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ECONOMIC THEORY

**INSTITUTIONAL ENVIRONMENT FORMATION
IN MODERN PROCESSES
OF THE NETWORK ECONOMY DEVELOPMENT**

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The article is devoted to the formation of a network structure in the modern economy in the rapid development of globalization and the global economic crisis. The article analyzes the network interactions of economic agents and presents a model of the institutional environment formation in the context of network interactions development in the economy.

Key words: institutions, institutional environment, institutional changes, network economy.

ECONOMICS AND MANAGEMENT OF NATIONAL ECONOMY

**DEVELOPMENT OF THE RAILWAY TRANSPORT MARKET
IN THE CONTEXT OF ECONOMIC SECURITY OF RUSSIA**

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The paper justifies and shows the influence of railway service market to the economic security of Russia. There were formalized key criteria of effective high speed transport using vector coefficient of intensive displacement. The investigation determines threshold levels and parameters for transport system model of economic security in general.

Key words: economic security, railway transport market, threshold levels and parameters for transport system model of economic security.

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THE DETERMINATION OF THE ECONOMIC OUTCOME IN NOVATIVE ACTIVITY AT INDUSTRIAL ENTERPRISES DURING THE STRATEGIC PERIOD

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This paper considers the estimation of efficiency in innovative activity, the advantages and disadvantages of the discounting methods usage to determine the algorithm to calculate the economic outcome and evaluate its effectiveness.

Key words: innovation, enterprise, investment, economic results, discounting.

Improvement of the innovation activities is critical for the Russian industrial enterprises. Evaluation of the effectiveness during its implementation is one of the main elements in this process. Currently, the definition of efficiency in innovative activity is realized mainly on the evaluation methods in investment efficiency. These methods allow to take into account many critical factors, including the effect of the time factor, however, not fully characterize all possible outcomes of innovative activity. Reliable assessment is proposed to define a specific indicator - economic outcome of innovative activity.

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**NPP INTEGRATED SALES FOR SUSTAINABLE DEVELOPMENT
IN THE FIELD OF NUCLEAR ENERGY**

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The article presents a concept of integrated sales of nuclear power plants which are implemented with due consideration of IAEA methodology in the field of nuclear infrastructure and UN approach to sustainable development.

Key words: sustainable development, nuclear power, nuclear infrastructure, integrated sales, NPP, partnering strategy.

In December 2015 representatives of more than 190 governments will meet in Paris at the 21st Conference of the Parties to the UN Framework Convention on Climate Change (COP21) to launch a new ambitious international agreement to decrease CO₂ emissions up to 80 % by 2050 which is challenging in terms of balancing economic and technological development.

International nuclear community is convinced that energy sustainability coupled with climate preservation goals is to be achieved only with nuclear power being a part of global energy-mix. For that reason Nuclear for Climate initiative is launched in 2015. Nuclear power provides 11 % of global electricity production, 27 % of Europe's electricity and 53 % of its carbon-free electricity. According to the latest World Energy Outlook by the IEA, it has avoided the release of 56 Gt of CO₂ since 1971 [7].

"Nuclear power clubmen" enjoy power, economic, technological and ecological advantages. Countries with mature nuclear power sector are well aware of NPP fleet benefits while new-comers show more and more interest in launching nuclear power program. IAEA plays significant role in facilitation all member states through guidance and capacity building [8]. IAEA holistic approach encompasses 19 elements of Nuclear infrastructure (NI) which are to be elaborated.

IAEA methodology on sustainable nuclear power development was customized by Russian NPP vendor through concept of Integrated sales which comprise the following components: turn-key NPP supply (optionally with desalination, research reactor, etc.), nuclear fuel cycle services, O&M, NI and HR development, localization and technology transfer (for local industry involvement), financing (equity and debt).

The core of any Integrated sales is NPP and its configuration which is to suit Customer's needs both technologically and commercially. Great attention is paid to capital costs which are influenced by financing and technological partnering strategy. Thus unique commercial and technological configuration of an NPP project is developed with three principles in mind: 1) market defines financing sources and forms; 2) Customer's requirements and financing mechanism influence the technological cooperation; 3) Market peculiarities, financing and technological partners stipulate particular Integrated sales terms and components.

Such iterative tuning for the customer's needs allows implementing sustainable nuclear power development in the country of NPP recipient.

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**BACKGROUND INTRODUCTION OF IMPORT SUBSTITUTION
IN THE STEEL INDUSTRY**

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The article deals with current imports of steel products from the perspective of the selected state policy orientation to import substitution. This article discusses the possible reasons for the current situation, in which despite the existing import duties, as well as the weakening of the national currency, there is no significant reduction in imports of steel products in the Russian Federation. We consider the external factors that create incentives for innovation and technological development in the world.

Key words: import substitution, ferrous metallurgy, modernization of production, advanced development, innovative development.

The article discusses the current state of the import of steel products from the perspective of the selected state policy orientation to import substitution. The possible reasons for the current situation, in which in spite of the existing import duties, as well as the weakening of the national currency, there is no significant reduction in imports of steel products in the Russian Federation.

Depending on various factors of innovative development company builds a particular innovation strategy. In most cases, innovation strategy centers around one of the factors of innovative development and focuses on a group of related factors.

Currently, the industry appeared all the prerequisites mentioned above, to create incentives for the development of innovative technologies and their implementation in the domestic steel industry to higher levels of redistribution. It is also important to note that the steel industry is considered one of the branches of specialization of Russia in the modern international division of labor. Branch has all the necessary natural resources, including the chief - a powerful mineral resources base of iron ore. Soon to be launched new plants (for example, UMMC-Steel Tyumen, JSC “Severstal” Balakovo, Saratov region, NLMK’s Kaluga region, etc.) For the production of end products. Additional production volumes would have to create pressure on the market, as the growth in production volumes significantly higher than the rate of growth of real domestic consumption of metal, however, the program of import substitution just could solve these problems.

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**THE RATIONALE FOR MEASURING SUSTAINABLE
REGIONAL DEVELOPMENT***

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The expediency of using modern concepts for modeling of sustainable development indicators. The basic principles methods of calculation of the index of adjusted net savings the world Bank and UNDP's human development, which in addition to traditional macroeconomic indicators GRP fully reflect the sustainable development of the region.

Key words: sustainable development, integral index, indicators of sustainable development, “the Millennium development Goals, sustainable development Goals”, human development index, adjusted net savings.

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**CLUSTER POLICY AS AN INSTRUMENT
OF THE INNOVATIVE DEVELOPMENT OF A REGION**

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The given article assesses realization of the cluster policy as one of the instrument to implement the innovative policy of the Russian Federation regions. Authors has analyzed a regulatory and legal support of the cluster policy realization on the Federal level. Possibilities of the effective realization of the cluster policy through instruments of the governmental support of innovative territorial clusters and industrial clusters have been identified.

Key words: cluster policy of a region, territorial cluster, innovative territorial cluster, industrial cluster, governmental support of territorial clusters, innovative industrial complex.

In implementing scenario of the innovative development of the regional economy, the most relevant is to use instruments of the cluster policy in order to improve management efficiency of the innovative industrial complex of a region.

Priorities for the use of the cluster policy instruments are defined in the strategic legal documents of the Russian Federation.

At the federal level, several mechanisms are created to provide a creative financing for the development of a regional clusters.

Based on the developed regulatory and legal framework of the cluster policy implementation in the Russian Federation, the main characteristics were defined to make it possible to identify clusters according to following types: innovative regional cluster and industrial cluster.

Analysis of the terminology doesn't allow to identify distinctive features of an innovative regional cluster and an industrial cluster. Therefore, for this article we will use the term "*innovative regional cluster*" considering integrated organizations implementing joint realization of the innovative process from the research activities to the batch production of high-tech industrial products and their further modifications.

That is, joint implementation of the process connected with development of technologies and their commercialization by participants of a cluster is the distinctive feature of the innovative regional cluster.

In *an industrial cluster*, production of high-tech products are carry out on the basis of already existed technologies which were bought for further improvements.

The main idea for the formation a regional cluster is to create conditions for implementation of all stages of the production process in the framework of a cluster.

Therefore, implementation of the cluster policy instruments is more effective for such regions of the Russian Federation, which have a strong technocal and scientific potential.

To improve efficiency of an innovative industrial complex in a region there is a need to use instruments of the governmental support which can be used for both an innovative cluster and industrial cluster. Formation of industrial clusters in regions with regional innovative clusters will result in multiplier effects due to expansion and complementarities; their implementation is enable to provide development of regional industrial complexes and, consequently, to increase economic growth.

Thus, effective implementation of the cluster policy in a region will provide achievement of strategic aims of the economic development, which were highlighted in a decree of the President of the Russian Federation □596, including:

- creating and modernizing high-performance jobs;
- increasing proportion of products generated by highly knowledge-intensive enterprises in the Gross Regional Product;
- productivity increase.

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**REGIONAL NETWORK SYSTEM OF INDIRECT MANAGEMENT
OF DEVELOPMENT CONSTRUCTION ENTERPRISES**

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It is defined the main tasks of development of the construction complexes of regions. For integration direction of development of construction enterprises it is updated prerequisites, it is analyzed constraining factors and compensatory steps. It is proposed regional network management system and mechanisms of development.

Key words: region, building complex, construction companies, development, management system, enterprise network.

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**ENSURING THE SUSTAINABILITY OF DEVELOPMENT
AND INVESTMENT PROCESSES IN AGRARIAN
AND INDUSTRIAL COMPLEX OF THE REGION**

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Discusses the mechanisms to ensure the sustainability of agricultural development in region based on overcoming the investment deficit-based optimization of unit investment ka-fed and state regulation of investment processes in agrarian sector of economy.

Key words: investments, investment management, sustainability of agricultural development, investment climate, public investment policy.

**INVESTMENTS AS A TOOL FOR THE DEVELOPMENT
OF THE LIVESTOCK INDUSTRY**

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Discusses the problems of investment attractiveness of the agro-industrial complex and the livestock industry, in particular, studied the investment policy of the region, analyzed the financing of investment projects in rural areas and suggested measures to attract investment in the livestock sector for the implementation of major infrastructure projects and development of the region.

Key words: investment, farming, agriculture, economic sanctions, import substitution.

**INNOVATIVE PROCESSES SMALL AND MEDIUM ENTERPRISES
IN THE RUSSIAN FEDERATION**

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This paper presents the structural forms of innovation. It was found that each of the small and medium-sized businesses have innovation potential, and can act as a market participant innovation. At the same time the introduction of innovative processes in the practical activities has the character of a non-permanent form. It was found that the interest of small and medium enterprises in innovation is quite low and is not an institutional factor of economic development of the country. The paper identifies possible ways of development of the situation on the integration of innovative processes, an assessment of measures for their implementation and identify potential economic effect.

Key words: small business, economic development, the process of innovation, entrepreneurship, integration.

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METHODICAL ASPECTS OF THE COMPARATIVE ANALYSIS OF DEVELOPMENT OF MUNICIPALITIES OF TOMSK AGGLOMERATION

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The technique of carrying out the comparative analysis of rates of social and economic development of municipalities of Tomsk agglomeration is presented in article, the main priorities of strategic development of the studied municipalities are opened.

Key words: agglomeration, comparative analysis, social and economic development, Tomsk agglomeration.

In article methodical aspects of the comparative analysis of rates of social and economic development of municipalities of Tomsk agglomeration are considered.

The author's technique of carrying out the comparative analysis of rates of social and economic development of municipalities of Tomsk agglomeration is presented. For a reasonable assessment of tendencies and prospects of development of municipalities as a part of Tomsk agglomeration in a technique it is offered to calculate an integrated indicator of social and economic development of the studied municipalities on the basis of rated values of growth rates of socio-economic indexes. For interpretation of results it is offered to use the principle of the majority on the basis of which the area of coherent development of the studied municipalities is defined.

The offered methodical approach has universal character and can be used in the course of the comparative analysis of development of the Russian agglomerations.

In the conclusion the main priorities of strategic development of the studied municipalities of Tomsk agglomeration are opened.

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THE CLUSTER MODEL OF SERVICES SECTOR: THE APPLICATION OF PROCESS APPROACH

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Considered the Genesis of the formation of the cluster concept, highlights the distinctive features of industrial-territorial complexes and clusters, the possibility and necessity of using the cluster approach in the service sector, and proposed a structural model of a cluster of sphere of services based on the use of the principles of the process approach.

Key words: services, cluster concept, process approach, business processes.

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**STRATEGY OF BEHAVIOR OF WORKERS IN LABOR MARKET TAKING
INTO ACCOUNT BRANCH SPECIFICS (ON THE EXAMPLE OF THE ENTERPRISES
OF WHOLESALE TRADE)**

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In article the author defines characteristic strategy of behavior of workers for branch of wholesale trade in labor market, through imposing of features of employment in branch on the theory of the strategy of behavior considered in economic science.

Key words: employment in wholesale trade, strategy of behavior of workers in labor market, labor market, motivation of work.

Competition for talent in today's labor market is characterized by a high degree of activity, which is usually manifested in the creation of strong brands Hr-offering to potential workers and the employed certain set of benefits that would be allowed to attract, engage and retain them. At the same set of goods for each industry will be specific. Specificity is this, on the one hand, determined by the specifics of the industry in which it operates, the company and, therefore, imposes certain features of the nature and content of the work, and therefore the peculiarities of employment of workers of the industry, on the other, - the strategies of behavior of workers in general, which in turn form the characteristic behavior of a strategy for the industry workers in the sector in the labor market. The article deals with the concept of the characteristic strategies of workers involved in the wholesale trade sector. For this the analysis of authoritative sources, including: Representatives of behavioral economics; The universally recognized and respected scientists in the study of labor market and human resource management - Odegov Yu, S. Kartashov, Pavlenko VV.; The data of sociological research. As well as the analysis of employment in the sector of trade, namely, its advantages and disadvantages.

As a result, we conclude that the dominant strategy of conduct for employees in this sector will be - the average income with a minimum of labor, for the most part this is due to the poor quality of the labor force, which is characterized by the industry because of its features. Let us explain: the motivation of the majority of employees of wholesale trade industries, the basis of the above advantages and disadvantages, based primarily on the basic needs - wages and security. The amount of wages in the industry average, but the security can be assessed as below average. A large number of employees in wholesale simple tech work with the absence of high skill requirements also talks about the predominant mechanism of stereotypes and beliefs among workers that, according to behavioral psychology also affects the strategy of behavior. And in this case - it will be to talk about the tendency of the majority of employees of wholesale enterprises to take trivial decisions and follow accepted patterns in society. Speaking about the research, employees of wholesale businesses also form a significant body of people who in choosing the place of work is primarily governed by the amount of wages. In turn, the strategy of behavior have an impact on productivity

in the industry, and it is logical, then, is that the industry of wholesale trade is one of those industries, the development of which is constrained by human resources, as a strategy of behavior in the long run - a key factor in performance workers. But that's a topic for a separate discussion.

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SPECIFIC CHARACTER OF SOCIAL SERVICE MARKET

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At present the concept of social marketing is an integral part of the marketing theory and practice. The analysis of this problem authors' researches shows that social marketing originates in the 50th-s of the XXth century, i.e. in the period of consumer-oriented concepts of marketing.

Key words: social service market, chargeable services, infrastructure, sphere of services.

Last decade social service market development was characterised with stable growth tendency of provided to population volume of chargeable services. Thus, the study of the processes occurring on the market of chargeable social services is an important aspect in determining the consequences of economy reforming and specific characteristics and tendencies of services consuming capacity as well.

The objectives of social service market research are following:

- to present the current state of social service market in basic indicators;
- to study the basic tendencies of chargeable social service market supply development;
- to research the demand for chargeable services and its inter-temporal changes.

There have occurred cardinal changes on the social service market in the time of transition from economy administrative management to market economy in the 90th-s of the XXth century. The transformations which have taken place in social sphere in the period of transition to market conditions of management were carried out on the basis of provided to population chargeable service sector expanding.

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**CORPORATE SOCIAL RESPONSIBILITY
OF THE INSURANCE COMPANIES AS AN EFFECTIVE METHOD
OF PROVIDING SOCIAL AND ECONOMIC SECURITY
OF THE PERSON**

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Corporate social responsibility of insurance companies (CSR) opening a range of possibilities for minimizing or optimizing the risks (including the management of environmental and social risks) and implementation of policies and procedures that ensures the correct response to the negative factors affecting the business processes, define a space for synergy and achieve high social and economic results of financial activity.

Key words: corporate social responsibility, insurance, risk management, sustainable development, ISO 26000.

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THE USE OF MARKETING TOOLS AS A FACTOR IN MAINTAINING THE COMPETITIVENESS OF THE TOURISM SECTOR

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The article substantiates the importance and necessity of using marketing tools in the management process, as a key factor in maintaining competitiveness is, in a volatile and rapidly changing market conditions. Particular attention is paid to the use of communicative marketing tool that plays a leading role in promoting the services of tourist organizations and the formation of consumer loyalty.

Key words: marketing, marketing tools, competitiveness, tourism sector, advertising, promotion, personal selling, incentives.

FINANCE, MONEY CIRCULATION AND CREDIT

THE INSURANCE MARKET OF THE RUSSIAN FEDERATION IN THE CONTEXT OF GLOBALIZATION AND WTO ACCESSION: CURRENT STATE AND PROSPECTS OF DEVELOPMENT

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The article considers topical issues of functioning and development prospects of the Russian insurance market in the conditions of globalization and WTO accession, the conditions for the opening of the domestic insurance market to foreign insurance companies.

Key words: globalization, integration, global insurance market, the world trade organization, the insurance company.

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**THE ROLE OF CAPITAL TO ENSURE FINANCIAL STABILITY
OF THE BUSINESS UNITS IN THE CONTEXT
OF CURRENT MACROECONOMIC TRENDS**

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The article analyzes the current state of the Russian economy (2008-2014 AD), the results of which emphasize that Russian corporations are excessively under the influence of the global economic situation. It determined that business - is the main potential of the economy (especially small and medium enterprises). Decline of investment became the sequel of wrong capital management of Russian companies. This factor created negative conditions for the national economy. All these findings underscore the priority role of capital in the ensuring of economy strategic development, underlines the importance of this category as the chief object of financial management at the state level and at the level of corporations.

Key words: corporate capital, financial stability, net capital inflow/outflow, GDP dynamics, economic growth, investment in fixed assets.

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**THE INFLUENCE OF EXTERNAL FACTORS ON THE RISK
OF FINANCIAL FAILURE**

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The subject of the study, the results of which are presented in the paper is the relationship between indicators of financial insolvency of companies in the real economy and external environmental factors.

The aim of the study was the identification and measurement of external factors, having predictive ability in predicting the risk of financial insolvency of the company. As the object of the study were chosen companies of aviation industry of the Russian Federation.

Theoretical and methodological basis of the study were basics of the corporate finance, macroeconomic theory and statistical analysis.

The study highlighted external factors that have predictive power in forecasting the risk of financial insolvency of the company.

The practical significance of the results comprise the improvement of instruments of financial risks management and developing one of the possible approaches to accounting for market factors in predicting the financial risks of the company.

Key words: risk of financial insolvency, external factors, financial condition.

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**TAX EXPERIENCE AND ITS ATTRACTIVENESS: THE SEARCH
FOR NEW APPROACHES TO PROBLEM SOLVING**

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The subject of research is the study of the current tax experience and the identification of existing problems and the search for new approaches. This topic is of great scientific and practical interest, because it is the system of taxation allows for consideration of all variational possibilities of obtaining the best results.

Key words: taxes, taxation, tiscalinet, income, expenses, budget, level of taxation, differentiation of taxation.

BOOK KEEPING, STATISTICS

**PROBLEMS OF FORMATION AND REALIZATION
OF TAX POLICY IN SMALL BUSINESS ORGANIZATION**

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The importance of tax policy and the business due to the growth of the economy, the tasks of strategic development of industries and organizations. The special role is played in the economy of small businesses, that public policy is paid a lot of attention. The article describes the types of tax policies realized at the level of an economic entity shown their characteristics and areas of application. The author presented a model of a single information space of a small business accounting and management functions shown conditionality tax risk and tax burden on the basic functions of business management.

Key words: tax policy, types of tax policy, tax burden, accounting, tax accounting, single information space.

WORLD ECONOMY

US EXPERIENCE IN SUPPORTING EXPORT AND EXPORT CREDIT

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The article analyzes the practice of export credits and export maintain in the United States, which is primarily due to under-content of the level of employment in the United States and the need for speeding up the creation of new conditions in the transformation of the global economy; the author analyzes the contradictions between WTO rules and OECD Export Support Arrangement, as well as holding the US strategy in the case-law of the imposition of the system of dispute resolution, and the dominance of WTO rules and disciplines on OECD Export Support Arrangement. Single temporarily author examines the practices of the US Eximbank, which is an important institution of export credit in the United States.

Key words: export support, export credits, export credit arrangements (OECD DOEK), WTO.

**TRADE AND INVESTMENT COOPERATION OF BRICS COUNTRIES
AND DEVELOPMENT OF THEIR ECONOMIES**

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Relevance of research is connected with development of trade and investment interaction of BRICS countries as a new paradigm of formation of growth of their economies. This problem is important, but still insufficiently studied. Author suggests to use multiple-factor correlation model for definition of the degree of interrelation of trade and investment cooperation of BRICS countries and growth of their GDP.

Key words: BRICS countries, international trade, foreign investments, trade and investment cooperation, model of multiple correlation.

**MEASURES TAKEN BY TAIWAN GOVERNMENT IN RESPONSE
TO THE 2008 FINANCIAL CRISIS***

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The financial crisis, which emerged in 2007 and reached a peak in 2008, has impacted the world including Taiwan significantly. This article will discuss and analyze the measures that Taiwan Government took for future references. The structure of this article is as follows: Part I introduces the background and the impacts of the financial crisis to Taiwan; Part II summarizes the responses of various countries, as a comparison to Taiwan's responses; Part III details the measures that Taiwan Government took; Part IV analyzes and examines the effects of these measures; Final part provides a summary.

To view it positively, Taiwan government has done all it can to cope with the financial crisis. Negatively, Taiwan government did not analyze pros and cons for each of the measures and simply accepted all prescriptions. This article is for reminding: some policies actually make more harm than good. Learning from the past and we should be more cautious to properly assess the relevant policies when facing this kind of crisis in the future.

Key words: anticrisis measures and regulation, financial crisis, Taiwan, China, Taiwan Government.

I. 2008 Financial Crisis

1. US Low Interest Rates

In late 1990s, US internet economy started to heat up with NASDAQ closing at 5048.62 (peaking at 5132.52 in intraday trading) on March 20, 2000. To curb the Internet bubble, the US Federal Reserve Board (FED) raised interest rates six times in a row from June 1999 to May 2000 and the benchmark interest rate was from 4.75% to 6.5%. But after the Internet bubble burst, the US economic situation is declining rapidly, instead forced the FED to cut interest rates nine times in less than one year, from January 2001 to December 2001, and the rate was from 6.5% to 2%, and after June 2003 to 1%.

The stock market and the housing market are two major places for funding, but the

Internet bubble caused the investing public to avoid the stock market and turned to the housing market. Low interest rates also provided more conveniences for house purchases. The cost of capital is inversely proportional to the asset prices, and therefore low interest rate environment pushed up the house prices.

2. Housing Policy

President George W. Bush took office in 2001 and pushed hard to expand homeownership. He addressed the importance of lowering the barrier for first-time homebuyers and reiterates goal on homeownership. Afterwards, US federal government funded the Federal National Mortgage Association (FNMA)¹ to help the public on mortgages.

3. Deregulation of the Financial Regulations

(1) Banking Act of 1933

The Banking Act of 1933 enacted on June 16, 1933, often referred to as the Glass-Steagall Act, after its Congressional sponsors, Senator Carter Glass and Representative Henry B.

* The given article is written in the framework of the RGNF grant □ 14-23-10002 "The comparative analysis of the legislative regulation of the financial-banking sector of Russia and Taiwan".

Steagall, strictly separated the commercial banks from investment banks. The Act required commercial banks to eliminate their securities affiliates, and prevented securities firms and investment banks from taking deposits. The reasons is the investment banking activities caused a conflict of interest when the granting of credit, lending, and the use of credit / investing, are all by the same entity.

(2) Financial Services Modernization Act of 1999

Commercial banks have long been restricted since the Banking Act of 1933. As the commercial banking services developed, the commercial banks wanted more business in addition to just taking deposits. After a long history of lobbying, the passage of the Financial Services Modernization Act of 1999, also called the Gramm-Leach-Bliley Act, after its Congressional sponsors, Senator Gramm, Representatives Leach and Bliley, repealed part of the Banking Act of 1933, removing barriers in the market among banking companies, securities companies and insurance companies which prohibited any one institution from acting as any combination of an investment bank, a commercial bank, and an insurance company. With the bipartisan passage of the Gramm-Leach-Bliley Act, commercial banks, investment banks,

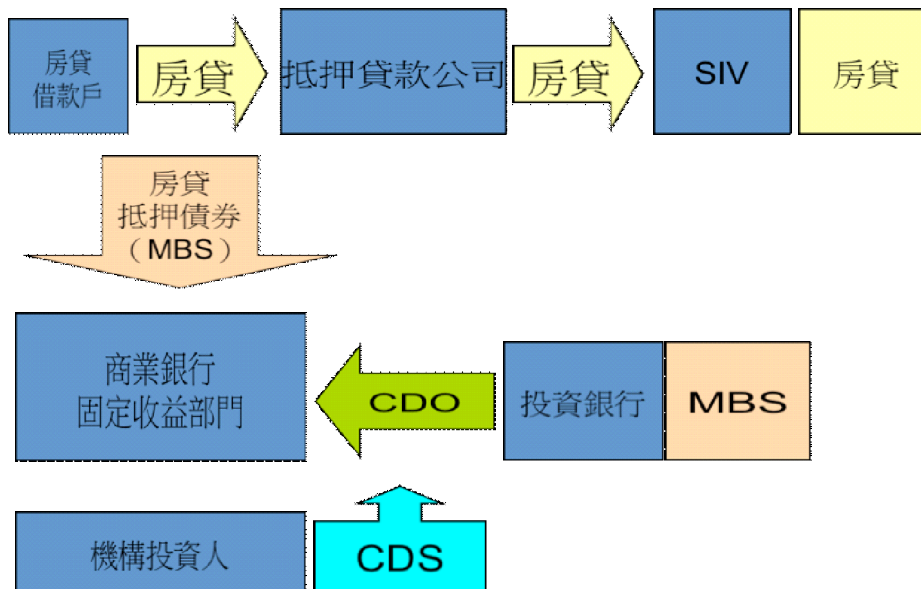
securities firms, and insurance companies were allowed to consolidate.

(3) Commodity Futures Modernization Act of 2000

The Commodity Futures Modernization Act of 2000 (CFMA) clarified the law so that most over-the-counter (OTC) derivatives transactions would not be regulated as “futures” under the CEA or as “securities” under the federal securities laws. Prior to CFMA, the OTC derivatives market was generally understood to be subject to regulation under the Commodity Exchange Act (CEA), because OTC products were a form of futures contracts. Under the CEA, all futures contracts were required to be traded on publicly transparent and fully regulated exchanges such as Chicago Board of Trade. In other words, CFMA removed OTC derivative transactions from all requirements of exchange trading and clearing under the CEA. Therefore, the major dealers of these derivatives, including credit default swap (CDS), would continue to have their dealings in OTC derivatives with less supervision compared to those regulated by CEA and security laws.

a. The Architecture of the Subprime Mortgage Credit Derivatives

1. The architecture of the subprime mortgage credit derivatives is shown as follows:



- 房貸借款 - Mortgage borrower
- 抵押貸款公司 - Mortgage bank
- 機構投資人 - Institutional investor
- 商業銀行固定收益部門 - Commercial bank fixed income department
- 房貸 - Mortgage
- 投資銀行 - Investment bank

2. Explanation:

(1) Mortgage borrowers applied for mortgages from mortgage banks².

(2) Mortgage banks packaged and sold the mortgages to structure investment vehicles (SIV) set up by commercial banks or investment banks.

(3) SIV used the mortgages as collateral and issued bonds. It's called mortgage-backed bonds (MBS).

(4) The investment banks then make short-term financing from the money market funds to buy MBS. MBS is mixed with other loans, such as credit cards, school loans, car loans, and then be layered (tranche) to form a combination of collateralized debt obligation (CDO).

(5) In order to improve the CDO's credit rating, investment banks may purchase CDS from insurance companies or other financial institutions. Because the insurance company or financial institution itself has high credit rating, and it is willing to sponsor the risk of default, so the CDO's credit rating would improve to the level equal to the insurance company or financial institution's credit rating.

(6) The investment banks then sold the stratified CDO to institutional investors or the general investing public according to the level of risk appetite.

b. Spread

With the mortgage packaged for sale, the original bank or mortgage bank could transfer out the risk of default and recover funds for the next round of loans. Since the original bank/mortgage bank does not bear the risk of default, it does not really consider the borrower's ability of repayment when lending. Therefore, those homebuyers who once could not get loans now can obtain mortgage (with higher interest rates) because of the loose audit mechanisms. This type of mortgage is riskier than prime loans and Alt-A mortgage, and called sub-prime loans. The industry gives it a nickname: NINJA - the borrower has no income, no job and asset.

Subprime mortgages, by the above-mentioned "financial engineering" of package, layered, portfolio, insurance, transform into a high-income, low-risk financial dream product. It is popular and welcome by labor retirement funds, insurance companies, hedge funds, asset management companies and other institutional investors, and even the original lending banks have forgotten the prototype of these derivative

financial instruments and investment on it. The subprime mortgage spread out across the world by these financial derivative products.

c. Outbreak

Commercial banks, mortgage banks, and investment banks usually have aggressive financing behaviors: after accepting public deposits (very short agreed term of period, or demand deposits), the commercial banks lend to borrowers, generally with an agreed term of certain period, such as short-term (1 year), medium term (5-7 years), or long-term (over 7 years). Mortgage banks and investment banks cannot accept public deposits and therefore they often raise funds from the money market where the funds are usually short-term (less than one year) funds. The biggest risk for aggressive financing is a run on the bank. Commercial banks have accompanying mechanisms to cope with a run. First, banks must help themselves. The banks must have capital of bank shareholders as the first line buffer to protect depositors. Second, banks can seek rescue from other banks through the interbank call loan to schedule funds. Moreover, banks can seek help from the central bank. Finally, there is deposit insurance. These mechanisms, however, are not available for mortgage banks and investment banks. They are extremely weak when faced with the liquidity risks. Many of the powerful financial institutions fell due to the lack of liquidity - Northern Rock³, New Century Financial Corporation⁴, Bear Stern Companies⁵, Merrill Lynch⁶, Lehman Brothers⁷, etc.

d. Impacts to Taiwan

1. Funds Pulled Out, the Stock Market Fell

According to the statistics from the Financial Supervisory Commission (FSC) in Executive Yuan, foreign capital sold over NT\$ 292.6 billion in the Taiwan stock market (about \$ 8.9 billion based on then exchange rate of one US dollar exchanging for NT\$ 32.9). Meanwhile, the stock market fell 9744 points on July 25 to 8090 points on August 17, dropping 17%.

September 15, 2008, financial crisis came to a climax - Lehman Brothers filed for bankruptcy, Bank of America acquired Merrill Lynch, and the US Dow Jones Industrial Average dropped 504 points on that day. Taiwan Stock Exchange Capitalization Weighted Stock Index (TAIEX) dropped 1094 points (6813 → 5719, 16%) in September 2008, 849 points in October (5719 →

4870, 14.8%), and then 410 points (4870 - 4460, 8.4%) in November. In three months, TAIEX had dropped 2353 points, a drop of 34.5%. If compared with TAIEX 9744 points before July 25, 2007 (before the crisis hit Taiwan), the drop of 5284 points was down as much as 54.2%. Within half year from June 2008 to November 2008, foreign capital oversold TAIEX NT\$ 509.6 billion (about 15.5 billion US dollars).

2. Export Hardship

The total value of Taiwan's export trade is still positive growth in August 2008, but from September 2008 to September 2009, the annual growth rate⁸ of Taiwan's export trade value showed a negative growth:

| 2008 | | Aug. | Sep. | Oct. | Nov. | Dec. | | | |
|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| | | 18.2 | -1.6 | -8.3 | -23.3 | -41.9 | | | |
| 2009 | Jan. | Feb. | Mar. | Apr. | May | June | July | Aug. | Sep. |
| | -44.1 | -28.6 | -35.8 | -34.3 | -31.4 | -30.4 | -24.5 | -24.6 | -12.7 |

3. Increased Un-employment Rate

Taiwan's unemployment rate⁹ had raised since July 2008:

| 2008 | July | Aug. | Sep. | Oct. | Nov. | Dec. | | | |
|-------------------|------|------|------|------|------|------|------|------|------|
| Unemployment rate | 3.99 | 4.02 | 4.27 | 4.39 | 4.68 | 5.08 | | | |
| 2009 | Jan. | Feb. | Mar. | Apr. | May | June | July | Aug. | Sep. |
| Unemployment Rate | 5.38 | 5.59 | 5.79 | 5.82 | 5.91 | 5.97 | 6.02 | 6.03 | 6.02 |

4. Weak Consumption

From September to December 2008, the annual growth rate¹⁰ for Taiwan's wholesale industry, retail industry, and food services industry almost all showed a negative growth:

| | Wholesale industry | Retail industry | Food Services industry |
|-----------|--------------------|-----------------|------------------------|
| September | 3.70 | -4.58 | -3.93 |
| October | -3.20 | -3.42 | -3.68 |
| November | -13.33 | -6.97 | -0.51 |
| December | -19.31 | -9.96 | -6.91 |

5. Derivative Financial Instruments Loss (Financial Institutions, Investors)

According to the FSC press release on January 29, 2008, Taiwan's banking industry had a loss of NT\$ 19.07 billion in the subprime mortgage crisis, the insurance industry NT\$ 4.63 billion, a total of about NT\$ 23.7 billion. Compared to the NT\$ 2 trillion of the total assets of financial institutions, it's only about 1% and would not cause harm. But for general investors, the loss incurred, due to buying financial products linked to the subprime, was about NT\$ 400 million, even higher than the losses suffered by financial institutions themselves.

II. Responses from Major Countries

This article summarizes the measures that major countries took in response to the financial crisis as follows:

| | USA | UK | Germany | Japan | China | Taiwan |
|--|-----|----|---------|-------|-------|--------|
| Lower interest rate and deposit reserve ratio | • | • | • | | • | • |
| Direct injection of market funds | • | • | • | • | | • |
| Taking over troubled financial institutions | • | • | • | | | • |
| Raised deposit guarantee | • | • | • | | | • |
| Pause shorting stocks | • | • | | | | • |
| Adjusted price limits on stock market volatility | | | | | | • |
| Using national fund to stabilize stock market | | | | | | • |
| Lower tax rate | • | | | | • | • |

All the major countries of the world took some rescue measures in response to the financial tsunami, mainly for financial stability; the measures taken could roughly categorized as: cut interest rates, lower deposit reserve ratio (loose money supply), directly injecting capital in the market, taking over troubled financial institutions, raised deposit guarantee, etc.

The above table shows that Taiwan government has taken all kinds of measures, including those other countries did not implement. The pros and cons of such a practice would be analyzed in the later part of this article.

III. Taiwan Government's Responses

Taiwan government's responses to the financial crisis can be divided into five parts: First, financial stability - financial sector bears the brunt of the crisis, so it is imperative to stabilize the financial industry; the second is to promote employment - the goal is to avoid higher unemployment rate; the third is to boost domestic demand to make up the gap in export decline; the fourth is to strengthen financial supervision to prevent local type of financial crisis; and last is remedial measures to deal with problems arising from the financial crisis.

a. Financial Stability

Financial sector bears the brunt of the crisis, so financial stability is the top priority. Funds needed to run the enterprise are either from indirect financing (loans from the public through banks) or direct financing (financing from the

(1) Government supporting banks

Although the underlying cause of the financial crisis is the loose of loan checks, the proximate cause is the lack of bank liquidity. Commercial banks, mortgage banks, and investment banks all made aggressive financing and the greatest risk is a run. To prevent the illiquidity by a run, the Taiwan government wanted to eliminate the motivation of a bank run by increasing the money supply.

A. Monetary easing policy

Taiwan's Central Bank announced on September 18, 2008 (the third day after Lehman Brothers filed for bankruptcy) to lower various deposit reserve ratio for 1.25%¹¹, releasing approximately NT\$ 200 billion based on the then deposits of NT\$ 13 trillion.

In addition, on September 26, 2008, Taiwan's Central Bank declared "expanding the 'repo operation mechanism' in response to the domestic and international economic and financial situation; the operation target includes banks, bills companies, postal companies, securities firms and insurance companies; the operation is within 180 days, to provide longer-term liquidity in the market"¹².

Meanwhile, Taiwan's Central Bank cut interest rates seven times in a row¹³, for a total decrease of 2.375%, since September 26, 2008. The rediscount rate, rate on accommodations with collateral, and rate on accommodations without collateral decreased from 3.625%, 4%, and 5.875% down to 1.25%, 1.625%, and 3.5% accordingly.

| Date | Drop | Rediscount Rate | Rate on Accommodations with Collateral | Rate on Accommodations without Collateral |
|-------------|--------|-----------------|--|---|
| 2008.9.26. | 0.125% | 3.5% | 3.875% | 5.75% |
| 2008.10.9 | 0.25% | 3.25% | 3.625% | 5.5% |
| 2008.10.30. | 0.25% | 3% | 3.375% | 5.25% |
| 2008.11.10. | 0.25% | 2.75% | 3.125% | 5% |
| 2008.12.12. | 0.75% | 2% | 2.375% | 4.25% |
| 2009.1.8. | 0.5% | 1.5% | 1.875% | 3.75% |
| 2009.2.19. | 0.25% | 1.25% | 1.625% | 3.5% |

public through the stock market). Therefore, in order to stabilize financial industry, the measures can be divided into the stabilizing of financial institutions and the stabilizing of the stock market. The core of financial institution is bank. Taiwan government proposed the "3S policy" as the spindle to stabilize financial institutions and related measures to stabilize the stock market.

1. 3S Policy

The 3S Policy refers to "government supporting banks, banks supporting enterprises and enterprises supporting employees."

B. Blanket guarantee

The original deposit insurance provided in Taiwan was up to NT\$ 1.5 million. October 8, 2009, in view of the global and domestic economic and financial crisis remains unsolved, to ensure stability of financial market, Taiwan's government announced that the blanket guarantees of all bank deposits are set to run through December 31, 2010.

(2) Banks supporting enterprises

Banks were required to support the enterprise after accepting the supports from the government. The specifics are:

- October 1, 2008, the Executive Yuan set up a “government assistance for business capitals ad hoc group” responsible for assisting the government to develop policies of stable funding for the enterprise. The group members include the heads from the Ministry of Finance, the Ministry of Economic Affairs, the Central Bank, the Council for Economic Planning and Development, Economic and Financial Supervisory Commission, and the Financial Supervisory Commission. The Minister of Finance was the convener. Those with corporate debts due but operate normally with short-term cash flow problems could apply for extension, 6-month renewal, or other credit and debt negotiation.

- Small and Medium Enterprises (SMEs) account for over 98% of the total Taiwanese companies, employing about 80% in the job market. SMEs are in fact the lifeblood of Taiwan’s economy. Therefore, the Executive Yuan on October 16, 2008 announced the “domestic banks strengthening the SME lending program” to increase the loan balance of NT\$ 300 billion. Small and Medium Enterprise Credit Guarantee Fund of Taiwan (SMEG) accelerated the claims processes, reduced guarantee fee rate, raised additional 10% for the authorized guarantee (up to 80%), and increased the ceiling of financing guarantee from NT\$ 100 million to 120 million, as incentives for the banks to make loans to SMEs. At the same time, the Central Bank would refuse to accept the bank’s negotiable certificates of deposit if the bank’s lending to SMEs was found declined.

- November 12, 2008, “economic stimulus special loans and credit guarantees for non-SMEs” was announced to provide loans of NT\$ 6000 billion for non-SMEs to apply.

- Companies with returned checks could apply for six months grace period of normal credit records; the reporting of dishonored account would be delayed if approved.

- “Self-discipline Standards for Members of the Bankers Association of the ROC in Handling Corporate Debt Negotiation Cases”¹⁴ was set up. Financial institutions may, upon application, extend 6 months to the enterprises that were in financial need and their principle of loans fell due before December 2009. If further extension was needed, the Ministry of Economics and the creditor bank would decide after assessment to extend, renew, or negotiating settlement. The

Bankers Association also approved the “Provisional Supplementary Principles for Banks Handling Stock Collateral in Line with the Government’s Economic Response Program”¹⁵ to change credit conditions by lowering the stock collateral maintenance ratio, extending the repayment period to pay interest, or interest-rate cut to those who pay interests normally when the stock market fell and the value of the collaterals decreased.

(3) Enterprises supporting employees

Similarly, the Taiwan government also required companies to assist employees, not hundreds of layoffs. “Caring enterprises” that pledge not to lay off employees are provided loans at reduced interest rates.

2. Package: stabilize the stock market

(1) Prohibit the emptying

FSC announced on September 22, 2008 that stocks of 150 listed companies could not be short sale under unchanged. It further announced on the 30th that margin trading and short selling was temporarily prohibited from October 1, 2008 to the 14th, which was also a ban on day trading.

(2) Reduce the change limit

Following the prohibition of short selling, the FSC announced on October 13, 2008 that change limit of the stock market would be reduced from 7% to 3.5%, and later extending the reduced change limit for another week.

(3) National Financial Stabilization Fund¹⁶ to support the market

September 18, 2008, the Executive Yuan announced that the National Financial Security Fund would enter to support the market for one month. With the US stock market fell and the reduced change limit for Taiwan stock market could not stop the decline, Taiwan government once again coordinated the Fund to support the market with extended period, until September 18, 2008 when Taiwan’s stock market came to a more stable status.

(4) National Development Fund to support the market

October 23, 2008, the Executive Yuan approved the expansion of the function and use of the National Development Fund, the fund size expansion from the previous NT\$ 200 billion to 1 trillion, and is ready to revise the “Executive Yuan National Development Fund safekeeping and utilization of the balance of payments” Article 5 (now Article 14, paragraph 2) to allow increased portion from previous 5% to 20% of

purchasing securities of listed companies, which means the maximum amount of its investment would increase from NT\$ 10 billion to NT\$ 200 billion. It did not pass the Congress since there were doubts that the revision was contrary to the mother law, Statue for Industrial Innovation.

b. Promote employment

1. Caring enterprise financing program

For those “caring enterprises” operating and paying interests normally, banks would provide better interest rate if the enterprises sign to promise not to lay off more than 1% of their employees. The program promotes the assistance from the enterprises to employees.

2. Short term measures to promote employment¹⁷

Since November 2008, the Executive Yuan launched a “short-term measures to promote employment.” The measures were to reinforce general measures to promote employment, where in a short period the government provided more job opportunities to help unemployed workers obtain employment as soon as possible in order to alleviate the unemployment situation and reduce social problems that may arise due to the unemployment. In other words, the government agencies, in place of business, provided short-term (one year) employment opportunities.

What worth paying attention to is the “immediate start work plan.” The plan provided direct subsidies to enterprises that hired the employees, payment up to NT \$ 12,000 per person per month.

3. To promote the cultivation of high-quality manpower plan

Executive Yuan in February 2009 launched the “cultivation of high-quality manpower plan.” The plan covers 16 sub-plans, with 5 departments (Ministry of Education, Ministry of Economic Affairs, the National Science Council, Council of Labor Affairs, and the Council of Agriculture), elementary schools, high schools, colleges, county and city governments, libraries, businesses nationwide, non-profit institutions, educational foundations, and other relevant units. The plan provided 69,156 jobs, 42,200 refresher training opportunities and 50-60 joint research projects of key technology industries, aiming to reach the “foster quality manpower for stable employment” objective.

c. Boost Domestic Demand

1. Expand fiscal expenditure

Legislative Yuan on January 13, 2009 passed “The Special Act for Expanding Investment in Public Works to Revitalize the Economy”, agreeing a special budget of NT\$ 500 billion, from January 25, 2009 and expiring on December 31, 2012. Subsequently, the Executive Yuan approved the “Economic Revitalization Policy - Project to Expand Investment in Public Works.” The main framework was for six major goals, 20 major focuses of investment and construction, 64 execution plans. Among them, a special budget of NT\$ 150.6 billion was listed for 2009 with the estimation of raising the real GDP in 2009 for 0.68% compared with no implementation, and the creation of 190,000 to 220,000 job opportunities.

2. Consumption vouchers

November 18, 2008, to cope with the tightening spending by the financial crisis, the Executive Yuan decided to issue coupons to promote consumption; the Legislative Yuan thus passed the “Special Act for the Distribution of Consumption Vouchers to Revitalize the Economy” and issued bonds as the sources for the “Central Government Special Budget for the Distribution of Consumption Vouchers to Revitalize the Economy” of NT\$ 85.653 billion. The issuance of the vouchers could be based on per person, without restrictions on income, age, and identify. The total amount is about NT\$ 82.8 million (NT\$ 3,600 per person, roughly 23 million people as Taiwan’s population). The vouchers must be redeemed by September 30, 2009.

3. Tax reduction

(1) Lower capital gain tax (not adopted)

The Executive Yuan proposed an amendment to the Securities Transaction Tax Act on September 10, 2008, lowering the tax from 0.3% to 0.15% for a period of six months. It did not go through the Legislative Yuan.

(2) Lower estate and gift tax

The amendment to the Estate and Gift Tax Act was adopted on January 12, 2009 and effective on January 23, 2009. The highest marginal tax rate was from 50% down to a single rate of 10%. The exemption that may be deducted from the gross estate was increased from NT\$ 7,790,000 to NT\$ 12,000,000. The annual exemption that may be deducted from total amount of gift for each donor was increased from NT\$ 1,110,000 to NT\$ 2,200,000. It was aimed at attracting overseas capital back.

(3) Lower personal income tax

The annual exemption was raised from NT\$ 77,000 to NT\$ 82,000 per person, standard deduction from NT\$ 146,000 to NT\$ 152,000; special deduction of income from salaries/wages from NT\$ 100,000 to NT\$ 104,000.

(4) Lower fixed excise duty for motor vehicles

Article 12-1 was adopted on January 12, 2009 and effective on January 19, 2009. The commodity tax for passenger sedans, trucks and dual-purpose vehicle with cylinder volume not exceeding 2,000c.c. which have been purchased and completed registration during the period from January 19, 2009 to December 31, 2009 could be cut NT\$30,000 each. The commodity tax for motorcycles with cylinder volume not exceeding 150c.c. which have been purchased and completed registration during the period from January 19, 2009 to December 31, 2009 could be cut NT\$4,000 each.

d. Strengthening financial supervision

Because Taiwan's financial system was not like the US and did not have the subprime mortgage and financial derivatives instruments, the focus of financial supervision would be the bank's liquidity and bank constitution, and to strengthen the supervisory authority of power. In addition, due to the complexity of financial products, financial institutions should improve the transparency of financial products, and be required higher obligations to its consumers.

1. To strengthen the bank's liquidity

During the financial crisis, the bank faced the financial risk even with adequate capital because of the failure of prudent management of liquidity risk. In order to strengthen liquidity risk management of banks, Basel Committee on Banking Supervision published "Basel b!: International framework for liquidity risk measurement, standards and monitoring" in 2000, proposing Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) as quantitative index for global liquidity. It further published in 2013 "Basel b!: The Liquidity Coverage Ratio and liquidity risk monitoring tools" to determine the method of calculation of the liquidity coverage ratio. The main purpose of the liquidity coverage ratio is to strengthen the bank's short-term liquidity resilience under pressure situations by assessment of whether banks have enough qualified high-quality liquid assets to respond to the future cash outflow demand for thirty days. It will help the banking sector better manage

the liquidity risks and therefore a sound banking system. Therefore, Taiwan's Central Bank and FSC set the "Standards Implementing the Liquidity Coverage Ratio of Banks."

In addition, the FSC also strengthened the bank's liability structure management to avoid liquidity problems easily led by the high proportion of large deposits. The so-called large deposit usually refers to more than NT\$ 100 million. The average ratio for large deposits in financial institutions was 20-30%, so FSC would make a closer look if a financial institution had large deposits higher than the average ratio.

2. To strengthen the financial institutions constitution

FSC also strengthened the supervision on the financial institutions with proper capital adequacy ratio but run a higher risk on operation, the measures including closer look on credit glued to the interested parties and other major investment plan, to avoid the risk to increase. As for the banks lack of proper capital adequacy ratio, FSC urged the banks for improvement by enforcing Article 44-2 (immediate corrective measures), 62 (takeover) and 64 (deadline to make up capital) of The Banking Act.

3. To strengthen supervisory authority of power

Taiwan had experienced many financial crises earlier and the supervisory authority did not have administrative measures to deal with the troubled financial institutions. Therefore, Article 62¹⁸ and Article 64¹⁹ was amended on March 5, 2007, before the financial tsunami. The amendment authorizes the supervisory agency to close down the business and the deadline to clean up, to stop partial business, to take over, and the deadline to make up the capital.

After the financial tsunami occurred, Taiwan again on December 9, 2008 updated Article 44-2²⁰ of The Banking Act 2, to establish immediate corrective measures. Based on different capital levels, the supervisory authority would take timely adoption of different restrictions as soon as possible and remedial measures to protect the safety and soundness of the bank's operations.

4. To increase the transparency of financial products

November 11, 2011, the Financial Supervisory Commission issued the "rules for financial services provider in advertising and sales promotion activities to attract business," "rules for financial services provider to ensure that

financial products or services fit for financial consumers,” and “rules for financial services provider disclosing the important contents and risks of the contract. “

The reason behind the “rules for financial services provider in advertising and sales promotion activities to attract business” is that these activities are the major sources for financial consumers to obtain relevant information of financial services industry. If there is hypocrisy, fraud, concealment or other misleading contents or expression when the financial services provider advertises, solicits, or promotes its business, the consumer’s rights will be seriously affected and easily lead to financial disputes.

The “rules for financial services provider to ensure that financial products or services fit for financial consumers” requires the financial services provider, before entering contract with financial consumers, to have in-depth knowledge of the financial consumers’ relevant information, such as basic information, financial background, sources of income, risk preferences and past investment experiences, to assess the appropriateness and establish risk management mechanism. In addition, the financial services provider shall ensure that the goods or services fit to the consumer. The so-called fitness refers to the reasonable belief the financial services provider possesses when providing financial products or services to financial consumers. There should be a reasonable basis to believe that the transaction is suitable for financial consumers, including consideration of the sale target’s age, knowledge, experience, financial status, risk tolerance, etc. The purpose is to prevent the financial services industry from self-benefit by providing financial products or services not suitable and therefore damage the financial interests of the consumers.

The reason behind the “rules for financial services provider disclosing the important contents and risks of the contract” is to have consumers protected by sufficient information when facing the financial products. The financial products provided by the financial service industry are innovative and complex and the usually there is a gap on the information and risk perception between the financial service providers and the general financial customers which could easily lead to disputes. Therefore, it is necessary to set financial product or service information described in line with the principles of openness and transparency and to strengthen the protection

for financial consumers, and maintain transaction order and establish market confidence. The rules require the financial products/services provider to explain and disclose the risks before entering the contracts, in order to facilitate financial consumers to fully understand the rights, obligations, and risks of the products/services, to protect the financial interests of consumers, and to avoid the disputes.

January 17, 2013, the FSC will further announced the “Directions for Sale of Investment-linked Insurance Products” and “Compliance Matters for Disclosure of Information on Investment-linked Insurance Products” which categorized investors into “professional investor” and “non-professional investor”. Professional investors can be either a professional institutional investor or a nature person. A nature person, as a professional investor, should has sufficient professional knowledge or trading experience in financial products, and has proof of financial capacity of at least NT\$ 30,000,000. Non-professional investors are classified into three risk categories - aggressive, steady, and conservative. When the product sold is linked to a structured product, higher protection should be provided to non-professional investors.

e. Remedial Measures

1. FSC temporary measures

Lehman Brothers filed for bankruptcy protection in September 2008. Taiwanese investors suffer loss due to the purchase of linked debt disputes arose between the investors and the commission of financial institutions. Taiwan’s FSC took the following measures²¹:

(1) The handling of disputes of linked debts is a dual system - the Bank Association appraisal mechanism and customers reconciliation system. The banks should consider its fiduciary duty and assess the negligence based on the maximum goodwill. For disputes from the investors who are senior citizens, with low education, or with major injuries, there should be greater flexibility in the process and a priority to settlement.

(2) Bank Association Review Committee had completed deliberations of all cases on January 5, 2010. Up to April 23, 2010, there were 20,797 cases (88.44%) settled through the assistance of the Committee.

(3) For the establishment of a single foreign structured commodity review mechanisms and

related measures, the integration of the relevant existing review of legislation to facilitate the relevant industry to follow, and to strengthen our investor's protection, with reference to the management structure of the offshore fund, the "Regulations Governing Offshore Structured Products" was adopted on July 23, 2009.

(4) "Directions for Banks Conducting Financial Derivatives Business" was modified for the introduction of customer classification management system and to strengthen the regulations for client fit, promotion propaganda, and risk disclosure obligation, etc., in order to improve customer rights protection. In addition, the directions for other structural bank commodity and equity derivatives of TAIEX goods were issued to strengthen the management of bank commitments for related products.

2. Financial Consumer Protection Act and Financial Ombudsman Institution

It is increasingly common for the general public to buy financial products and services provided by the financial services industry, and the offer of financial products and services from the financial services industry is more and more complex. Disputes could easily arise due to unequal information. It is costly both in time and money to seek judicial remedy when there are disputes between the financial institutions and financial consumers. It is necessary to provide another dispute resolution for financial consumers, with fair and reasonable financial professionals and as a quick mechanism to deal with the disputes effectively.

Therefore, Financial Consumer Protection Act was passed on June 3, 2011 and based on this Act, the Financial Ombudsman Institution was established to handle the disputes arising from the purchase of financial products and services.

IV. Effect Evaluation

The financial tsunami, caused by the United States subprime mortgage, surfaced since March 2007 as the New Century Financial Corporation filed for bankruptcy and Bear Stearns was acquired. However, Taiwan has yet to feel the financial crisis power until September 2008 when Lehman Brothers declared bankruptcy and Merrill Lynch was acquired. Taiwan's stock market dropped 2353 points (34.5%) in three months from September to November 2008,. Foreign

oversold TAIEX NT\$ 509.6 billion (about USD 15.5 billion) from June to November 2008. The annual growth rate of gross exports showed negative growth from September 2008 to September 2009. The unemployment rate climbed to a peak and then subsequently depressed consumer strength. In such an emergency, it is hard to blame the then government of Taiwan for the measures introduced. However, we should learn from past. Even it is hindsight, it may also benefit in the future.

a. Blanket Guarantee for Bank Deposits

Article 1 of Taiwan's "Deposit Insurance Act" expresses the purpose of the Act is to "protect the rights and interests of depositors in financial institutions, to maintain credit order, and to enhance sound development of financial businesses." If the bank needs to face the massive depositors' withdrawing deposits (i.e., bank run) when a problem just occurred, the run will make matters worse. It will collapse even when it originally would not have to close down, and therefore leading to a domino effect and cause more harm to the overall financial system. With deposit insurance, depositors will not worry about the loss of their deposits with bank failures and therefore will not run. In this connection, it is necessary to have deposit insurance.

However, once the bank counts on the protection of deposit insurance and engage in high-risk operations, it will lead to moral hazard. Therefore it is more of a compromise where deposit insurance covers only a portion of the amount of the deposit in order to curb bank moral hazard. It too makes depositors to bear partial risk. After all, the financial resources of the deposit insurance compensation come from all taxpayers. Article 13 section 1 of the Deposit Insurance Act states that "the maximum insurance coverage that the CDIC offers to each depositors of any insured institution shall be determined by the competent authority along with the Ministry of Financial and the Central Bank." The maximum insurance coverage before October 7, 2008 was set as NT\$ 1.5 million.

October 7, 2008, the Executive Yuan raised the deposit insurance coverage to the full amount of the deposits until December 31, 2009. Later, it was extended to December 31, 2010. Although the move was due to the situation and the government was eager to pacify the depositors, was it necessary to cover the full amounts? The original insurance set the coverage to NT\$ 1.5

million because it was considered the “protection” for desired life of depositors, and those exceeding NT\$ 1.5 million belong to the category of “investment.” When it comes to investment, investors should bear the risk and therefore the depositors should bear the risk of bank collapse.

In addition, the then premium for Taiwan deposit insurance was only 5~6.2 / 10,000²². The difference was so small to achieve the desired effect on the banks for awards and punishment. The blanket guarantee on October 7, 2008 was in fact a punishment for sound and stable banks and a reward for speculating banks.

The Emergency Economic Stabilization Act of 2008 adopted by the US on October 3, 2008 only raised the deposit insurance coverage from \$ 100,000 up to \$ 250,000²³, rather than a full amount coverage. Taiwan government may consider, next time when there is a need to raise the insurance coverage, rather than a blanket guarantee, to raise the coverage to close to NT\$ 5 million.

b. Reduce the Change Limit

FSC reduced the change limit of the stock market from 7% to 3.5% between October 13 and October 24, 2008. Taiwan’s stock market dropped from 4996 points on October 13, 2008 to 4579 points on October 24, 2008, about 8.3%. October 27, 2008, the first day for the change limit back to 7%, the stock market still dropped 213 points and closed at 4366 points.

Taiwan’s stock market dropped 5.5% every 10 days as an average from September to November 2008 (the stock market dropped 2353 points (34.5%) in three months (63 transaction days)). Compared to the period of reduced change limit where the stock market dropped 8.3% in ten days, the stock market did not react positively to the administrative measures. In contrast, it dropped even more when the government reduced the change limit.

There were only Pakistan, Vietnam, and Taiwan to adjust the change limit of the stock market in the worlds. It is obvious that most countries do not think this measures beneficial to their stock markets. In fact, if this measure would work, the government could simply reduced the change limit to 0% — but everyone knows a change limit of 0% would not work

since the liquidity of the stock market will disappear. Therefore, a reduced change limit is not a good measure to save the stock market.

c. Consumption Vouchers

Taiwan is the first country to issue overall consumption vouchers. Before Taiwan, only Japan issued regional consumption vouchers in 1999 and that was limited to specific groups of people.

Taiwan Government issued the consumption vouchers, hoping to achieve the economic growth rate of 0.66%²⁴. However, the post evaluation by CEPD (now National Development Council) shows that the economic growth rate by the consumption voucher was only 0.28% - 0.43%²⁵. 72% of the people used the consumption vouchers for their ordinary daily expenses rather than extra shopping²⁶. The vouchers were issued on January 18, 2009 and the merchants could exchange for payment from the next day to October 31, 2009 (the period of use of vouchers expiring on September 30). More than 80% of the vouchers were already exchanged for payment by the merchants from the financial institutions by the end of February and the money multiplier effect was lost. Taiwan’s government raised NT\$ 85.6 billion debts to issue the vouchers, in which the budget for the issuing counts over NT\$ 700 million and budget for the printing and payment coupons over NT\$ 1 billion. The then prime minister, Sean Chen, expressed frankly during the Q&A session in the Legislature Yuan on October 26, 2012 that the issuing of the consumption vouchers made the government’s cap space for debt financing sacrificed.

d. Lower Estate Tax and Gift Tax

The attract overseas capital back, the highest marginal tax rate for estate tax and gift tax in Taiwan was lowered from 50% down to a single rate of 10% in January 2009. The exemption that may be deducted from the gross estate was increased from NT\$ 7,790,000 to NT\$ 12,000,000. The annual exemption that may be deducted from total amount of gift for each donor was increased from NT\$ 1,110,000 to NT\$ 2,200,000. However, the capitals returning were not properly re-invested into real industries, but rather mostly to real estates taking advantages of the loopholes in Taiwan’s real estate tax system. The prices of

real estates in Taiwan increased dramatically and further expanded the gap between the rich and the poor.

e. National Security Fund Entering to Support the Stock Market

Although the stock market is sometimes called the economic indicator, Taiwan government often mistakenly thinks the economic development responsibilities equals to the stock market performance and then use the national budget to “protect” the stock market. In fact, what the government should “protect” is fair, transparent and efficient stock market, not the stock price index. On one hand the government is the banker of the stock market; on the other hand, the government buys shares in the stock market. It is inevitable ridicule a player and referee, and even more, the risk of insider trading. Taiwan probably is the only country that uses its national budget to set up a fund into the stock market.

f. Short-Term Measures to Promote Employment

Promoting employment is government’s responsibility, but the premise is to be able to promote the national welfare. If the government hires two persons - one digs a hole and the other fills it back, although the creation of two jobs bring the GDP growth, it will not bring any economic value. The “short-term measures to promote employment” proposed by the Executive Yuan employed 7.3 million people, all labor outsourcing, for the period of only one year. Since it’s outsourcing and only a year, it implies that the administrative authorities do not need this manpower for their regular governance. Then no matter what name was the crown, these jobs for 7.3 million people are no difference from the dig-and-fill example.

V. Conclusion

Faced with the huge financial crisis, the main countries in the world, based on their own political and economic situation, adopted the appropriate measures to be taken, but the Taiwan government took all measures adopted by all major countries in the world. To view it

positively, Taiwan government has done all it can to cope with the financial crisis. Negatively, Taiwan government did not analyze pros and cons for each of the measures and simply accepted all prescriptions. This article is for reminding: some policies actually make more harm than good. Learning from the past and we should be more cautious to properly assess the relevant policies when facing this kind of crisis in the future.

¹ Also known as Fannie Mae. The corporation’s purpose is to expand the secondary mortgage market by securitizing mortgages in the form of mortgage-backed securities (MBS), allowing lenders to reinvest their assets into more lending and in effect increasing the number of lenders in the mortgage market by reducing the reliance on locally based savings and loan associations (aka “thrifts”).

² Mortgage banks, like commercial banks, can lend to others. The biggest difference between mortgage bank and commercial bank is that the mortgage bank does not accept deposits from the public but can make financing from other financial institutions. In order to compete with commercial banks, mortgage bank’s credit requirements are usually lower than the commercial bank.

³ Northern Rock was Britain’s fifth largest mortgage bank lender. Although Northern Rock bank was a commercial bank and could absorb public deposits, it was highly dependent on wholesale funding % currency markets. At the end of 2006, the deposits only accounted for 26% of its sources of funding. From August 2007, the currency market, due to the US subprime mortgage crisis, declined rapidly and spread to the European money market, resulting in Northern Rock bank liquidity problem. Northern Rock sought help from the British government. The British government was originally interested in having Northern Rock bank acquired by other banks in order to defuse the crisis, but because the British government was reluctant to provide funds to acquire the bank, no bank was willing to take over. Northern Rock applied for financial intermediation on September 13th to the Bank of England (which equals to Britain’s central bank), but the news leaked accidentally, and the Northern Rock bank had a run on the 14th. The British government was forced to announce on September 17 to protect for Northern Rock bank deposits and on February 18, 2008 Northern Rock bank was nationalized.

⁴ New Century Financial Corporation was the second largest US mortgage lender, New York Stock Exchange (NYSE) listed. The company undertook a large number of subprime mortgages. With the FED raised interest rates 14 consecutive times since June 2003 to the highest point in 2007, a lot of households were in default because they could not pay their mortgage interests, the company’s creditors (Goldman Sachs, Citigroup Morgan Stanley, GE Capital, etc.) did not provide financing after the maturity of the debts. On

March 8th, 2007 the company announced that because of funding problems, it would no longer grant new loans. Then on the 13th, the NYSE delisted it. April 2, New Century Financial Corporation filed for bankruptcy.

⁵ Bear Stearns was US's fifth-largest investment bank in 2007. In June 2007, two of its subprime mortgage-related securities investment (ie, the Bear Stearns High-Grade Structured Credit Fund and the Bear Stearns High-Grade Structured Credit Enhanced Leveraged Fund) came with losses. Merrill Lynch, creditor of the funds with \$ 850 million loan, proposed to sell \$ 100 million of the debt in exchange for cash. The news caused the fund investors to rush redemption. Under a run, Bear Stearns on June 27 announced the cessation of the redemption of the two funds. March 2008, Bear Stearns' debtor Carlyle Capital filed for bankrupt. Because the loan from Bear Stearns to Carlyle Capital was too large and the recovery hopeless, Bear Stearns' creditors have refused to refinance to Bear Stearns (under normal circumstances, investment banks can use securities as collateral, issuing Asset Backed Commercial Paper to obtain financing in the money market). Within just a week, Bear Sterns lost \$ 17 billions in cash, a complete loss of the liquidity of its assets. Eventually it was merged and acquired by JPMorgan Chase Bank on March 24th.

⁶ Merrill Lynch was the world's largest securities firm and one of the top three investment banks. Merrill Lynch was only valet for subprime mortgage transaction, but later changed tactics and invested on its own behalf. To expand in subprime territory, it spent \$ 1.3 billion and acquired the largest US mortgage company, First Franklin Financial Corp., in December 2006. Merrill Lynch had a loss of \$ 7.9 billion because of subprime in the third quarter of 2007 and eventually was acquired by Bank of American in September 2008.

⁷ Lehman Brothers was the fourth largest US investment bank in 2007. Similarly, because of the subprime mortgage business losses, it could not obtain further financing from the money market. Meanwhile, many of its investors redeemed and making its liquidity deteriorated rapidly, It finally announced \$ 613 billion debts and filed for bankruptcy in September 15th, 2008. It was the largest bankruptcy case in the US history. Unlike Bear Stearns that was bailed out by US government indirectly, Lehman Brothers ultimately did not get the US government bail-out, so it went into bankruptcy. Lehman's bankruptcy was also seen as the culmination of the financial crisis.

⁸ Department of Statistics, Ministry of Economic Affairs. URL: <http://dmz9.moea.gov.tw/GMWeb/common/CommonQuery.aspx>.

⁹ Ministry of Labor. URL: <http://statdb.mol.gov.tw/statis/jspProxy.aspx?sys=210&kind=21&type=1&funid=q02077&rdm=jckeqxKj>.

¹⁰ See Department of Statistics, Ministry of Economic Affairs. URL: <http://dmz9.moea.gov.tw/GMWeb/common/CommonQuery.aspx>.

¹¹ Central Bank of the Republic of China (Taiwan) . URL: <http://www.cbc.gov.tw/ct.asp?xItem=45641&CtNode=561&mp=1>.

¹² Ibid.

¹³ Ibid.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ The National Financial Stabilization Fund, also called the National Security Fund, was established in 2000 in accordance with "the Statute for the Establishment and Administration of the National Financial Stabilization Fund" "for purposes of responding to significant occurrences at home or abroad so as to preserve stability in capital markets and other financial markets and guarantee national stability." Its size is NT\$500 billion (Article 4). A National Stabilization Fund Management Committee is established and has 11 to 13 members, including 1 chairman, in which post the vice president of the Executive Yuan shall concurrently serve. Also concurrently serving as Committee members shall be the Governor of the Central Bank of China, Minister of Finance, Minister of Transportation and Communications, Director General of Budget, Accounting & Statistics, Chairman of the Council of Labor Affairs (now Minister of Labor), and Minister of Personnel. The remaining members shall be selected by the Competent Authority from scholars and experts recommended by the party caucuses of the Legislative Yuan (Congress).

¹⁷ For detail and specific contents of the measures, see Executive Yuan. URL: <http://www.ey.gov.tw/Upload/RelFile/26/51427/91291081971.pdf>.

¹⁸ Article 62 of The Banking Act, "When there is a concern that a Bank is unable to pay its debts when due or there might detriment to the depositors' interests due to obvious deterioration in the Bank's business or financial status, the Competent Authority shall assign officials to take receivership over the Bank, order such a Bank to suspend and wind up business , or take other necessary measures. If deemed necessary, the Competent Authority may notify relevant authorities or institutions to prohibit the Bank's responsible person from transferring, delivering or creating other rights in his/her properties, and/or request the immigration agency to prohibit the responsible person from departing the country.

When a Bank's capital is graded as being seriously inadequate, the Competent Authority shall assign officials to take receivership over the Bank within ninety (90) days from the date the Bank is listed as having seriously inadequate capital. Notwithstanding the foregoing, for Banks that are ordered by the Competent Authority to undertake capital restructuring or merger within a prescribed period but have failed to comply therewith accordingly, the Competent Authority shall assign officials to take receivership over the Bank within ninety (90) days from the next day following the expiration of the prescribed period.

The regulations governing the procedure for receivership mentioned in the preceding two paragraphs hereof, the responsibilities and powers of the receiver, assumption of related expenses and other matters to be complied with shall be prescribed by the Competent Authority.

For Banks that are ordered to suspend business under Paragraph 1 hereof, the winding-up procedure

for such Banks shall be deemed as liquidation under the Company Law.

A court that receives a Bank's filing for bankruptcy shall promptly forward a copy of the petition to the Competent Authority and consult the specific opinions of the Competent Authority on whether bankruptcy declaration should be allowed."

¹⁹ Article 64 of The Banking Act, "If the losses of a Bank exceed one third (1/3) of the Bank's capital, the Bank's directors or supervisors shall immediately report such information to the Central Competent Authority.

In the above-described circumstances, the Central Competent Authority shall require the Bank to make up such a deficit within three (3) months. If the Bank fails to do so within such a prescribed period of time, the Central Competent Authority shall send officials to take receivership over the Bank or the Bank shall be ordered to suspend its business."

²⁰ Article 44-2 of The Banking Act, "The Competent Authority shall take the following actions in part or in whole based on the grading of a Bank's capital:

1. Banks having inadequate capital:

(1) Order the Bank or its responsible person to propose a capital restructuring or other finance and business improvement plans. For Banks that fail to propose a capital restructuring or other finance and business improvement plans as ordered, or fail to carry out the said plan accordingly, supervisory actions for the next capital grade may be adopted.

(2) Restrict the new acquisition of risk assets or take other necessary actions.

2. Banks having significantly inadequate capital:

(1) Apply the provisions in the preceding paragraph.

(2) Remove the responsible person from his/her position and notify the competent authority in charge of company registration to take note thereof on the registered items.

(3) Order the Bank to obtain the prior approval of the Competent Authority before acquiring or disposing of specific assets.

(4) Order the Bank to dispose of specific assets.

(5) Restrict or prohibit credit extension or other transactions with interested parties.

(6) Restrict the investment activities or some businesses of the Bank, or order the Bank to close a branch or department within a prescribed period.

(7) Limit the interest rate the Bank pays on deposits to a level not exceeding the interest rate other banks pay on comparable deposits or deposits of the same nature.

(8) Order the reduction in remuneration of responsible persons, and the reduced remuneration shall not exceed 70% of the average remuneration paid out to the said responsible person within twelve (12) months before the Bank's capital becomes significantly inadequate.

(9) Assign officials to take conservatorship over the Bank's operations or take other necessary actions.

3. Banks having seriously inadequate capital: The Competent Authority shall take actions set out in Paragraph 2 of Article 62 of this Act in addition to the actions prescribed in the preceding subparagraph.

The Competent Authority may examine at any time the implementation status of the Bank's capital restructuring or finance and business improvement plan, if deemed necessary, consult with relevant authorities or institutions and entrust a professional institution to provide assistance to the cost of the Bank.

Where a Bank is under the conservatorship of an official assigned by the Competent Authority, Paragraph 3 of Article 62-2 of this Act shall apply *mutatis mutandis*.

Where a Bank's business operation is seriously inadequate or its capital might be downgraded, the Competent Authority may adopt supervisory actions for the next capital grade. Where there is a concern of imminent danger of the Bank's continuing operation or adverse effect on the financial stability, the Competent Authority should renew the review or adjustment of the Bank's capital grade.

The regulations related to the procedure for conservatorship mentioned in Paragraph 1 hereof, the responsibility and authority of the conservator, assumption of related expenses and other matters to be complied with shall be prescribed by the Competent Authority."

²¹ FSC Annual Report 2008, page 18. URL: <http://www.fsc.gov.tw/ch/home.jsp?id=137&parentpath=0,4>.

²² The current rate for the deposit insurance premiums are 5, 6, 8, 11, 15 per 10,000. See Central Deposit Insurance Corp. URL: <http://www.cdic.gov.tw/public/Attachment/3102414213471.pdf>.

²³ SEC. 136. TEMPORARY INCREASE IN DEPOSIT AND SHARE INSURANCE COVERAGE.

(a) FEDERAL DEPOSIT INSURANCE ACT; TEMPORARY INCREASE IN DEPOSIT INSURANCE.-

(1) INCREASED AMOUNT.-Effective only during the period beginning on the date of enactment of this Act and ending on December 31, 2009, section 11(a)(1)(E) of the Federal Deposit Insurance Act (12 U.S.C. 1821(a)(1)(E)) shall apply with "\$250,000" substituted for "\$100,000".

²⁴ See National Audit Office, "Special Account Audit Report on the Central Government Issuing Consumption Vouchers," page 6. URL: http://www.audit.gov.tw/ezfiles/0/1000/attach/89/pta_692_670563_74965.pdf.

²⁵ See Council for Economic Planning and Development, "Statistics and Impact Assessment of the Implementation of the Revitalizing the Economy Consumption Vouchers". URL: <http://www.ey.gov.tw/Upl o a d / U s e r F i l e s / % E 6 % B 6 % 8 8 % E 8 % B 2 % B B % E 5 % 8 8 % B 8 0 2 . p d f>.

²⁶ *Id.* at 23.