Chapter 2
Impact of the 2008 Global Financial Crisis

In order to present the impact of the 2008 global financial crisis, this chapter will first graphically compare the real GDP growth, total general government debt, unemployment rate, and consumer price inflation of the four economies during the time period from 2005 to 2010. Then, it elaborates on its impact on each economy individually in the sequence of China, Hong Kong, Singapore, and Taiwan.

At the onset of the financial crisis, many countries viewed it as a purely American subprime mortgage problem. Yet, the crisis rapidly developed and spread into a global economic shock. This resulted in the US government bailing out several large financial institutions, such as AIG, Fannie Mae, and Freddie Mac. In addition, coupled with the trouble in America, a number of European banks also failed and stock markets declined across the board (Altman 2009; Fackler 2008). Many Asian countries, far from the epicenter of the financial troubles, felt relatively safe at the beginning. This was especially true for the Greater China economies which held large foreign exchange surpluses at the time. Yet, that view quickly changed as the global economic activities declined over a short period of time. The two largest import regions, the USA and Europe, were in deep financial troubles. This caused international trade to drastically drop, credit to tighten, and direct foreign investments to be swiftly withdrawn, thus resulting in the domino effect of global recession. In the increasingly interconnected world, the Greater China economies were unable to escape unscathed from this financial crisis with their heavy reliance on international trade.

Following the outbreak of the financial crisis, in late 2008, the European Union proposed a European stimulus plan amounting to around US$256 billion or 1.5% of the European Union's GDP—around 1.2% of the GDP from national budgets and 0.3% of the GDP from the EU and European Investment Bank budgets (Europa 2008). For the entire world, the estimated US$2 trillion total in stimulus packages amounted to approximately 3% of the world gross domestic product. This exceeded the call by the International Monetary Fund (IMF) for fiscal stimulus by 2% of the global GDP (Nanto 2009).

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The impact of the 2008 global financial crisis on each economy can be easily observed from the following four graphs, namely, the percentage of real GDP growth per capita, total general government debt percentage of GDP, unemployment rate of labor force, and consumer price inflation.

Comparisons of the Four Economies

This section presents four graphs in order to examine the Greater China economies as a whole from 2005 to 2010. Figure 2.1 shows that Hong Kong, Singapore, and Taiwan together had a drastic decline in real GDP growth from 2007 to 2009, yet their growth all rebounded quickly in 2010 indicating good recoveries. In the case of China, its percentage of GDP growth per capita fluctuated the least over the six years and managed to still achieve 9.08% and 8.56% growth in 2008 and 2009, respectively. Although Hong Kong had good GDP growth of 5.84% in 2010, it is still lower than its 2005 growth level. Singapore had the earliest decline to negative growth in 2008 and remained in negative growth in 2009 due to its heavy reliance on international trade. However, its rebound in 2010 is the strongest among the four economies, reaching 12.46% and exceeding its 2005 growth level. Taiwan has a fast GDP growth rebound in 2010, reaching 10.62% and exceeding its 2005 growth level as well.

In terms of the total general government debt as a percentage of the GDP, Fig. 2.2 indicates that Singapore has the highest amount of government debt, followed by Taiwan, China, and Hong Kong. The government debt of China and Hong Kong did not have much fluctuation over the six-year period, which means the financial crisis

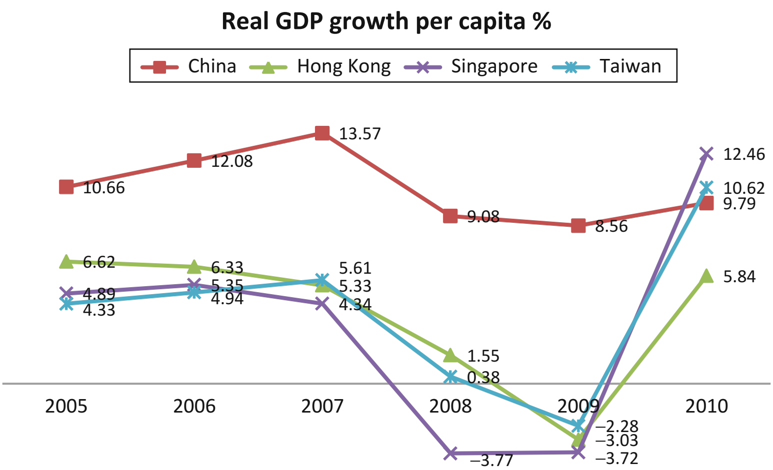

Fig. 2.1 Real GDP growth per capita of China, Hong Kong, Singapore, and Taiwan, 2005–2010

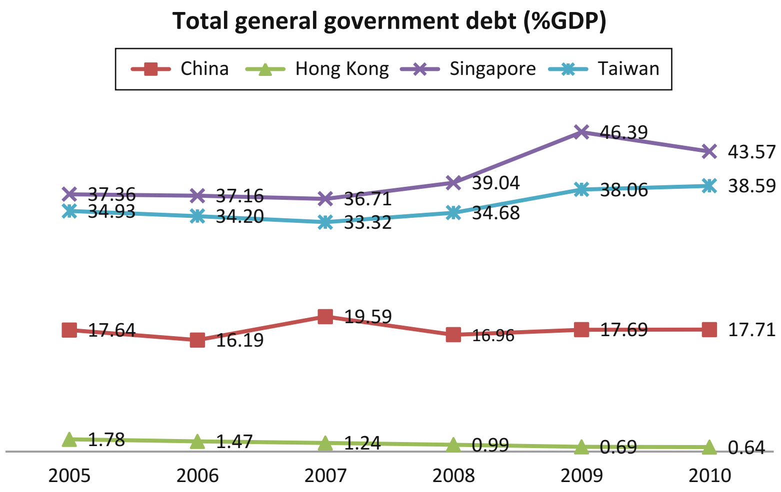

Fig. 2.2 Total general government debt (percentage of GDP) of China, Hong Kong, Singapore, and Taiwan, 2005–2010

did not impact the government debt level. Hong Kong actually reduced its debt year by year, indicating its solid financial status. Singapore and Taiwan had government debt increase starting in 2008, reflecting their increasing financial needs during and after the financial crisis.

Reinhart and Rogoff (2009) reported findings from their research on financial crises over the last 800 years that the aftermath of a financial crisis brings slow and halted growth, sustained high unemployment, and surging public debt—with the overhang of public and private debt being the most important impediment to a normal recovery from the recession.

Figure 2.3 shows the unemployment rate of the four economies. China's unemployment rate is relatively stable, even during the financial crisis. Hong Kong has its lowest unemployment rate (3.6%) in 2008, a sharp increase in 2009 (5.4%), and then a reduction to 4.4% in 2010, which is lower than its 2005 level. Singapore started out with the lowest unemployment rate in 2005 (3.1%) and remained the lowest out of all the economies through the six years. Its large amount of foreign labor (from one out of four to one out of three in 2010) may have served as the buffer and keep its unemployment rate low during the bad times. Taiwan has a clear rising unemployment rate in 2009. Although reduced in 2010, the rate is still higher than its 2005 level.

Figure 2.4 clearly shows the impact of the financial crisis on the general public, as consumer price inflation hiked in 2008 for all four economies, with Singapore being the highest and Taiwan the lowest. This figure also explains the influence of financial stimulus plan as inflation was reduced sharply in 2009, albeit with a slight increase again in 2010. Overall, consumer price inflation in 2010 of these

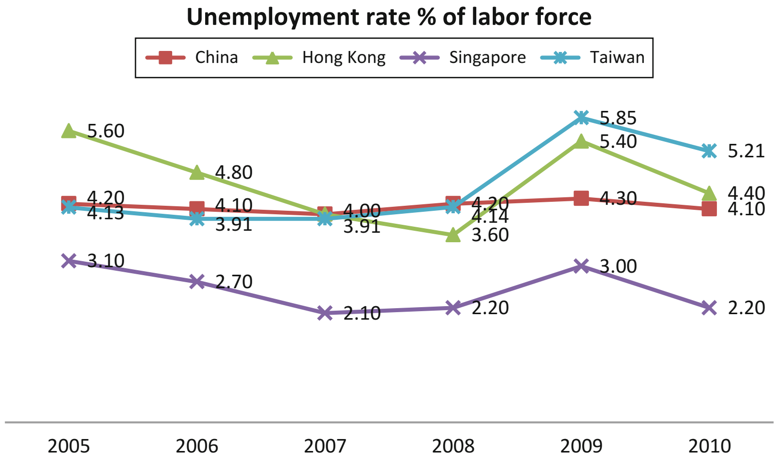

Fig. 2.3 Unemployment rate percentage of labor force for China, Hong Kong, Singapore, and Taiwan, 2005–2010

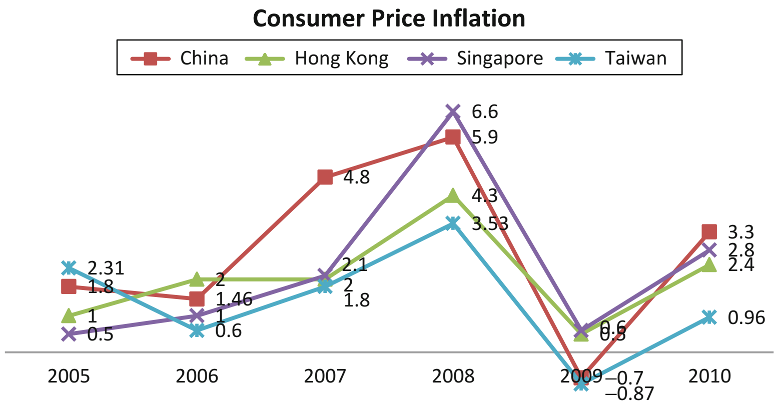

Fig. 2.4 Consumer price inflation of China, Hong Kong, Singapore, and Taiwan, 2005–2010

four economies had not yet returned to their 2005 levels. However, the inflation dropped to about half of 2008 levels explaining consumer markets have been somewhat stabilized.

In general, the four figures shown above indicate that China is relatively unaffected by the financial crisis statistically. The three democratic economies—Hong Kong, Singapore, and Taiwan—were significantly impacted by the crisis, yet they were all able to rebound rapidly.

In what follows, we briefly describe the impact of the 2008 global financial crisis on the four Greater China economies. The depth of the report depends on the English literature available for each economy. For readers to gain a general picture about the efforts that each economy has put in to mitigating the negative impact of the financial crisis, we have summarized the details of stimulus packages implemented by the four economies in Appendix 1. Please note that the reported package is based on publicly available data and is not an exhaustive list. In addition, the reported amounts of stimulus packages were based on the exchange rate at the time of each stimulus, and thus vary. Readers can also refer to Appendix 2 for the important meetings conducted by key global leaders during this financial crisis.

China

China is the fourth largest country in the world in terms of the geographical size after Russia, Canada, and the U.S. Currently, it is also the world's second-largest economy after the U.S. if adjusted for differences in cost of living (CIA 2012). Starting in the 1990s, China's open door policy prompted drastic economic changes that allowed China to be an economic superpower by 2008. A milestone came in December 2001, when China became a member of the World Trade Organization (WTO) (WTO 2012), which accelerated its integration with the world economy. Since then, underpinned by rapid expansions of trade and deep structural changes, its economy has continued to deliver yearly double-digit growth. The speed of its integration with the world economy, coupled with excess demand worldwide, pushed up China's current account surplus to as much as 11% of its GDP by 2007. In 2007, with a trade dependency rate of 66%, China was categorized as having a very open economy by international standards (Heilmann and Schmidt 2010). This high dependency explains why China was not immune from the 2008 global financial crisis.

After the financial crisis hit, thousands of private companies in China closed down. In the first half of 2009, exports sank 21.8% and imports declined 25.4% (Heilmann and Schmidt 2010). The Chinese government estimated that as of 2007 there were 286,200 approved foreign-invested companies in China. Such firms employed more than 42 million people and accounted for 31.5% of gross industrial output value (Morrison 2011). With the international money market crunch, capital flight from emerging countries is a common practice. The speed and scope of this hit came as a shock for Chinese policy makers. In an effort to mitigate the crisis, Chinese president Hu Jintao pledged an economic stimulus measure worth US$586 billion (RMB 4 trillion) in early November of 2008, which amounted to 15.5% of the country's GDP in 2007 (Heilmann and Schmidt 2010). In addition, China also implemented measures such as increasing investments in public infrastructure, loosening monetary policies to increase bank lending and providing various incentives to boost domestic consumption (Morrison 2011). It is important to note that the size of China's stimulus package is comparable to that of the United States' when its GDP is only a third as large (Fleet 2010). Herd et al. (2011) also reported that China responded to the 2008 crisis with fiscal stimulus far greater than that of other OECD countries.

China launched its Economic Stimulus Plan mainly to expand the public sector, including pumping more public investments into infrastructure for rail network, roads, and port development. It also created measures to increase affordable housing, lower taxes on real estate sales and commodities, and ease credit restrictions for mortgage as well as small and medium enterprises (Fleet 2010). China's stimulus funding differs significantly from that in other countries, the central government contributes only about one-fourth of all funds by issuing bonds over a two-year period from 2008 to 2010. The remaining three quarters was to be provided by local governments, state-controlled enterprises, and the market (i.e., government-linked financial institutions and nonpublic firms under government guidance) (Heilmann and Schmidt 2010). That is, a large part of the stimulus package involved off-budget expenditure by local authorities, which resulted in the public expenditure rising by nearly 3% of GDP in 2009.

Critics pointed out that the share of the package was aimed at major infrastructure projects, as opposed to direct stimulus of consumption, and the RMB 4 trillion stimulus package was more a policy than a package (Fleet 2010). Nonetheless, the package worked and recovery started to show by the second half of 2009. This timeframe preceded that of the other major economies. As a result, companies were hiring again, restaurants were filling up, and consumption statistics were turning upward. After the crisis, both the estimated output gap and the OECD composite leading indicators suggested that China is operating above capacity with its ongoing rapid economic transformation (Herd et al. 2011).

Looking back at the stimulus decision-making process, the experience of focusing on public expenditure in the 1997 Asian financial crisis gave the 2008 Beijing policymakers valuable lessons to draw from. Beijing designed more than 50% of the entire RMB 4 trillion in the initial stimulus package to focus on infrastructure. In this manner, the money could be spent quickly and had a significant impact on employment where it was needed the most since many low-skilled workers had lost low-end export-processing jobs. In reality, much of the money actually found its way to private firms who were subcontractors to the initial state-owned enterprise beneficiaries, and it had a huge impact on consumer confidence (Fleet 2010). In addition, China included in its stimulus package a massive increase in liquidity; i.e., funds from the national government would not exceed around a quarter of the designated RMB 4 trillion. Also, the package stipulated that 40% of the amount would be provided by bank lending matched with reduced reserve requirements and interest rates cut (Heilmann and Schmidt 2010). Furthermore, the measures consisted of substantial regulatory change, including a lowering of down payments required for mortgages, reduction or elimination of value added tax (VAT), lower fuel prices and subsidies for smaller cars (fuel efficiency), and an expansion of subsidies for consumer goods purchases in rural areas.

In a knowledge forum conducted by the Wharton school at the University of Pennsylvania, Chou (Khemka et al. 2008) commented that the financial crisis was not a bad thing for China as its economy was growing too fast and needed to be held in check. The preoccupation of the Chinese government for the last few years before the crisis had been how to cool down the economy and the real estate prices, which had become out of the reach of the common people. As far as China can, it had been trying to move away from being overly reliant on the exports sector of the economy. Therefore, the financial crisis offered an opportunity for China to adjust its economy to be more independent and resilient to future external impact.

In general, the fast and decisive government stimulus measures worked well in China. In addition to its own recovery, China also helped pull the world economy along during this financial crisis (Fleet 2010).

Hong Kong

Currently, Hong Kong is a Special Administrative Region (SAR) of the People's Republic of China. In the July 1997 handover agreement, China promised that its socialist economic system would not be imposed on Hong Kong under its "one country, two systems" formula and that Hong Kong would enjoy a high degree of autonomy in all matters except foreign and defense affairs for the next 50 years (CIA 2012).

Ever since, China has been Hong Kong's largest trading partner, accounting for about half of Hong Kong's exports by value. During the past decade, as Hong Kong's manufacturing industry moved to China, its service industry has grown rapidly and accounted for more than 90% of the territory's GDP in 2009. Hong Kong has a free-market economy highly dependent on international trade and finance. The value of goods and services trade in Hong Kong, including reexports, is about four times its GDP. Heavily dependent on trading, Hong Kong was hit hard by the financial crisis in terms of exports, GDP, and employment. Impacted by the crisis, economic growth dropped from 6.4% in 2007 to 2.5% in 2008 and then to further negative growth of -2.5% in the last quarter 2009, which was Hong Kong's worst performance since 1999 (Yang and Tong 2009). Total exports dropped by 21.8% year on year in January 2009, and the stock market saw a sharp decline with the Hang Seng index plunging 48% from a year before, unseen since 1974 (Yang and Tong 2009).

In response to the crisis, the Hong Kong government swiftly put forward a series of measures to stabilize the financial market, support enterprise, and create employment. Externally, China's central government also announced measures to boost Hong Kong's economy through cross-boundary infrastructure projects. In its 2009/2010 budget, the Hong Kong government proposed an expenditure of around US$38.4 billion (HKD 300 billion) and set a budget deficit of about US$5.1 billion (HKD 40 billion), 2.4% of the GDP, yet it is considered by many as conservative given Hong Kong's ample fiscal resources (Yang and Tong 2009).

With a service economy, Hong Kong's financial sector was hard hit by the crisis as output and employment declined. Fortunately, most banks in Hong Kong are sufficiently capitalized and have raised their provision levels so they were able to weather the crisis (Deutsche Bank Research 2009). In addition, Hong Kong's sound banking system, minimal public debt, strong legal system, ample foreign exchange reserves, rigorous anticorruption measures, and close ties with China, enabled it to quickly respond to the financial crisis.

While Hong Kong's open economy left it exposed to the global economic slowdown, its increasing integration with China has mitigated the effect of the financial crisis. Trade, tourism, and financial links between the two economies helped Hong Kong recover quicker than many outside observers anticipated. Particularly, foreign investors continued to contribute capital inflows as they took advantage of Hong Kong's "free"-market economy with high accessibility to the China mainland economy (Tuan and Ng 2011). Although Hong Kong's GDP fell in 2009 as a result of the global financial crisis, a recovery began in the third quarter 2009, and the economy grew nearly 6.8% in 2010 (CIA 2012).

Singapore

For decades, Singapore had a highly developed and successful free-market economy. It enjoyed a remarkably open and corruption-free environment with stable prices and a per capita GDP higher than that of most developed countries. The economy depends heavily on exports, particularly in consumer electronics, information technology products, pharmaceuticals, and financial services. As a result of all this, Singapore's real GDP growth averaged 7.1% between 2004 and 2007 (CIA 2012).

When the 2008 global economic crisis hit, Singapore was the first East Asian country to fall into recession (Thangavelu 2009). This clearly showed the vulnerability of the trade-dependent Singaporean economy. The manufacturing sector was hit particularly hard due to falling demand induced by the overall deterioration of economic conditions in the U.S. and Europe (key export destinations which account for nearly 33% of the total Singapore's non-oil exports over the last few years) (Thangavelu 2009).

Fortunately, due to its well-regulated market, the exposure of Singapore's banks to subprime mortgage was limited (Thangavelu 2009). Even though damage to the banking sector was limited, Singapore still suffered a huge loss of wealth as the stock market plummeted from a high of 3500 points in December 2007 to 1700 points in the last quarter of 2008. This depressed domestic demand and investment in assets (Kesavapany 2010).

Singapore's policy makers responded with a series of measures aimed at insulating the population at large from the negative effects of the financial crisis. The Monetary Authority of Singapore (MAS) guaranteed bank deposits and flushed the money market with enough liquidity to restore market confidence. It established a US$30 billion swap line with the US Federal Reserve to abate any strain in USD funding in the Asian dollar market (Kesavapany 2010). To assist local, small- and medium-sized companies in obtaining access to credit, the Singaporean government established a US$1.56 billion (S$2.3 billion) loan facility and launched a risk-sharing initiative which took on significant shares of bank-lending risks in November 2008

(Kesavapany 2010; Thangavelu 2009). Moreover, the Singapore central bank shifted its currency policy to a "zero-percent appreciation" stance and devalued the Singapore dollar (S$) to help electronics exports (Kesavapany 2010).

The Singaporean government also set aside US$406.2 million (S$600 million) for training and development of workers to improve its human capital (Thangavelu 2009). This had a strong impact on future reemployment and retention of productive workers in the labor market. Furthermore, the government delivered a US$13.8 billion (S$20.5 billion) resilience package for the 2009 financial year for temporary measures to combat the effects of the financial crisis (Abidin 2010). The key objective was to help Singaporeans keep their jobs and thus increase overall confidence. Measures included strategic industrial support in order to drive down business costs and avoid corporate failures as well as income tax rebates to ensure household flexibility without locking down rates (Kesavapany 2010). In addition, Singapore's government spent heavily on big investment projects in the construction sector such as the construction of two integrated resorts, the Marina Bay financial sector and the new MRT line (Kesavapany 2010).

In many ways, Singapore is well positioned to ride out what is likely to be a prolonged global recession for the following reasons: first, the Singaporean government is swift in initiating effective coping measures. Second, its public finances are sound and can run budget deficits without increasing the tax burden. Third, the large pool of foreign workers, about one in every four workers in Singapore, provides a buffer against a sharp rise in unemployment. Fourth, the flexible wage system allows employers to adjust costs better and reduce job cuts (Fong 2009).

In general, Singapore's economy contracted 1.3% in 2009 as a result of the global financial crisis, yet rebounded nearly 14.7% in 2010, on the strength of renewed exports (CIA 2012).

Taiwan

Since the 1970s, Taiwan has continued to develop as a dynamic capitalistic economy with gradually decreasing government guidance in investments and foreign trade. In keeping with the free-market trend, a number of large state-owned banks and industrial firms have been privatized. Taiwan runs a large trade surplus, and its foreign reserve was the fourth largest in 2011, behind only China, Japan, and Russia. Since 2005, China has overtaken the U.S. to become Taiwan's second-largest source of imports after Japan. China is also Taiwan's number one destination for foreign direct investment (CIA 2012).

With a small internal market of only 23 million, fully 70% of Taiwan's gross domestic product is accounted for by exports and the lion's share of these exports consists of electronics, machinery, and information technology products (CIA 2012; Cooke 2012). Heavy dependence upon exports exposes Taiwan to upturns and downturns in world demand. As a result, during the 2008 financial turmoil, Taiwan's unemployment reached levels not seen since 2003, and the economy fell 8.36% in the fourth quarter of 2008 while its GDP contracted 1.9% in 2009, due primarily to a 20% year-on-year decline in exports (QFinance 2011). In response, Taiwan's government launched a US$5.6 billion Economic Vitalization Package in September 2008 (about 3% of its GDP) (QFinance 2011). The stimulus package focused on infrastructure development, low-income households, tax breaks for new investments, and financial incentives for small- and medium-sized businesses. It also aimed at boosting exports to new overseas markets, such as Russia, Brazil, and the Middle East (QFinance 2011).

The Economic Vitalization Package implemented a series of monetary policies, financial stability measures, and fiscal policies in order to increase domestic demand, stabilize the financial system, and maintain economic growth. To increase domestic demand and provide a sufficient injection of liquidity into the market, Taiwan's central bank adopted an easy monetary stance. Key measures included reducing bank base rates by 2.375% through seven cuts between September 2008 and February 2009, to a record low of 1.25% (QFinance 2011). To stabilize the financial markets, improve confidence, and assist individual and corporate funding, Taiwan's government guaranteed all deposits in insured financial institutions by their full amount until the end of 2009. This measure effectively stabilized the market and restored the confidence of depositors. The impact of global financial turmoil also resulted in acute slumps in the local stock markets. To stabilize domestic equity prices, Taiwan temporarily resumed the ban of short selling 150 listed shares below the previous day's closing price and suspended borrowed stocks from short selling. Such policies helped restore the stock market order and reduced man-made manipulation.

In January 2009, the government followed its initial stimulus with a second round of measures entailing the distribution of around US$108 (NTD3600) in shopping vouchers to each of its residents. In addition, the government also launched a number of public construction projects and provided incentives to encourage further private investments. In total, this second package was estimated to worth approximately US$14.9 billion over the four subsequent years.

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