Chapter 1

Assessment on the Impact of Stimulus, Fiscal Transparency and Fiscal Risk: Overview of the 8 Asian Countries

Takahashi Ito
University of Tokyo, Japan

March 2011

This chapter should be cited as
Ito, T. (2011), 'Assessment on the Impact of Stimulus, Fiscal Tranparency and Fiscal Risk: Overview of the 8 Asian Countries', in Ito, T. and F. Parulian (eds.), *Assessment on the Impact of Stimulus, Fiscal Transparency and Fiscal Risk.* ERIA Research Project Report 2010-01, pp.1-27. ERIA [online]. Available at: www.eria.org/publications/research_project_reports/images/pdf/y2010/no1/ch1Overview_Takahashi_Ito.pdf

CHAPTER 1

Assessment on the Impact of Stimulus, Fiscal Transparency and Fiscal Risk: Overview of the 8 Asian Countries

PROF. TAKATOSHI ITO

University of Tokyo, Japan

1. Global and Regional Background

Introduction

Although the theme of this volume is fiscal policy in the wake of the Global Financial Crisis (GFC), what happened in the GFC have to be explained first as a background. The GFC is commonly identified as financial and capital markets difficulties, failures of financial institutions, mainly in the US and Europe, and global declines in economic activities in 2007-2009. The financial troubles were limited among the US and European investment banks between 2007 and fall of 2008, and the global spillovers occurred after the failure of Lehman Brothers in September 2008.

The GFC of 2007-09 has left serious scars on the Asian economies as well as the US and European economies. The epicenter of GFC was the housing bubble in the early 1990s to 2007 and eventual burst in 2007-2009 in the United States. However, through securitization, the burst bubble in the United States made damaging impacts on financial institutions, institutional investors, such as pension funds, hedge funds, and retail investors across the world, but more so in advanced countries, and especially in the United States and Europe. As the global risk aversion suddenly rose after the

failure of the Lehman Brothers in September 2008, many money and capital markets suddenly lost normal pricing and became dysfunctional. The US and European markets were most severely affected.

The Asian financial institutions were mainly distant from a chaos in the United States and Europe because they did not own "toxic assets," i.e., mortgage back securities (MBS) and structured products (CDO) that have MBS as underlying assets, in contrast to major US and European banks. The Asian economies were not affected severely before the fall of 2008, unlike the slowdown in the US economy that had already started in 2007. However, after the Lehman failure, the economic activities, business sentiment and consumer confidence completely changed in a global scale. Major global financial markets also became very dysfunctional and even Asian financial institutions were affected in obtaining US dollar liquidity. The exchange rate became volatile, as the yen soared and the euro plummeted. Several emerging market exchange rates experienced heavy depreciating pressure, as hedge funds and other institutional investors pull reversed their investment to prepare for retail investors' cash redemption.

In response to these developments in the financial markets, many central banks immediately eased their monetary policies, and the government started to employ expansionary fiscal policies. Both monetary and fiscal policies were quickly directed to managing aggregate demand.

Sharp slowdown of the US economy and, to lesser extent, the European economies occurred in the wake of the Lehman failure. Import demands in these economies plummeted, and the Asian economies, as exporters to these markets, found themselves in a severe recession. Exports declined with unprecedentedly high rate in the last

quarter of 2008 and first quarter of 2009; in some countries by more than 50% compared to the same quarter of the previous year. Japan, Korea and Singapore, among others were hit with declines in their exports of semi-durable consumer goods and high tech components. With the exports being an important engine for growth, the Asian economies went into severe output losses. The more sophisticated consumer semi-durables they export, the more they suffered, as the US and European consumers delayed purchase of consumer durables. Negative growth rates were registered in the last quarter of 2008 and the first quarter of 2009 in many Asian countries, with notable exceptions of China, India, and Indonesia, where domestic demand growth more than offset sharp decline in exports. In China, India, and Indonesia, the growth rates remained positive, but were much lower than their potential rates.

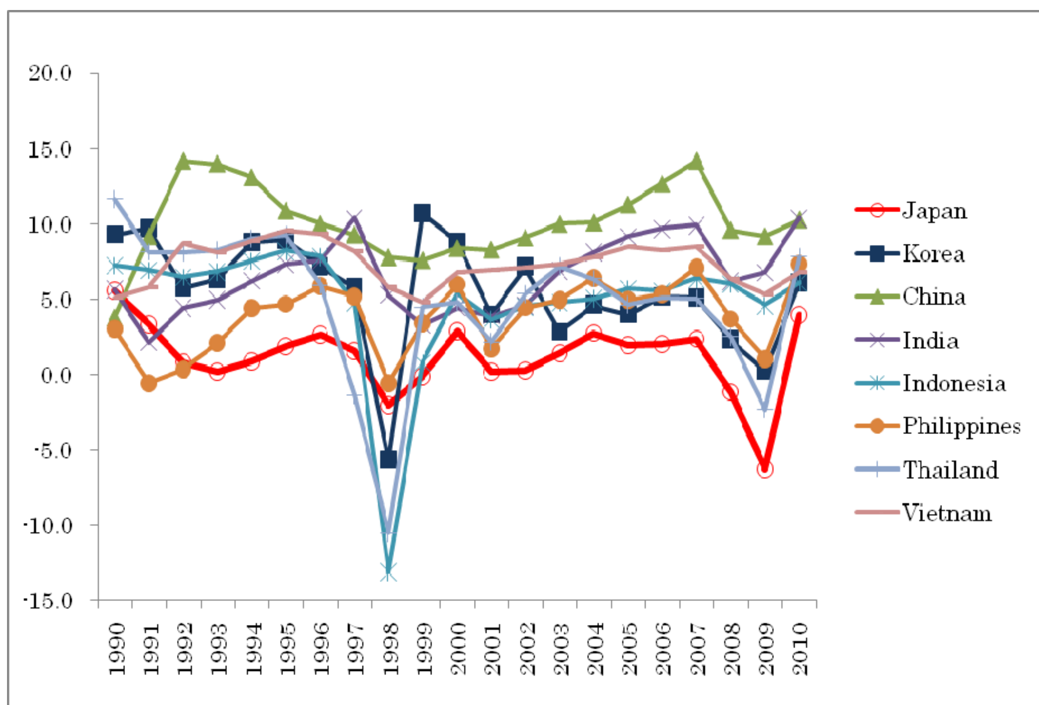
Asia was no exception to active policy interventions responding to declines in activities in private-sector activities. Central banks quickly lowered the interest rate and fiscal policies were employed.

GFC Impact on Macroeconomic Performances in Asia

The GFC was a major downward shock for the Asian countries, but how bad was it? The GFC was talked about among advanced countries, as one in 100 year event. But was it so for Asian countries? In fact, the economic downturn for most Asian countries in 2009 was less severe than that in the aftermath of the Asian currency crisis in 1998. Figure 1 shows this. There are three reasons for this. First, the Asian currency crisis destroyed the financial markets and institutions in Asia—just like the US and Europe in 2008-09—while Asia did not experience a systemic problem in the financial sectors in GFC. Second, the epicenter of the crisis was in Asia in 1998, while a crisis was transmitted to Asia mainly via trade channels in 2009. It was much milder in 2009 as a

shock to the Asian economies. Third, the Asian countries reacted to the shock with monetary and fiscal policies appropriately in 2009. Lowering the interest rate and massive fiscal spending was much faster in 2009 than in 1998.

Figure1. Gross domestic product, constant prices



Data Source: IMF, WEO data base, April 2011

As buyers of securities have disappeared from many traditionally-safe financial markets in the US and Europe, the Federal Reserve of the United States and European Central Bank poured in a large amount of liquidity, and started to purchase risky assets, which they do not hold in normal times, directly from the market. Credit easing was the term that Chairman Bernanke used to explain the new central bank policy to counter severe market stress in 2009. Both Bank of England (BOE) and European Central Bank (ECB) started to purchase government bonds. The three central banks, FRB, BOE, and ECB rapidly expanded their balance sheets after the Lehman failures. FRB

also extended the swap agreement with G10 countries and several emerging market economies. Among the Asian countries, Korea and Singapore received the swap agreements with the FRB, and Korea used it extensively. As the Asian economies fell into a serious recession, Asian central banks also lowered the interest rate and support the economy.

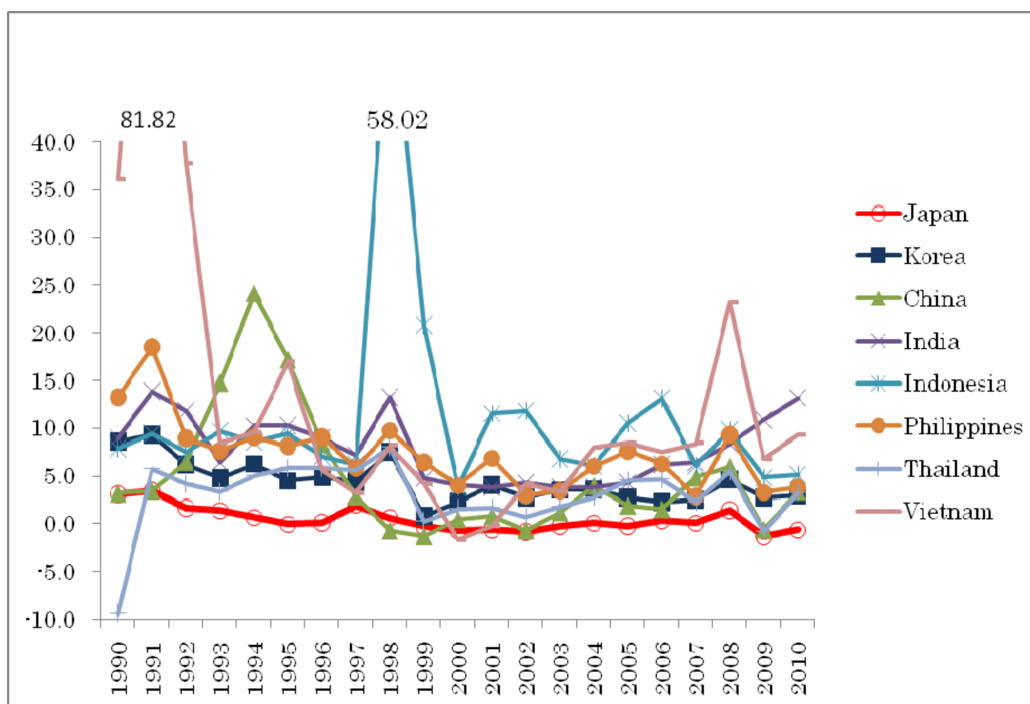
In addition to unconventional monetary policy, the governments of major countries also used the fiscal policy. They started to increase spending and to lower taxes. Prior to GFC, many economists had become skeptical about the virtue of Keynesian fine-tuning, i.e., use discretionary fiscal spending/tax cut during a recession, while reverse it when the economy is in boom. However, when the GFC occurred, the United States and European countries did not hesitate to introduce expansionary fiscal policies. In the London Summit of G20 coordinated fiscal expansion was pledged.

During the GFC, the advanced countries experienced deflationary pressure along with stagnation in output. Asian countries also received deflationary pressure. The inflation rate of the most Asian countries dropped from 2008 to 2009, as shown in Figure 2. However, significance of this deflationary pressure differs across countries. Some high-inflation countries like Vietnam and Indonesia, a correction was from too high an inflation rate to a moderate one. India did not experience any decline in the inflation rate.

There is a contrast between the Asian crisis and the GFC in terms of the inflation rate. In 1998, the inflation rate for most crisis countries rose sharply, reflecting importing inflation caused by sharp currency depreciation. In 2009, although output activities were subdued due to decreased export demand, while the exchange rate depreciated only mildly. In short, the Asian crisis produced stagflation in 1998, while

the GFC produced a traditional recession from decreased exports. In terms of policy responses, it was much easier to cope with in 2009. The straight fiscal spending to stimulate domestic demand that would replace diminished external demand is the right policy.

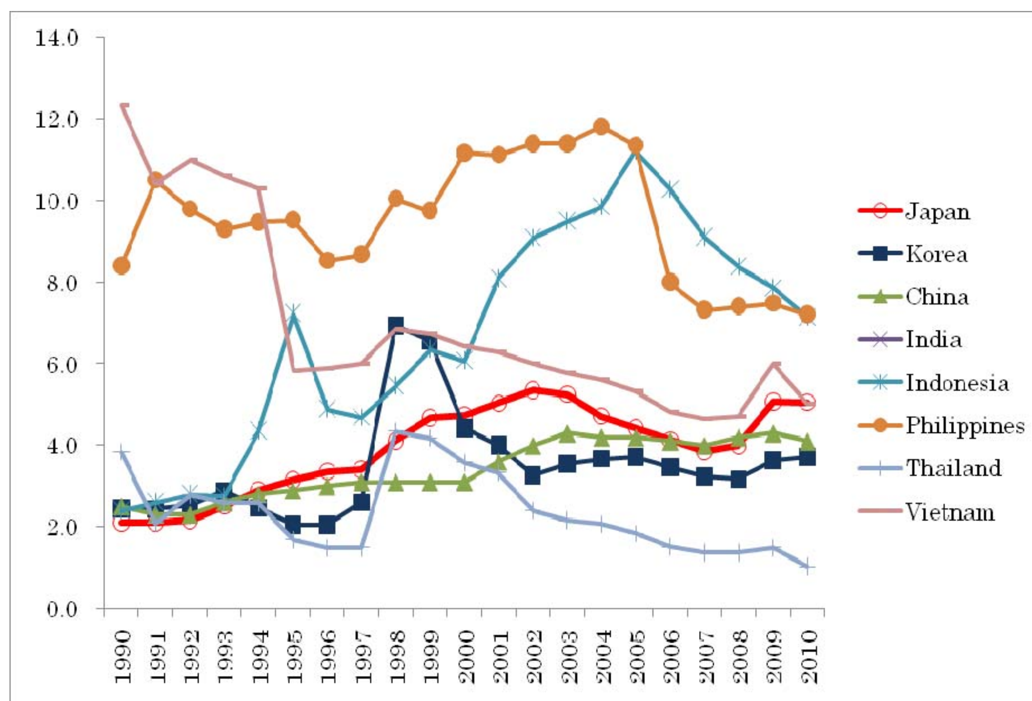
Figure 2. Inflation, average consumer prices



Data Source: IMF, WEO data base, April 2011

The movement of the unemployment rate is also consistent with the findings from Figures 1 and 2, namely, the GFC was milder compared to the Asian crisis for Asian countries. The sharp increases in the unemployment rate in Thailand ad Korea during the Asian crisis was much more prominent that any increase in the unemployment rate in 2009, as depicted in Figure 3. In the GFC period, only Japan, Vietnam, and Korea experienced a moderate increase in the unemployment from 2008 to 2009.

Figure 3.　Unemployment rate

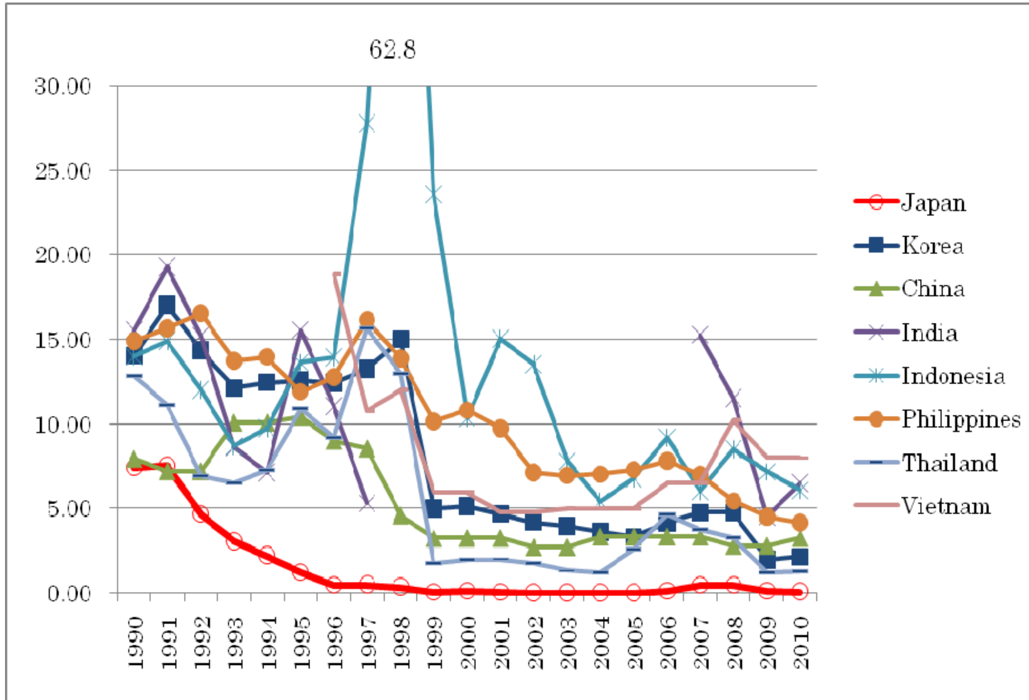


Data Source:　IMF, WEO data base, April 2011

Policy Responses to GFC

In response to the downturn in the GFC of 2007-09, most Asian countries adopted monetary easing and fiscal spending, just like the United States and European counties. advanced countries.　From 2008 to 2009, all Asian countries cut interest rate, as shown in Figure 4.　The policy rate of India declined by more than 5% point.　Korea also cut the interest rate sharply.　Japanese policy rate was only 0.5% before the Lehman Brother's failure, hence cutting it to zero did not have a large impact as the interest rate policy.　However, the Bank of Japan adopted unconventional monetary policy, and started to purchase risky securities as well as increased the outright purchase of the government bonds.

Figure 4. Policy (Discount) Rate

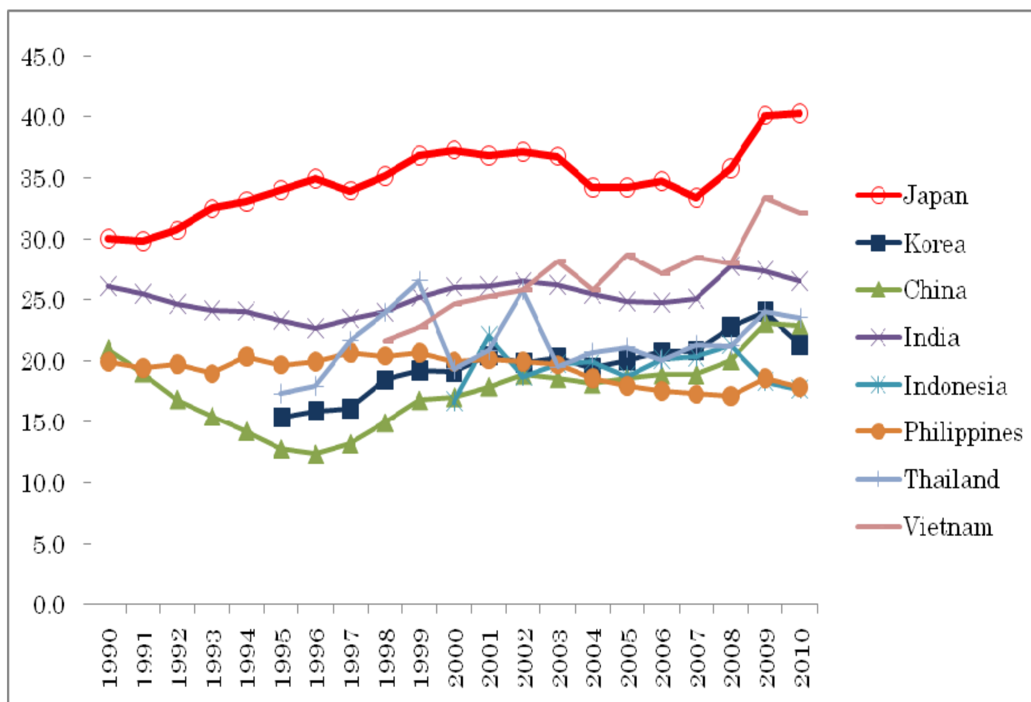


Data Source: IMF, IFS and CEIC data base

Asian countries adopted traditional fiscal policies as well as monetary easing. In many countries, fiscal easing took place as stimulus packages that had spending programs as a main pillar, with some tax cut and subsidies. Figure 5 shows the general government fiscal expenditures. Except for India and Indonesia, all other countries experienced increases in the total expenditures form 2008 to 2009. Before GFC, the expenditure/GDP ratio was already high for Japan and Vietnam, and they increased the ratio more so than other countries.

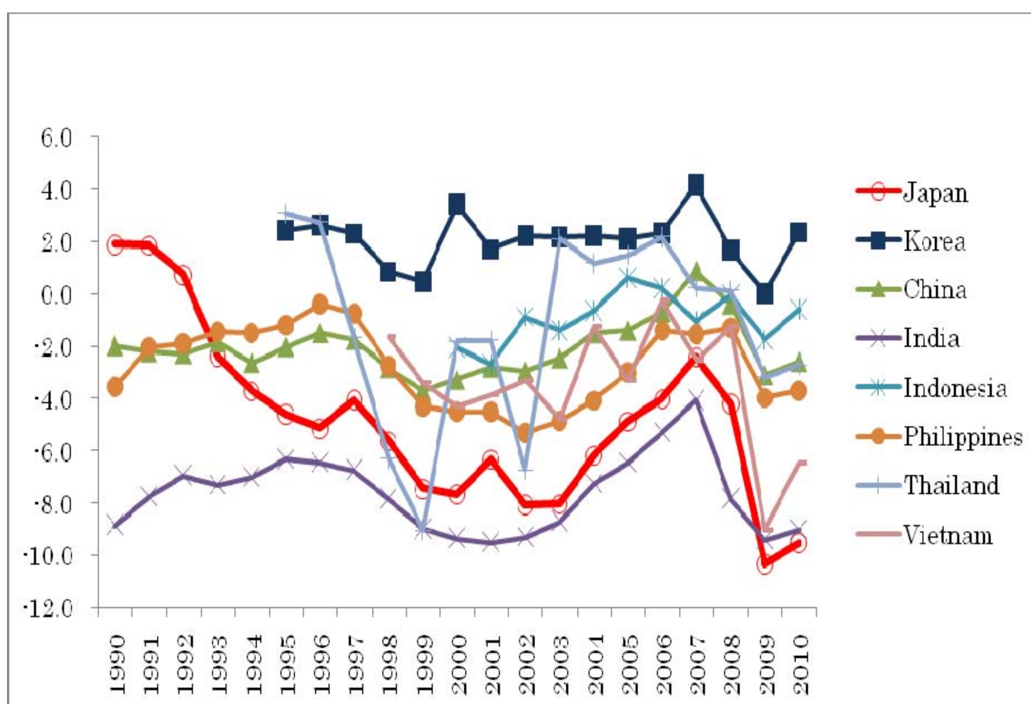
Some countries increased subsidies and decreased taxes, which works on the revenue side. Combining both increases in spending and cuts in taxes, the fiscal deficits widened (or surpluses diminished) in all Asian countries from 2008 to 2009, as shown in Figure 6. The largest change was seen in Vietnam (8 % point) and Japan (6 % point). Other countries increased deficits by 2 to 3 % points.

Figure 5. General government total expenditure in % of GDP



Data Source: IMF, WEO data base, April 2011

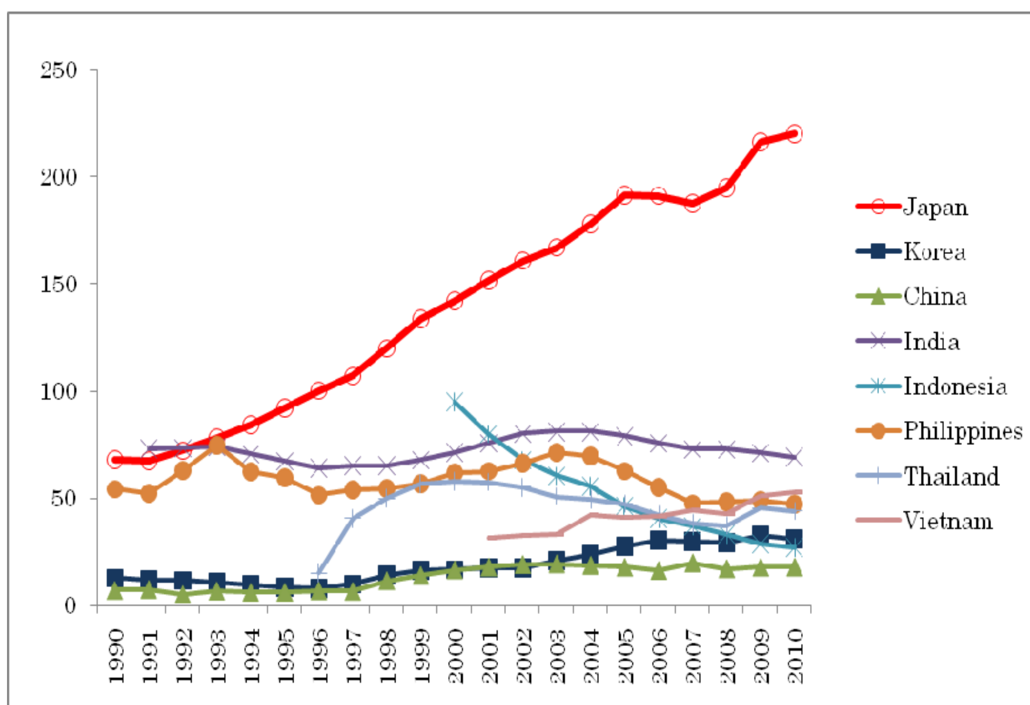
Figure 6. General government net lending/borrowing in % of GDP



Data Source: IMF, WEO data base, April 2011

As a result of increasing deficits, the debt-GDP ratio, as shown in Figure 7, tends to increase. This is most evident for Japan. The debt-GDP ratio increased sharply from 2008 to 2009. However, the change in the debt-GDP ratio in other Asian countries in the same period was either minimal or negligible. Of course the sustainability of fiscal situation is not completely tied to the debt-GDP ratio,

Figure 7. General government gross debt in % of GDP



Data Source: IMF, WEO data base, April 2011

Figure 7 also reveals a history of fiscal prudence among Thailand, Korea, and China. They started to show an increasing trend only after 1997. India and the Philippines have had high debt/GDP ratio.

Role of G20

Triggered by sharp declines in financial and economic activities following the failure of Lehman Brothers, leaders of the major countries called for some framework to discuss financial issues to avoid the repeat of the Great Depression. Leaders of France and Germany, as well as Britain, were quite vocal in creating the new Summit that involves emerging market countries in addition to G7. As leaders were hasty in creating a group for leaders, they decided to use the grouping of G20 Finance Ministers and Central bank governors meeting. They created the leaders' version of G20—thus, "the G20 Summit" was born in November 2008. The meeting was held in Washington, DC.

In G7, Japan was the only Asian country. In G20, China, Japan, Indonesia, Korea, Australia, and India belong to G20. On the one hand, having six countries from Asia is a good beginning that Asian agenda can be pushed in the conference. On the other hand, the group of twenty countries may be too big to act timely, as GFC that united members subside.

One of the most prominent achievements of the G20 Summit, in its short history, was the coordinated fiscal expansion that was agreed in the London Summit, in April 1-2, 2009. At the time, there was a fear that the severe recession in both advanced economies and developing countries might deteriorate into the Depression of the 21st century. Leaders agreed to engage in the coordinated fiscal expansion. The Leaders' Statement April 2, 2009 declared: "We are undertaking an unprecedented and concerted fiscal expansion, which will save or create millions of jobs which would otherwise have been destroyed, and that will, by the end of next year, amount to $5 trillion, raise output by 4 per cent, and accelerate the transition to a green economy. We are committed to

deliver the scale of sustained fiscal effort necessary to restore growth."

This paragraph gave comfort to leaders to engage in massive fiscal expenditures and tax cut. Any domestic opposition could be muted by the global commitment.

After 14 months form the London summit, the economic fundamentals and directions of policy challenges had changed. In the Toronto Summit, June 26-27, 2010, the European countries expressed concerns about ballooning fiscal deficits among some European countries, since the bond spreads and CDS rates for bonds issued by Greece, Ireland, Portugal, Spain and Italy had started to become higher. The European countries led the medium-term fiscal consolidation plan. The United States and Japan were not ready to move toward fiscal austerity. At the end, the Toronto Summit Declaration stated: "Reflecting this balance, advanced economies have committed to fiscal plans that will at least halve deficits by 2013 and stabilize or reduce government debt-to-GDP ratios by 2016. Recognizing the circumstances of Japan, we welcome the Japanese government's fiscal consolidation plan announced recently with their growth strategy." The exit in Japan seemed to lag behind other G20 member countries. Details will be examined in the Japan chapter in this volume.

2. Summary of Chapters

2.1. Japan

Chapter 2 gives an overview of the Japanese fiscal situation and its response to GFC. Since Japan has run large fiscal deficits in the last twenty years, it debt-to-GDP ratio became so high, near 200%. The chapter analyzes why deficits continued to be in deficits and why the bond yield remains so low, despite growing debt-to-GDP ratio.

Government expenditures and revenues started to diverge in the early 1990s. Deficits became larger and larger. Whenever the economy gets into a recession, stimulus packages were applied and supplementary budgets were formed. It has been shown that unexpected slowdown prompts a mid-year correction, namely stimulus package that is supported by a supplementary budget. The problem in the 1990s and 2000s was that the fiscal tightening was not applied during the ordinary years, and the growth rates tended to be lower than what the government thought to be potential. The large jumps in deficits were observed in 1998, Japan's banking crisis and 2009, the GFC.

Part of explanations why fiscal deficits persisted in the 1990s and 2000s was the systemic bias in supplementary budget and too optimistic forecast of growth rate, which results in larger supplementary budget given the countercyclical policy.

When fiscal sustainability is formally tested, it was shown that the current Japanese fiscal stance is not sustainable. It is on the explosive path of debts. The puzzle is that the bond yield has stayed rather low. Market participants firmly believe that JGBs would not default. This apparent irrationality can be explained by low consumption tax (VAT) rate. If and when the VAT rate is raised to a European norm, the fiscal situation would become sustainable.

The GFC affected Japan similar to its neighbors. Exports plummeted and the government tried to stimulate both consumption and investment as well as the government expenditures. In 2009, through supplementary budget, tax revenues became less than half of budget. New bond issues have important implications. Just when the Japanese economy recovered from the GFC, another disaster struck Japan,

namely the earthquake/tsunami on March 11 and nuclear disasters are putting pressure on the Japanese government to spend more like it did in 2009.

However, with already too high a level of debts, there is a danger that more bond issues may prompt the JGB yield to rise. The disaster could become a window of opportunity; but the disaster could become a last straw that would break "camel's back."

2.2. China

In 1993, the government passed a law forcing the Ministry of Finance to finance all its budget deficits by issuing bonds instead of taking money from the People's Bank of China. China's total government revenue has increased at an extraordinary rate since the 1994 tax reform. In the wake of the Asian financial crisis in 1997, China adopted an expansionary fiscal policy for the first time, and as a result, budget deficits and government debt increased quickly.

In 2008, in order to stimulate the economy that was affected by GFC through trade channel, China adopted an expansionary fiscal policy again. As a result, economic growth quickly picked up, but central and local government debt rapidly increased, raising concerns among academics and business firms over China's fiscal riskiness and economic future. The GFC affected China mainly through decline in exports. GDP growth was 14.2% in 2007, down to 10.6% in the first quarter of 2008, 10.1% in the second quarter of 2008, and 9.0% in the third quarter of 2008. Unemployment was increasing, with the urban registered unemployment rate hitting 4%, the highest since 1980. FDI declined by -0.86% in October 2008 and by -36.52% in November 2008. From In November 2008, exports declined by -2.2%, the first time in seven year, and imports declined by 17.9%.

On November 5, 2008, the State Council announced that China would adopt expansionary fiscal policy with government investment of 4 trillion yuan to stimulate domestic demand and economic growth. This was well-publicized 4 trillion yuan stimulus package.

The followings were major spending items: (1) Housing for low income groups; (2) Rural social safety net and rural infrastructures; (3) Construction of railroads, highways, airports, bridges, urban electricity network, and other large infrastructures; (4) Healthcare, culture and education; (5) Ecological and environmental projects; (6) Innovation and industrial structure changes; and (7) Sichuan earthquake reconstruction. These expenditures add up to 4 trillion yuan.

The investments span was from the fourth quarter of 2008 to the end of 2010. The sources of the funds were planned as follows: central government 1.18 trillion yuan; local governments 1.25 trillion yuan; and banks and individuals or firms 1.57 billion yuan. The National Commission on Development and Reforms, The Ministry of Finance, and The People's Bank of China together made decisions to provide long-term low-rate loans to finance some of the projects. Firms undertaking the projects were encouraged to issue corporate bonds for their funding.

The funding sources of the local government included (1) local government revenue, (2) bonds issued by the central government on behalf of the local governments, (3) urban land rents or revenue from land sales (renting for 70 years), and (4) borrowing, through government-run investment companies, from commercial banks and policy banks. For example, in 2009, the amount of the bonds issued by the central government on behalf of the local governments was 200 billion yuan. Revenue from land sales and borrowing from banks by local governments were substantial but details

were not transparent in China.

It is clear that the stimulus package is a combination of government spending, i.e., fiscal policy, as well as a result of monetary easing. In fact, the actual government budget deficits were 126.231 billion yuan in 2008, 778.163 billion yuan in 2009 and 649.5 billion yuan in 2010. The total fiscal stimulus was about 1.6 trillion yuan, out of the package size of 4 trillion yuan.

Some concerns remain. The local government may be in worse shape than the central government. The pace of increase in local governments' revenues has been much slower than that of expenditures, resulting in severe deficits. Also, China's pay-as-you go social security system will result in funding problem as the one-child policy will generate a graying society. Although the size of China's government debt is smaller than that in the early 2000s and fiscal risk is limited in the short run, reforms are needed to increase local government revenue and reduce their debt, to increase fiscal transparency, to reduce government deficits and debt in the long run, and to reform the pay-as-you-go social security system for fiscal sustainability.

2.3. Korea

In response to the Global Financial Crisis (GFC), Korean government announced several large fiscal stimulus packages. Chapter 4 examines whether these unusual expansionary fiscal policy contributed to the quick recovery from the crisis. Next, it evaluates the so-called "the exit plan" and forecasts whether the plan will retrieve fiscal balance effectively. Then, it identifies potential risk factors on various fiscal areas and suggests long-term measures for them.

An official report from Ministry Of Strategy and Finance (MOSF) confirmed that the size of fiscal stimulus package was 38.8 tril. won (3.6% of GDP) in 2009 and 17.1 tril. won (1.5%) in 2010. In terms of composition, the fiscal stimulus package consists of various fiscal items but seems to concentrate more on tax cut, SOC building and support for SMEs and self-employed. According to fiscal index such as FIS and FI, they increased sharply in response to the negative real GDP growth following the GFC. The fiscal stimulus package executed after the GFC was quite substantial and unusual in the fiscal history of Korea.

It is assessed that Korea's fiscal stimulus package was quite effective and has an important role for Korea's rapid recovery. Contribution of fiscal stimulus on real GDP growth in the first half of 2009 was 1.4% point and in the second half was 1.1% point. The effects of fiscal stimulus also continued in 2010, but its magnitudes became smaller than the preceding year. These empirical results lend support to the popular belief that countercyclical fiscal policy boosted aggregate demand and output at least in Korea as well as rest of developing Asia during the GFC.

Korean economy recently announced the exit plan via Medium Term Fiscal Management Plan for 2010~2014. The priority of fiscal policy is on fiscal consolidation. The medium-term fiscal targets are to return to balance of operational budget in 2013~14 and to reach the government debt to 31.8% in 2014. Details are explained in the Chapter.

There are several potential risk factors on fiscal sustainability of Korea mainly due to ageing demographic structure as well as hidden debt of public enterprises. According to a long-term fiscal projection, social welfare and health expenditure will grow gradually for the period of 2015 to 2050. In 2050, it is expected that social

welfare and health expenditure will be 16.9% and 3.6% of GDP respectively. Consequently, Korea's government debt continuously rises for the projection period. It is expected to get to 140.1% of GDP in 2050.

For fiscal sustainability, Korean government needs to perform the following reforms. In a short and medium term perspectives, Korea government should continue to establish fiscal foundation as well as enforcement of SOEs' debt reduction. On the tax revenue side, it is necessary to expand the tax base by diminishing tax redemption and reduction and non-refundable tax credit, while at the same time expand the tax revenue base by enhancing the accuracy of reporting income through consistent improvement in tax administration.

In the medium run, institutional reform associated with social welfare such as public pension is required. Periodical release a long-term fiscal outlook report which takes into account low fertility rate and population aging will be helpful to get publics' consent related to increase in contributions.

2.4. Indonesia

The impact on economic growth in Indonesia also became evident after the Lehman Brothers' collapse. The decline in exports caused the decrease in Indonesia's overall economic growth. In the fourth quarter of 2008, economic growth slowed to 5.2% year-on-year, this was still much better than other emerging-market Asian countries, except China. In the second quarter of 2009, the global economy showed signs of improving, and so did the Indonesian economy. With the improvement of global economies, Indonesian exports grew. In monetary terms, inflation was strictly controlled, and in 2009 inflation reached its lowest levels since 2000, at only 2.8%. The low prices stimulated consumption, and contributed to macroeconomic stability,

which in turn stimulated foreign investment to Indonesia. In 2009, Indonesia grew by 4.5%, and Indonesia became the third fastest growing G-20 country after China and India.

One factor which helped to limit the impact of the GFC on the Indonesian economy was support by the government in terms of economic stimulus. The share of total Indonesian exports on GDP is 29%. This is much lower than in countries like Singapore, Taiwan and Korea. So, there was a room for government spending. This emphasizes the importance of domestic demand. With exports hard hit plus weak investment, economic growth was practically totally dependent on household and government consumption.

It is somewhat puzzling why growth in domestic demand was relatively strong during the GFC. The chapter addresses the following questions: (a) What was the fiscal position before and after the GFC? How dis the fiscal stimulus minimize the impact of GFC? What challenges need to be anticipated in fiscal policy to face future economic crises? The chapter also discusses lessons learned and policy implications from the current global financial crisis.

The Minister of Finance unveiled a stimulus package for 2009, valued at Rp 73.3 trillion (US$ 6.4 billion), to boost the economy amid the threat of an economic downturn. The package addressed three major areas: income tax cuts, tax and import duty waivers, and subsidies and government expenditure. Aiming to stimulate more household and corporate spending, almost 60% of the Indonesian fiscal stimulus was allocated to income tax cuts. The government cut personal income tax from 35% to 30% and corporate income tax from 30% to 28%.

In addition to the tax cut, around Rp 2.5 trillion was allocated to finance import duty waivers for raw materials and capital goods. This was part of the Rp 12.3 trillion tax and duty package, accounting for 18% of the total stimulus package, meant to support businesses. To help reduce operational business costs, the stimulus package also included diesel and electricity subsidies. Lastly, close to Rp 12 trillion was allocated to support infrastructure and rural sector development.

The total size of the budget expansion was criticized at the time as negligible. The forecasted deficit of 2.6% of GDP was partly driven by the decline in revenue (especially tax and non-tax revenues). Only about 1.2% of GDP can be considered as the real expansionary and discretionary stimulus, the authors argue.

Despite having a healthy fiscal position (relatively low debt/GDP), the size of the fiscal stimulus in Indonesia was modest compared to other economies including Malaysia, Thailand and Australia. The authors find two reasons. First, the State Financial Law and Government Regulation prescribes that the consolidated national and local government budget deficits be limited to 3% of GDP in any given year, and that total central and local government debt not exceed 60% of GDP—similar to the Maastricht criterion, to pre-commit the government to be fiscally prudent. Second, the government was worrying that a large deficit could not be financed with stable interest rate. Emerging economies, including Indonesia were hit particularly hard by the fallout from the financial crisis. In the end, it looked that only with the modest stimulus, the Indonesian economy performed well in the wake of the GFC.

2.5. Philippines

The GFC caused a recession in advanced economies in the latter half of 2008, and it has had an adverse impact on the Philippine's exports and remittances of overseas workers. Exports from Philippine registered negative growth in the fourth quarter of 2008 and through all four quarters of 2009. The remittances of overseas workers continued to post positive growth in 2008 and 2009, but with much slower pace of growth. Growth rates of remittances were 13.2% in 2007 and 13.7% in 2008, but dropped to 5.6% in 2009. The growth of real GDP decelerated from a high of 7.1% in 2007 to 3.7% in 2008, to 1.1% in 2009.

Prior to GFC, the government expanded the rice price subsidy program and launched a number of programs meant to provide temporary relief to vulnerable sectors in response to the surge in the price of food and petroleum products in 2008. In response to projected economic downturn, which became evident with contraction of exports and remittances of overseas Filipino workers, the government formulated and announced the Economic Resiliency Plan (ERP) in early 2009. The Plan is designed to (i) to ensure sustained growth and attain the higher end of the government's economic growth targets, as a countercyclical policy; (ii) to save and create as many jobs as possible; (iii) to protect the most vulnerable workers, i.e., the poorest segment, returning overseas Filipino workers, and workers in export industries; (iv) to ensure low and stable prices; and (v) to improve competitiveness in preparation for the global rebound.

The ERP was worth PhP 330 billion, divided into PhP 160 billion of government budget interventions, PhP 40 billion of tax cuts, and PhP 130 billion of off-budget interventions

Chapter 6 aims (i) to assess the size and composition of the fiscal stimulus applied

in 2008-2009 and its effectiveness in increasing aggregate demand, (ii) to evaluate the country's exit strategy and (iii) to identify risks to fiscal sustainability. While the evidence on the relative effectiveness of expenditure expansion versus tax cuts is mixed, the overall effectiveness of the fiscal stimulus appears to be well supported by evidence. A number of fiscal risks associated with the fiscal stimulus package was noted by the chapter. First, the Philippine experience validate concerns raised in the literature that tax cuts made in response to an economic slowdown tends to be permanent or are difficult to reverse. Second, while most of the spending programs included in the fiscal stimulus package are temporary in nature, the expansion of the conditional cash transfer program is not. Third, even when the a country's fiscal position appears to be benign at the start of the crisis, countries with high debt-to-GDP ratio like the Philippines have very little elbow room to do countercyclical policy without running into fiscal sustainability concerns. Fourth, while the government's fiscal stance in 1998/ 1999 and 2009 is appropriately countercyclical, its fiscal stance was procyclical in about half the time in the period between 1991 and 2010. Given this perspective, there is a need to guard against procyclical policy as it tends to foster smaller than warranted fiscal balances and, consequently, higher levels of government debt over time. The lesson here is simple: fiscal prudence even during good times helps enhance the government's ability to do countercyclical fiscal policy when times are bad.

2.6. Thailand

The Thai economy was affected by the Global Financial Crisis (GFC) through shocks to value chain (trade channel) and financial channel. Contraction in global demand led to declines in exports, manufacturing production and capital utilization

accordingly, which then led to declining in the country's consumption and investment. On the other hand, interest rate gap between Thailand and advanced economy widened, as advanced economy (mainly US) lowered the interest rate much faster than Thailand. Massive capital inflows resulted and the Baht appreciated. Baht had appreciated by 10% against the US Dollar in 2010. The labor intensive sectors suffered from export declines and baht appreciation. The sectors with high import content benefited from this incident.

The automatic stabilizer worked effectively during and after the GFC, as the government revenue declined significantly in 2009 and surged again in 2010 after the economies recovered. However, the government has adopted various discretionary fiscal stimuli to counter impacts of global crises, which resulted in fiscal deficits and an upward trend of the public debt. The fiscal stimulus packages have included short-term expenditure measures namely Stimulus Package 1 (SP1) which amounted THB116.7 Billions aiming to reduce impact of the GFC, long-term investment plan (Stimulus Package 2 (SP2)) which amounted THB 1.43 Trillion aiming to improve the country's competitiveness, and tax measures. In 2009, the budget deficit became 5.6% of GDP due to these measures.

The chapter measured the impacts of fiscal stimulus and monetary policies. The SP1 was found to have increased real GDP by 0.9% point, while the tax measures by 0.06% point. On the other hand, disbursements of the SP2, a multi-year investment program, are estimated to increase the growth rate by 1.5% point in 2010, by 1.2% point in 2011 and by 1.1% in 2012.

To maintain the fiscal sustainability of the country, the Thai Ministry of Finance (MOF) and the Bureau of Budget (BOB) have signed a MOU to recover balance of

budget by using fiscal policies and budget management tools within 5 years or 2015 which leads to MOF strategic plan to revise government expenditure (expenditure control) and revenues (revenue collection efficiencies and introduction of new tax measures) to respond to that obligation. Currently, due to higher revenue collection, projected stable economic growth and controlled expenditures, it is expected that the Thai government can resume budget balance by 2015.

2.7. Vietnam

Like other Asian countries, Vietnam saw a fall in demand for its export and capital inflows in the wake of GFC. In particular, during the last quarter of 2008 and the early 2009, monthly exports dropped precipitously. Industrial production in the fourth quarter of 2008 slowed to 15.6% compared with 17.4% in 2007. Foreign direct investments declined significantly. Consumer sentiment was adversely affected and the stock market index kept falling. GDP growth rate fell from over 8% attained in 2007 to 6.28% in 2008, and deteriorated further in early 2009 when the GDP growth rate in the first quarter was only 3.1%. However, these declines were better than other Asian countries.

In the beginning of 2008, tight monetary and fiscal policies were implemented to combat its own home-made mini crisis (running inflation and twin deficits). Upon arrival of GFC, the government of Vietnam responded by reversing its tight monetary policy and the fiscal austerity. The government announced a large fiscal stimulus package (amounting to almost 10% of GDP). GDP growth rate bounced back to 7.7% in the fourth quarter of 2009. The annual GDP growth rate was 5.3% for 2009. In overall assessment, Vietnam has weather the global financial crisis relatively well.

It is still unclear how the government would manage its exit strategy. The economy recovered from the GFC and grew at 6.8 percent in 2010 (almost returning to the pre-crisis level). However, macroeconomic uncertainty remains as trade deficit keeps rising, government budget deficits is widening, external debt rising and inflation coming back. To complicate the question further, the economy is highly dollarized as evidenced by the commercial bank's offering US dollar interest bearing deposits and the state is captured by its own large SOEs and the soft budget constraint by the local (provincial) governments.

The government of Vietnam quickly and decisively responded to counter the negative effects of the global crisis. It reversed the course of the monetary tightening and fiscal austerity policy implemented in 2008. The central bank cut the base rate from 14% to 7% within a few months. In terms of fiscal policy, the stimulus package, was initially announced at $6 billion aiming at mitigating the impact of the global financial and economic crisis on the Vietnamese economy and the population, and preventing a general slowdown of economic activities. This figure was later revised to be approximately USD 8 billion. The budget plan of late 2008 put the Vietnamese stimulus package in the top tier of the regional comparison.

2.8. India

India has a long history of huge fiscal deficits and high inflation. The sharp increase in fiscal deficit in the wake of GFC is a major concern for academics and policy makers. The level of combined (central plus state governments) fiscal deficit in 2009-10 was 10.1 per cent of GDP, a record high. This follows a sharp rise in the fiscal deficit from 4.2 per cent of GDP in 2007-08 to 8.5 per cent in 2008-09. This is

considered to be unsustainable.

The debt to GDP ratio rose to 72.4 per cent for the year 2009-10, up from 71.6 per cent in 2008-09. This rise seems to have reversed all the fiscal gains made since 2003-04. The fiscal situation was reversed sharply as the government undertook a number of measures to stimulate the economy in the run up to the elections and subsequently in the wake of the global crisis. According to budget estimates for the year 2010-11, the ratio of fiscal deficit to GDP (for both the centre and states) is expected to be 8.5 per cent excluding off-budget bonds, and will be about 10 percent with the off-budget bonds (mainly oil bonds). Thus, the need for fiscal consolidation and the achievement of fiscal sustainability continue to be the key macroeconomic issues confronting Indian policy makers.

Chapter 9 cautions about off-budget items. More importantly, the growing practice of issuing special bonds to oil and fertiliser companies to support low consumer prices means that at least part of the subsidy burden is off the budget. Transparency is not perfect. The chapter also describes how taxation system has evolved to import duties and excise taxes to state-level VAT, to a proposed national goods and service tax.

The impact of the GFC has been transmitted to the Indian economy through three channels, viz., the financial sector, exports, and exchange rates. However, four factors helped India to cope with the crisis and soften its impact. They are: (1) the robust, well-capitalised and well-regulated financial sector; (2) gradual and cautious opening up of the capital account; (3) the large stock of foreign reserves and (4) greater dependence on domestic consumption as a driver of GDP growth. Consumption accounted for more than 70 per cent of India's GDP and the high potential GDP growth rate (the average for 2000-2007 being 7.3%.) India's GDP growth declined to 5.8 per cent

(year-on-year) in the second half of 2008-09 from 7.8 per cent in the first half. The growth improved to 7.4 per cent in 2009-10. Undoubtedly, the massive fiscal and monetary stimulus measures helped to prevent a sharper downturn in 2008-09 and promote recovery in 2009-10. The global economic recovery from second quarter of 2009 also helped.

3. Concluding Remarks

The rest of this volume compiles the country papers as summarize in the preceding section. There are similarities and differences. Similarities are the extent of damages through the trade channel. Differences come from the stage of development, the reliance on exports as opposed to domestic demands, and room of policy measures. In short, emerging markets with larger domestic demands fared the crisis better than advanced economies.

As the acute stage of the crisis was over and many economies rebounded in 2010, the governments started to withdraw extraordinary fiscal measures. The debt level rose in many countries, and it would take years to lower the rate to the pre-GFC level. There will be differences in how easy or difficult fiscal consolidation will be, depending on demographic structure and growth potential. This volume is a handy reference to summarize basic facts and prospects on the fiscal issues in Asia during and post GFC.