated to special municipalities, county level governments, and townships through CATR, the central government reserves 60 percent of this tax.

Through Table 2 and Table 3, it is not difficult to find that the growth of local expenditures has not been matched by a congruent rise in self-raised revenues. Increased local public spending was not funded by additional tax efforts that were intended to be facilitated by fiscal decentralization reforms.

(3) Intergovernmental grants

Fiscal decentralization in unitary countries commonly results in the decentralization of spending power and increased demand for revenue from the central government (Bahl and Linn 1994; Bardhan and Mookherjee 2006; Dillinger 1995). IGTs are mechanisms that eliminate fiscal imbalances between different levels of government, but can also be an obstacle to local autonomy depending on their structures (Bahl and Linn 1994). Generally, IGTs are classified into three types or components: revenue sharing payments, general or non-earmarked grants and specific purpose or earmarked grants. Revenue sharing payments and non-earmarked transfers allow autonomy for the recipient, whereas earmarked transfers involve controls imposed by the donor. The difference between tax sharing and grants is that the latter form of IGT refers to money flowing from the central to local governments, while the former form of IGT involves central and local governments splitting the tax revenue. We consider the issue of tax sharing in the next section, since it is in fact tax revenue rather

Table 2. Governmental Expenditure (1987–2011)[2] Data in NT$ million

Year	Central government	Provincial government	Special municipal government	County level government	Local government total[3]
1987	613,948	146,045	122,499	130,776	253,275
1988	683,218	163,088	135,406	154,933	290,339
1989	788,748	281,641	308,861	228,259	537,120
1990	882,602	291,043	162,324	234,922	397,246
1991	941,790	257,303	243,908	234,891	478,799
1992	1,178,971	298,548	206,723	306,028	512,751
1993	1,300,476	291,659	232,986	324,172	557,157
1994	1,141,003	364,598	287,427	357,985	645,412
1995	1,229,326	411,948	225,168	331,209	556,377
1996	1,081,331	396,242	248,980	324,446	573,426
1997	1,102,601	399,441	236,770	327,298	564,068
1998	1,147,954	420,964	249,352	338,154	587,506
1999	1,318,260	333,015	239,853	332,732	572,586
average (1987–1999)	**1,031,556**	**311,964**	**223,097**	**278,908**	**502,005**
2000	1,541,615	–	250,077	407,233	657,310
2001	1,649,060	–	263,928	479,774	743,701
2002	1,539,418	–	261,797	462,323	724,120
2003	1,611,295	–	259,021	481,952	740,973
2004	1,576,697	–	240,683	523,076	763,759
2005	1,565,041	–	235,757	541,238	776,996
2006	1,490,135	–	239,325	527,172	766,497
2007	1,515,880	–	252,685	528,553	781,238
2008	1,458,537	–	239,112	561,604	800,716
2009	1,731,655	–	252,865	611,698	864,562
2010	1,602,382	–	251,992	613,453	865,446
2011	1,557,475	–	640,555	346,724	987,279
average (2000–2011)	**1,634,167**	**–**	**292,736**	**524,035**	**789,383**

1. Data are deflated to 2011 dollar value adjusted by Taiwan's officially announced consumer price index (CPI).
2. Due to the change of fiscal year, there were 18 months of fiscal year 2000. The data are converted to 12-month base by dividing original data with 1.5.
3. Expenditures of provinces after year 2000 merged into central government expenditures.
4. Data source: National Statistics, Taiwan

than grant revenue. According to the OECD report (Blöchliger and Rabesona 2009), earmarked and non-earmarked payments each account for half of the total intergovernmental grants in OECD countries in 2005 (16). In Taiwan, non-earmarked grants comprised approximately 65% of total intergovernmental grants in 2011, and earmarked grants 35%. Taiwan's IGT structure seems therefore mostly to support local fiscal autonomy, but vertical fiscal imbalance remains substantial. In Table 3, we find that, in the last decade, more than 33% of local revenue came from intergovernmental grants (NT$257 million out of NT$775 million); if we only look at the county level governments, more than 43% of their revenue depends on central government's grant allocations (NT$215 million out of NT$505 million). Before 2000, intergovernmental grants comprised less than 28% of total local revenue and, for county level governments, the figure was 40%. The dependency of local governments on central revenue has therefore grown over time notwithstanding the decentralization of the fiscal system.

(4) Taxing Power

Taxing power is a key measure of fiscal autonomy (Blöchliger 2006). Taiwan's Legislative Yuan passed the *Local Tax Act* and the *User Fee Act* in 2002 to grant some taxing powers to local governments. Local governments can

Table 3. Government Revenue (1987–2011)[4] Data in NT$ million

Year	Central government	Provincial government	Special municipal government: revenue before grants	Special municipal government: grants	County level government: revenue before grants	County level government: grants	Local government total: revenue before grants	Local government total: grants
1987	693,828	151,454	127,791	NA	115,558	NA	243,350	NA
1988	823,512	183,121	151,823	NA	138,874	NA	290,697	NA
1989	925,238	584,882	306,259	NA	199,265	NA	505,524	NA
1990	987,434	322,797	190,030	NA	187,694	NA	377,724	NA
1991	878,676	190,221	183,586	9,405	167,840	121,821	351,426	131,226
1992	906,960	224,675	214,545	11,902	275,969	128,472	490,513	140,374
1993	1,032,166	245,690	210,106	13,326	285,327	157,469	495,433	170,796
1994	1,058,891	252,515	212,968	11,213	281,540	138,192	494,509	149,405
1995	1,050,033	267,395	205,690	9,633	277,106	157,802	482,796	167,435
1996	1,084,387	262,951	201,439	7,569	247,866	171,708	449,304	179,277
1997	1,110,917	297,280	226,672	12,030	260,214	185,138	486,885	197,168
1998	1,338,891	398,703	258,056	11,983	260,214	176,635	518,270	188,618
1999	1,407,221	310,084	231,446	2,851	248,145	173,252	479,591	176,103
average (1987–1999)[5]	**1,022,935**	**283,982**	**209,262**	**9,990**	**226,586**	**156,721**	**435,848**	**166,711**
2000	1,518,916	–	217,174	5,755	249,134	105,587	466,309	111,342
2001	1,578,414	–	189,553	9,798	243,221	214,550	432,773	224,348
2002	1,461,888	–	191,973	19,271	256,544	189,665	448,517	208,936
2003	1,605,643	–	206,240	21,614	273,554	228,451	479,795	250,065
2004	1,503,104	–	213,666	32,492	298,152	234,232	511,818	266,724
2005	1,739,528	–	227,360	42,370	314,954	205,720	542,314	248,090
2006	1,701,898	–	220,085	27,733	302,303	204,472	522,388	232,204
2007	1,719,262	–	228,476	11,829	314,415	207,414	542,891	219,243
2008	1,673,706	–	172,288	43,207	317,620	249,177	489,909	292,384
2009	1,604,182	–	166,385	52,913	295,493	269,555	461,879	322,469
2010	1,521,840	–	190,689	48,510	318,145	287,420	508,833	335,930
2011	1,672,871	–	407,263	183,384	172,054	185,930	579,316	369,313
average (2000–2011)	**1,671,726**	**-**	**228,312**	**41,573**	**290,013**	**215,181**	**518,325**	**256,754**

1. Data are deflated to 2011 dollar value adjusted by Taiwan's officially announced consumer price index (CPI).
2. Due to the change of fiscal year, there were 18 months of fiscal year 2000. The data are converted to 12-month base by dividing original data with 1.5.
3. Revenues of provinces after year 2000 merged into central government revenues.
4. Data source: National Statistics, Taiwan.

levy special taxes[6] and temporary taxes[7], and impose additional tax rates on existing local and central taxes with some legal restrictions. The application of these tax efforts must be approved by a local council and the Ministry of Finance (MoF). In addition to the taxes local government may initiate under the above legislation, local governments regularly collect house tax[8], land value tax, land value increment tax, amusement tax, vehicle license tax, and deed tax (see Table 1). Local governments can determine the rates of house and amusement taxes within a range stipulated by the central authority, and local governments can also determine the values used for assessing house, land value, and land value increment taxes. Tax relief is possible only when it relates to public-private partnership projects. Based on the OECD definition of taxing power (Blöchliger and Rabesona 2009), locally autonomous taxes comprised 40.6% of total tax revenues in Taiwan in 2011 (see Table 4). This

Table 4. Taxing Power as Share of Local Tax Revenue Data in percentage (%)

Local Tax and Tax Share		Taiwan (2011)	OECD (2005)
Collected tax revenues that local governments may decide tax rates and tax reliefs[9]		–	13.9
LG discretion on rates	Full	–	21.7
	Restricted	40.5	30.3
Collected tax revenues that local governments have discretion on deciding tax reliefs		–	0.4
Total autonomous tax as a share of total local government revenues		40.6	66.3
Tax sharing arrangements	Revenue split set by local governments	–	–
	Revenue split set with central government consent	–	2.6
	Revenue split set by central government, multi-year basis	39.1	15.9
	Revenue split set by central government, annual	–	1.0
Total tax sharing as a share of total tax revenues		39.1	19.7
Tax revenues where rates and reliefs are set by the central government		20.4	5.9
Other		–	8.1
Total local government tax revenues		100	100

[1]Sources: Blöchliger and Rabesona (2009), and data provided by the Tax Division of New Taipei City.
[2]OECD numbers are the average of all OECD countries, for federal countries, we use their local governments instead of state governments for the comparison purpose.

ratio is much lower than the average of the OECD countries in 2005 (66.3%).

Tax sharing refers to tax revenue shared between the central government and local governments, including CATR, the tobacco and alcohol tax, and the legacy and gift tax in Taiwan. These taxes are split according to statutes and are non-negotiable. They comprised 39.1% of total local tax revenues in Taiwan in 2011, far higher than the OECD average of 19.7% (in 2005).

Poor Response to the Effort to Promote Local Tax Efforts

The current tax structure favours Taiwan's central government more than local governments, but local governments still have taxing powers, including determining selected tax rates, to deciding values of certain tax taxes, and initiating new taxes subject to regulations. However, local governments seldom consider using these tools. Only nine of the 23 local governments have initiated new taxes since the enactment of the *Local Tax Act*. Twenty new taxes, mostly temporary taxes, were agreed by local councils and submitted to the MoF for permission, and 12 of them were permitted by the MoF. Over the past 10 years, these 12 taxes accounted for less than 1% of total local tax revenues.[10]

One reason for the limited tax efforts of Taiwan's local governments is the restrictions imposed by the new tax initiatives. For example, a new tax must not have any negative impact on the entire country or a region outside the local government's jurisdiction. However, the definition of 'negative impact' is left for the MoF to interpret. Therefore, a carbon emission tax proposal submitted by Yunlin County failed to secure the MoF's permission because the ministry considered it a national tax issue and could erode the central government's taxable base. In addition, local governments cannot tax businesses that operate across administrative jurisdictions or state-owned enterprises, which are business giants in Taiwan. Local areas might be seriously polluted by businesses, such as state-owned oil giants, but local governments cannot charge them emission fees. The Chief Secretary of the Finance Division of New Taipei City said, 'If we could tax them, we probably could increase NT$20 billion in tax revenue. Why bother taxing our residents to fill the fiscal gap?' In addition, tax financing is politically unattractive. All 20 of the mentioned tax initiatives were targeted at special activities, such as soil and rock management,[11] and did not really concern local businesses, local interest groups, and the local residents. A former mayor of Hsinchu City remarked that taxing local businesses would make the city 'lose the goose that laid golden eggs forever' (Lee 2006). If that happened, the top executive would be likely to get the blame for poor performance in local economic development. A relevant example is the reluctance of local governments to reimpose the vacant land tax. A long tax break on vacant lands was allowed from 1985 onward. In January 2011, the central government announced that the tax break had been terminated, and local governments were allowed to tax unused lands upon receiving the central government's approval. However, only Chiayi County has planned to submit a vacant land tax proposal to the MoF. Most local government officials fear incurring the wrath of land owners and a possible negative impact on local economies.

Interest groups can sway policy outcomes (Mueller and Murrell 1986), and this also applies to tax decisions. The Taoyuan county government decided to levy a golf tax, and received the approval of the local council and the permission of the MoF in 2004. However, golf club owners in Taoyuan united to oppose this tax, and even delivered a petition to the president (Fang and Liang 2009). As a result, the county government never enforced the tax before the 2-year permission expired.

The local government-council relationship is another factor. According to a survey of local governments conducted by Jang (2010), avoiding tensions between the government and the local council is a top political factor in the decision to not levy new taxes. Even in a unified government such as New Taipei City, councillors from the ruling party still warn the mayor not to increase local residents' tax burden. The primary question in the local council when a mayor starts a new term in New Taipei City is: 'Will you impose a new tax in the following 4 years?' The incumbent mayor Chu Li-lun used to answer: 'I will not do so unless you tell me explicitly that you will support the tax proposal'.

Local tax policies are not necessarily initiated by top executives or councillors. Given political obstacles, this rarely occurs. Typically, the local tax division within the local government proposes a tax initiative for the sake of the government's fiscal health. However, this approach is rarely effective in Taiwan. If a consensus of 'no tax burden increase' has been expressed in advance amongst the top executive and the local council, no initiative will be taken. Without such a consensus, the professional officials still hesitate to pursue a new tax because they must then directly cope with public pressure. For example, in 2011, the tax division in New Taipei City took an adjustment measure to increase taxable values of house properties in a district in which the property values had been greatly undervalued. Approximately 800,000 households were affected by this adjustment.

> Our house tax receipt increased NT$600 million this year, but we got more than 10,000 calls complaining about this adjustment. Can you imagine that? Some people only paid NT$200 more than they did last year.
>
> State by Chief Secretary of the Finance Division of New Taipei City

This overreaction discouraged officials from initiating change in the future, despite the taxable values being very low (30%-40% of actual prices).

Instead of raising funds through their own efforts, it is more desirable for local governments to gain revenue by convincing the central government to take action. The public debate of whether to use the 'real price' instead of the undervalued 'officially assessed price' as the taxable value of the house tax provides a relevant example. As shown in Table 1, house tax is a local tax revenue, and local governments have discretion on taxable values. A recently introduced price-reporting system for property sales provides an appropriate basis for local governments to adjust and increase the taxable values of properties. However, local governments still prefer to rely on the efforts of the central government. In a meeting with the Fiscal Soundness Committee of the MoF in December, 2012, some local governments and experts urged the central government to play the 'bad guy'— they suggested that the central government assess and decide the taxable values of properties. Therefore, local governments would only announce the values released by the central government, relieving themselves of pressure from constituencies, interest groups, and councillors (Lin 2012).

Local tax efforts are further inhibited by weak motivation for local governments to promote local economies. Tax competition might have the positive effects suggested by the model of 'market-preserving federalism' if local governments are able to take measures to promote economic prosperity in their own jurisdictions. However, this does not apply to Taiwan's local governments because significant economic functions, such as the Science Park in Hsinchu, the Industrial Processing Zone in Kaohsiung, Kaohsiung Port, and the international airport in Taoyuan, which helped Taiwan's economic expansion, were established by the central government and are still managed by central ministries. Elected local officials under democratization have occasionally proposed taking over some of these functions, mainly investments in ports and airports, to foster integrated economic development. However, the central government has never considered transferring these economic powerhouses to local governments because these functions are seen to be concerned with a national strategic role. Hence, local governments can only initiate and promote minor economic functions, such as local tourism.

Implicit tax competition accounts in part for the weak tax efforts of local governments in Taiwan. The fear of losing people, businesses, or tax bases to other jurisdictions causes local governments to hesitate to increase taxes. Tax competition paradoxically results in harmonized tax levels (Rounds 1992). As noted previously, seldom have new tax initiatives been imposed, and local governments are reluctant to adjust the taxable values of undervalued properties. Special municipal and county level governments have been applying the minimum rate without making even marginal changes. Consequently, harmonized tax bases and tax rates span all local governments in Taiwan. Local officials of Taoyuan County remarked that given the risk that an attempt to increase the tax revenue might conversely reduce total tax receipts due to losses of tax bases to other jurisdictions, local governments would rather be inactive in tax decisions (Fang and Liang 2009). The Chief Secretary of the Finance Division of New Taipei City asserted the following:

> The political reality is that we [New Taipei] cannot have higher tax rates than Taipei City does. Otherwise, people may think, 'Why not move to Taipei City for a lower tax burden while probably enjoying better public services?'

Because a local government fears it might lose constituents to other jurisdictions by increasing its own tax rates, the optimal strategy is to collectively increase the tax revenue through tax harmonization led by the central government. A centrally determined tax scheme is more desirable for local governments than a self-determined tax scheme because they do not incur any political cost by their own fiscal actions, such as unpopular tax increases or unsound fiscal conditions.

The Competition for Intergovernmental Transfers

The withdrawal of the provincial-level administration empowered county level governments to exercise more policymaking authority, but most new policy initiatives require funding. The county level governments used to depend on the provincial government's fiscal support, and became unmotivated to draw own-source revenues (Lin and Tsai 2003). Those governments and special municipal governments now still maintain that the central government must be ultimately responsible for local finances. A former minister of the MoF, Lin Chuan, stated the following:

> In the past few years, local governments have always asked the central government to give them more when they had fiscal gaps . . . Grants from central to local governments have risen from NT$30 billion 4 years ago to NT$140 billion today [2003]. (Wu 2003)

The maintenance of sound fiscal conditions when facing fiscal stress requires a government to either reduce the level of spending or increase available revenue resources. Taiwan's experience shows that both cutbacks and taxing efforts are not appreciated by voters, but that the acquisition of grants from the central government is. The pursuit of implicit tax competition or tax harmonization does not exclude other forms of inter-jurisdictional competition for revenues: IGTs are the focus of this competition. Attaining intergovernmental grants for a constituency has become a common platform in local election campaigns (Lei 2005). Certainly, obtaining allocations from the central government is politically more desirable than using local tax bases. This tendency has triggered a new jurisdictional campaign over CATR.

CATR is a pool of shared revenues that balance vertical and horizontal fiscal disparities through centralized transfers to localities. The distributional pool is composed of portions of three national taxes (income tax, sales tax, and excise tax), and a portion of a local tax (land value increment tax).[12] The pool is managed by the central government with formulas under the *Distribution Regulations for Centrally-Allotted Tax Revenues*. According to the regulations, CATR is split into a special municipal pool, a county and city pool, a township tool, and a special CATR reserve. In the past, the two special municipalities, Taipei and Kaohsiung, received the majority of CATR (43%), leaving 39% to 23 counties and cities. In 2006, Taipei County (renamed New Taipei City in 2010) applied to upgrade its administrative status to that of a special municipality, with the intention to join the other two and access the larger component of CATR moneys. Taipei County was granted a status of quasi-special municipality in 2007, and joined the 43% municipal pool from 2007 to 2010. The allocation of CATR follows strict formulae, so Taipei County's upgrade reduced the CATR funds received by Taipei and Kaohsiung special municipalities, but the central government increased their non-earmarked grants as compensation. Since there is an unwritten rule to incrementally adjust non-earmarked grants, an upgrade to the special municipality level guarantees more IGT receipts. The upgrade of Taipei County immediately earned it an additional NT$100 million but then drove other large counties and cities to follow its example.

In December 2010, four county level governments were officially upgraded (Taipei County renamed New Taipei Municipality), or merged and upgraded (Taichung City and Taichung County merged into Taichung Municipality; Tainan City and Tainan County merged into Tainan Municipality; Kaohisung City merged into Kaohsiung Municipality), to special municipalities with the expectation to be entitled to a greater share of CATR revenues.[13] In the end, the central government increased the special municipality pool of CATR from 43% to 61% and reduced the county level government's pool of CATR from 39% to 24%. With the unwritten rule about marginal annual increments of non-earmarked grants for those newly upgraded municipalities, IGTs (including CATR and non-earmarked grants) are gradually growing.

In addition to the increased acquisition of IGTs, top local executives believe that an upgrade to special municipality status can justify expenditure expansions, which is politically attractive. Elected local officials believe that simultaneously increasing expenditures and (external) revenues is a win-win strategy that generates public approval. As suggested by the 'common pool' model (de Mello 2000), the ability to offer improved public services with fewer funds generated by local taxpayers is considered a characteristic of smart leadership.

Discussion and Conclusion

The impact of fiscal decentralization on accountability for service provision (i.e., the expenditure side) has been a major focus in the past. Although some studies have identified the influence of fiscal decentralization on the revenue side, the emphasis is typically on issues related to intergovernmental transfers or tax assignments. In theory, fiscal devolution should involve responsibility of subnational governments for both revenue and expenditure in their own jurisdictions. Taiwan's experience shows that, although elected local governments bear full responsibility for expenditure, they prefer to render most, if not all, tax decisions back to the central government and rely on revenue from the central pool. This behaviour might not be unique to Taiwan, but existing literature does not sufficiently account for this occurrence. There are some factors that are not shared by many advanced countries, but may be relevant to other recently democratized countries. Taiwan is governed by a unitary-state system with a tax-rich central government. Democratization has not fundamentally altered this system, even with political elections introduced in the different levels of government. Uniform local taxation and a harmonized tax system remain despite fiscal decentralization and the devolution of taxing powers. Taiwan originally maintained uniform local taxation under a unitary-state system, Taiwan's experience with democratization provides an interesting case to explore the consequences and political behaviour involved in fiscal decentralization in new democracies.

In practice, fiscal decentralization is not necessarily conducive to full fiscal autonomy, particularly in democratic unitary countries. Local governments under an electoral democracy are not well motivated to exercise taxing powers, which commonly attract political dangers for local governments. For Taiwan, limited taxing discretion constrains tax efforts anyway but, in addition, local governments do not have sufficient incentives to exercise their taxing discretion. Imposing additional taxes on local constituents is considered politically reckless by elected local governments. It is more politically desirable for local governments to accept changes initiated by the central government than to introduce their own local tax initiatives.

To increase revenue, therefore, local governments in Taiwan look to maximize their shares in the common pool of IGTs, shifting the political burden to the central government. Apart from pressing the central government to initiate increases in taxes for local government, there has been an opportunity to increase some local governments' shares of IGTs through upgrading their administrative status from county level to 'special municipality' which has occurred towards the end of the 2000s. The pursuit of IGTs for political purposes rather than the initiation of tax efforts can also be found in South Korea, which is a recently democratised unitary state with an intergovernmental relationship similar to that of Taiwan (Kim 2013).

The experience of Taiwan demonstrates that inter-jurisdictional tax competition and democratization can have a negative impact on local fiscal health. Fiscal decentralization involving tax competition does not lead to full fiscal autonomy in practice. Moreover, the model of 'market-preserving federalism' does not apply to Taiwan because local governments have a poor command over economic development in their own jurisdictions. Hence, local governments in Taiwan are unable to develop their own 'niche tax bases'.

The central government in Taiwan is not expected to yield more revenue sources or significant economic policymaking powers to local governments. Strengthening revenue autonomy is not a priority for local officials unless such an effort is compatible with their political interests.

The Leviathan hypothesis does not appear to apply on the expenditure side in the case of Taiwan, but remains valid on the revenue-raising side because of the 'mini-max' strategy of local governments in Taiwan. Because of local governments' greater responsiveness to local service demands, but insufficient motives to tap fiscal resources on their own initiative, local governments have become more fiscally accountable, but not more fiscally responsible, in the process of fiscal decentralization.

Endnotes

1. The county level governments include counties and provincial cities. There are also

county-controlled cities in Taiwan which are the township level governments.

2. Expenditures shown here include all governmental expenditures but debt repayments.

3. The column 'local government total' is calculated by adding up the expenditure levels of special municipal and county level governments.

4. Revenues showed here exclude revenues from debt financing, governmental borrowing, and unused surplus of the previous years.

5. The averaged grant receives here has a shorter time span from 1991 to 1999, simply because the official data is currently not available.

6. As stipulated in the *Local Tax Act*, a special tax refers to a tax imposed on particular economic activities or groups of people. This tax can be collected for no more than 4 years. Extensions must be approved by the MoF.

7. As stipulated in the *Local Tax Act*, a temporary tax refers to a tax imposed on the general public. This tax can be collected for no more than 2 years. Extensions must be approved by the MoF.

8. The house tax is a type of property tax charging owners of buildings for both business and non-business purposes. Lands appurtenant to buildings are subject to land value and land value increment taxes.

9. Tax reliefs here refer to the tax that local governments may decide whether or not to reduce tax payer's tax liabilities.

10. In 2011, for example, temporary taxes collected by all local governments totaled NT$ 488 million, accounting for 0.11% of total local tax revenues.

11. Yilan, Taoyuan, Miaoli, Nantou, Kaohsiung, and Hualien counties have imposed soil and rock taxes to economic activities involving the erosion of soil and rock or the waste disposal of used soil and rock in local areas.

12. Land value increment tax collected in special municipalities does not go into the CATR pool.

13. Taoyuan City will become the sixth special municipality on December 25, 2014.

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