Economic Campaign Issues in the Presidential Campaign

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The economic outlook for 2012 remains uncertain due to the European sovereign debt crisis and since it remains to be seen whether slowing Chinese economic growth will result in a soft landing, and whether the U.S. economy can continue its moderate recovery. Against this backdrop we can, of course, not be optimistic about the Taiwanese economy. Market confidence hinges on whether Taiwan will be able to maintain an annual economic growth rate of 4 percent. The Institute of Economics, Academia Sinica, forecasts the Taiwanese economy will grow 3.81 percent in 2012. The Polaris Research Institute also expects an economic growth rate of 3.93 percent. Both forecasts indicate that it might not be possible to maintain economic growth of 4 percent.

After the latest financial crisis erupted, governments around the world spared no efforts to roll out fiscal and monetary policies to rescue the markets. As a result of such measures several European countries kept running into even deeper financial difficulties. Let's take Greece as an example. When the Greek government greatly increased its 2009 budget deficit in the fourth quarter of 2009, the three major international credit rating agencies – Standard & Poor's, Fitch Ratings and Moody's Investors Service – lowered Greece's sovereign credit rating, which gradually unleashed the Greek debt crisis. Eventually international organizations like the International Monetary Fund (IMF) and the European Union (EU) were forced to lend a helping hand to rescue Greece.

In May 2010 Greece reached an agreement with the IMF and the EU over debt restructuring conditions, promising to reduce its fiscal deficit from 13.6 percent of GDP in 2009 to 2.6 percent of GDP in 2014, in exchange for a three-year fiscal rescue program worth 110 billion Euros. But market concerns over unsound government finances gradually spread to other European countries. By the second half of 2011 the situation had already worsened to the point where not only the Five financially distressed PIGS countries – Portugal, Ireland, Greece and Spain – were engulfed in the European sovereign debt crisis, but EU core members such as Italy and France were affected too. At one time even German government bond auctions did not go smoothly. Interest rates for short-end government bonds issued by Spain and Italy temporarily also climbed to dangerously high levels. In combination with other developments such as bondholder hair cuts, which worsened liquidity at European banks, demonstrated that the European debt crisis was serious enough to considerably weaken the economy, and that the situation could become critical any time.

However, after the European debt crisis had led to changes of government in Spain and Greece, EU leaders and bank executives reached consensus at the EU summit to jointly take action to tackle the crisis. But given that in the coming years the foremost task for most European countries will be aggressively reducing deficits and bringing down government debt, it will not only be impossible for these governments to expand fiscal expenditure, but they might even have to cut social welfare spending. Households and businesses will cut down on investment and consumption expenditure, which in return will weaken domestic consumption within the Euro zone. Due to the expected continued slump, on top of a highly volatile politico-economic and social situation, banks' readiness to lend will be low. But given insufficient corporate investment and consumer confidence, economic growth in the Euro zone is unlikely to be particularly strong.

Yet if the Euro zone economy is not performing well, Taiwanese exports to Europe will suffer as a result. Should Taiwanese exports to Europe severely contract by 50 percent, Taiwan's economic growth rate is estimated to drop 3.85 percent. Moreover the European debt crisis is bound to cause an economic downturn in the United States, China and other important trade partners of Taiwan, which will further affect Taiwanese exports! Economic forecasters generally believe that Taiwan's economic growth rate will gradually decline over the coming four quarters. There is no reason for optimism regarding consumption in 2012, given global economic instability and a bleak outlook for the domestic stock and real estate markets. As a result corporations in all sectors have become conservative with regard to the economic situation in 2012, which will affect their readiness to invest and the progress of investment projects.

Financial institutions holding bonds of PIGS countries will have to take massive losses, when the governments of countries that were severely hit by the debt crisis are not able to refinance their debt or to postpone buying back government bonds when they mature, which again will cause a liquidity crisis. Then we are bound to see a replay of the 2008 financial crisis, when financial assets such as structural debt and sub-prime mortgage loans rapidly lost value, causing a liquidity crunch in the financial industry and triggering a severe crisis characterized by financial panic. As a small open economy Taiwan will very likely see another panic that prompts foreign investors to pull out of the local stock and foreign exchange markets. Given the risk that the European debt crisis might rapidly spread, our government should assess possible losses in international financial assets, quickly compile statistics of the domestic finance industry's risk exposure to European debt and put together concrete figures as to how much government bonds issued by European countries the entire banking industry holds.

In October 2009 well-known economists Kenneth S. Rogoff and Carmen Reinhart published a book that examined financial crises; titled This Time is Different Eight Centuries of Financial Folly. In the book they clearly stated what governments should worry about in the wake of the financial crisis is that the fiscal expansion behind the massive rescue measures will lead to skyrocketing public debt.

Yet as soon as Taiwan's government debt is brought up, government officials habitually attribute the rapid accumulation of debt to international factors such as the financial crisis. However, a public opinion poll conducted by Taiwan Brain Trust in November 2011, which asked "Do you agree with the statement 'The Ma government's massive debt issuance is due to international factors'," had the following results: As many as 60 percent of the respondents disagreed, with 29.1 percent answering "I absolutely disagree," and 30.1 percent saying "I somewhat disagree." Only 25.8 percent agreed that international factors were to blame, with 7.3 percent saying "I absolutely agree," and 18.5 percent responding "I somewhat agree." It is very obvious that the public does not acknowledge international factors as the cause for Taiwan's high government debt.

The inappropriate and mistaken policies that the government of President Ma Ying-jeou took after the financial crisis erupted in 2008 did not only fail to cushion the impact from the financial crisis, but even created a more severe fiscal imbalance and tax unfairness. The Ma government hoped, for instance, to stimulate domestic consumption to counter the economic slump caused by a severe contraction of exports. Among the policies taken were shopping coupons. Back then Ma prided himself on the measure, believing that countries around the globe would copy Taiwan's original idea of handing out shopping coupons to stimulate domestic demand. Subsequently the media reported that Japan and China intended to learn from Taiwan. And when quite a number of economists in Taiwan warned the government that shopping coupons would not contribute to boosting domestic demand, the Executive Yuan claimed that by distributing shopping coupons worth NT$3,600 per person domestic consumption could be stimulated so much that 0.64 percentage points could be added to the annual economic growth rate in 2009.

Finally the government used a special budget, borrowing NT$82.9 billion to issue shopping coupons, which only had a currency substitution effect. After the government handed out shopping coupons, people usually first spent their coupons instead of spending money out of their own pockets. Eventually the stimulus effect on domestic demand was quite limited and failed to help boost economic recovery. But bent on having its own way, the Ma government completely disregarded suggestions made by economists and other experts. Therefore it did not only miss out on opportunities for economic recovery, but dealt another blow to the soundness of government finances, since the shopping coupons were entirely financed through borrowing.

Moreover, the Ma government has taken a number of steps in recent years that have further aggravated the fiscal deficit and the spending imbalance. Such examples are: It carried out an estate and gift tax cut for high-income earners and raised salaries for military personnel, civil servants and teachers. It committed to an annual expenditure of NT$70-80 billion in interest subsidies for preferential savings accounts carrying 18 percent interest (for retired civil servants). The central government footed the huge bill for the 2010 Flora Expo in Taipei, borrowed NT$80 billion to finance shopping coupons, and wasted money on unwarranted expenditures such as infrastructure budget slack, events to mark the 100th anniversary of the founding of the Republic of China, and production of the musical Dreamers.

As a result of the continued severe imbalance between revenue and expenditure over the past years, the central government was forced to borrow NT$1 out of every NT$4 spent in 2011, which means that our fiscal deficit is already very severe. Data released by the Finance Ministry show that Taiwan's outstanding debt totaled NT$4.9213 trillion at the end of 2011, slowly edging closer to the 40 percent debt ceiling stipulated in the Public Debt Act. The government will soon be in dire straits without any room for any further debt issue.

The Finance Ministry figures show that the central government has compiled a NT$130.1 billion budget (including NT$570 million to manage government bonds) for fiscal year 2012 to pay interest on government bonds. Another NT$94 billion have been earmarked to repay debt so that in 2012 debt principal repayments and interest payments will add up to a total of NT$224.1 billion, or 11.4 percent of general budget and special budget expenditure. The central government uses more than 10 percent of its spending to repay debt. On top of that debt principal repayments are entirely debt-financed, which amounts to a debt rollover.

No matter whether the debt crisis is serious, our economy will need to face the onslaught. Given that our fiscal problems get worse year by year the European experience of unsound finances triggering crisis could serve as a valuable lesson for us. A responsible government and government

1. The survey was conducted between Aug. 18 and Aug. 20, 2011 and yielded 1,068 responses. It has a reliability of 95 percent and a margin of error of 3 percentage points.

officials who rise up to the challenge must deliberate well the thorny issues that the European debt crisis has created for our government. A look at the "seven big strategies, ten big focuses" in the "Economic Counter Measures" proposed by the Executive Yuan shows these include many steps that the government should routinely take in the first place, such as stabilizing commodity price and financial markets, or measures that are already carried out as part of government policy such as expanding the use of LED street lamps, encouraging energy-saving household appliances and green architecture. The inclusion of these routine, continuous tasks in the counter measures package demonstrates very clearly that the current government is busy with politics and the elections, and not yet able to comprehensively ponder the many problems that the Taiwanese economy faces. In the end we have no choice but to leave these nagging problems to the president-elect.