

Good morning, ladies and gentlemen. I am delighted to have the opportunity to participate in this Conference on Challenges to Taiwan's Democracy in the Post-Hegemonic Era and I want to thank the organizers for inviting me. Before I begin, I should disclose that I am an economist, and not a political scientist, and I have learned a great deal from all the papers presented here. The two papers that we just heard, by Prof. Pei-Shan Lee, and by Prof. Chengtien Kuo (and his collaborator Prof. Shangmao Chen), are both excellent and carefully and thoroughly researched papers.

Comments on Prof. Pei-Shan Lee, "Democratization and the Demise of the Developmental State"

I agree with Prof. Lee that the end of the "developmental state" has come in Taiwan. It has come, in part, as a result of the democratization process. It has also come in part because there is no longer the necessity (or as economists would say, the demand) for a "developmental state" both resources and talents are now in much more plentiful supply in Taiwan and it is difficult to justify why the power for the allocation of societal resources should be concentrated in the hands of a few. But the demise of the "developmental state" has not yet been followed by the emergence of an effective framework for economic governance. Without the reconstruction of a minimal social consensus on not only the large issue of cross-strait relations, but also on the trade-off between environmental protection and economic growth, and on the boundaries between individual and government responsibilities on such matters as retirement pension, health care, unemployment and welfare, economic policy making has become unpredictable, unstable and inconsistent.

Moreover, electoral competition has led to rising welfare expenditures (by electioneering politicians promising and delivering more) and falling tax receipts (Any Minister of Finance with the courage to say that tax increases risks losing his or her job). The result is a seriously worsened fiscal condition. However, this is not the right time to raise taxes even though increases are needed in the future. Instead, expenditures should be rationalized. Attention should be focused on the development and institutionalization of sustainable systems for the financing and provision of retirement pensions, healthcare and unemployment for the future.

The fundamental problem is of course the short-term focus of politicians that result from the possibility of governmental rotation. Without the assurance of long-term tenure, politicians (and political parties) have little or no incentive to focus on or tackle long-term problems, even though an early start on a solution may be socially more efficient and less costly. Instead, most governmental decisions are dictated by narrow, short-term electoral considerations rather than guided by a long-term vision of the future. This is a well known problem in all democracies.

What are some possible devices that can be used to overcome this exclusive focus on the short term? The first is the development of a framework for bi-partisan or multi-partisan cooperation. Before this can be achieved, all parties must come to accept the durability of the other parties and the normality and inevitability of governmental rotation. (Why cooperate with an adversary if it can be destroyed?) To be fair, part of the reason for the relative ineffectiveness of the current government is due to the fact that the victory of President CHEN Shui Bian in 2000 was not expected. DPP will in time have to adjust to the fact that it is now the government and will be held responsible for the effectiveness of its economic governance sooner or later. The Economic Development Conference convened by the government in 2001 was actually quite successful in terms of developing a national consensus on economic policy. Unfortunately, in retrospect, it is increasingly viewed as a successful election campaign ploy. The most important recommendations of the Conference, including the establishment of the three direct links, have not been implemented. Both the government and the parties in opposition must realize and accept the need to compromise—otherwise there will be gridlock and paralysis in government.

Second, key institutions such as the Central Bank should be insulated from politics as much as possible (like the Federal Reserve Board of the United States), through long fixed terms for the chief executive (e.g., Governor) and budget autonomy, subject only to confirmation by the parliament. The continuity of the personnel in these institutions enables the stability, continuity, and consistency of policy over time. Such positions should be nominated/appointed on the basis of professional ability rather than political orientation. (For example, Dr. Alan Greenspan, a Republican, has been reappointed by President Bill Clinton twice. Governor Fai-Nan Perng of the Central Bank of China has a fixed term of appointment and was the only holdover from the previous (KMT) government. He has been an important anchor of economic policy in Taiwan since the DPP came to power.)

Third, non-partisan national commissions can be used as covers to both isolate and tackle problems with unpopular or controversial solutions, e.g., the increase in the national health insurance premium, so that the decisions can be separated from political considerations and the responsibilities do not have to be borne solely by the party in power. Of course, to be effective, the recommendations of these commissions must be based on a multi-party consensus. Foreign pressure can sometimes be used as a cover too, e.g., the commitments made on the accession to the WTO.

There is no going back to the “developmental state.” Taiwan will have to develop its own way of reaching social decisions. However, it is fine if Taiwan is going to become another Italy, with its rather loose and light (some would say ineffective) government--it works too. Italy, after all, has achieved a very high standard of living. The difficulty arises only when Taiwan tries to govern like the U.S. when it has the political culture and landscape of Italy.

Comments on Prof. Shangmao Chen and Chengtian Kuo, “The Transformation of Crony Capitalism: Mixed Reforms of the Financial Institutions”

Professors Chen and Kuo have given us an excellent account of the rise of crony capitalism, which is also related to the black gold problem. The rise of crony capitalism in Taiwan dated to the late 1980s. It works through the financial institutions and the stock market. Crony capitalism, however, has much greater impact on the distribution of income rather than on the allocation of resources. Moreover, the current economic malaise cannot be laid solely to crony capitalism. It is due, in part, to the uncertainty about the future that gives rise to rather negative expectations which in turn greatly reduce the incentives for businesses to invest in Taiwan, and in part to external circumstances beyond Taiwan’s control.

The non-performing loans problem in the financial institutions was caused by the collapse in the real estate and the stock markets. This is compounded by the prevalence of self-dealing, undetected or undeterred by the inadequate prudential supervision and regulation. Moreover, the existence of deposit insurance and the low capital requirement encourage moral hazard. (Financial institutions raise money through customer deposits with sovereign credit rating but turns around to lend the money to high-risk ventures.) However, while the non-performing loans problem is serious, it is not critical, in the sense that it is not likely to lead to a collapse of the entire financial system. This is because Taiwan and its financial institutions have little or no net external debt, and the Central Bank can always provide enough domestic liquidity to take care of the problem.

The stock market has also performed poorly. Government efforts to support the market have not helped—it has instead created moral hazard and encouraged corrupt practices based on insider information. Fortunately, the current government has wisely refrained, for now, to support the market. The stock market is forward-looking and depends critically on expectations about the future. A predictable and stable policy environment in the future will definitely help. (The real-estate investment based firms are in deep trouble and are unlikely to recover.) The lack of reliable accounting standards (the famous three sets of books—one for the tax authorities, one for the other shareholders, and one for

the controlling shareholder-manager himself) and transparency and full disclosure and the prevalence of insider trading and market manipulation have discouraged long-term shareholders. Without long-term holders, it is unlikely that corporate governance will improve. More work by the Securities and Exchange Commission and by the government is required.

I am in favor of a clean-up of the financial system now, not so much because it is critical to do so, but because it is politically an opportune time. The non-performing debtors are well connected to the previous government. The DPP does not owe these people anything. The political costs of a clean-up to the DPP is low. However, if the problem is not cleaned up now, in time, these debtors will find a way to become new cronies of the current government.

I am also in favor of maintaining independence of the Central Bank. (However, the frequent turnover in the governorship of the Central Bank was primarily the result of unexpected events--one resigned because of illness after serving only a very short time and another died in an airplane accident.) Important government agencies such as the Financial Services Regulatory Commission and the Securities and Exchange Commission should have open and transparent operations and multi-party representation in their membership.

Finally, in order for the supervision and regulation to have some teeth, one must promote and implement as much as possible the rule of law. This implies, in the Taiwan context, the reform of the judiciary system in terms of the appointment process and accountability. The income tax laws can be used more vigorously to discourage wrong doing. Campaign finance laws and conflict of interest and disclosure laws have to be enacted.

There is a window of opportunity for reform here. The real danger is that crony capitalism continues, but with a different set of cronies.

The real economic challenge that faces Taiwan today is: How can the Taiwan economy adjust to the trend of rising globalization? Rising globalization implies that Taiwan must find its own high-value-added niche in the global supply chain and out-source the lower-value-added activities of the supply chain in order to remain competitive. Rising globalization also implies that Taiwan must find alternative employment for the displaced low-skilled workers until either they are retrained or retire. The Mainland Chinese economy can be helpful on both fronts. Perhaps the time has come for the normalization of economic relations between the two sides of the Strait—not so much in terms of the “three direct links,” which are important, but in terms making the economic interchange more two-way and reciprocal. Increased economic interdependence across the Taiwan Strait can contribute greatly to peace, security and stability of the region.