

“Public Governance and Avoidance of Collective Risks” International Conference

Hosted by Taiwan Insurance Guaranty Fund

Dec 5, 2014

Opening Remarks

SPEAKER: Doctor Jennifer Li Ling Wang, Vice Chairperson of Financial Supervisory Commission

Chairman Chu of Taiwan Insurance Guaranty Fund, distinguished keynote speakers and panelists, honorable guests, ladies and gentlemen: Good morning.

It's a great pleasure for me to attend today's conference. Thank you so much for the invitation. On behalf of the Financial Supervisory Commission (FSC), I would like to welcome many distinguished speakers who travel a long way from the United States, UK, France, Japan, and Hong Kong to Taipei. I hope you enjoyed your stays so far. There are many famous resorts in Taiwan, so don't forget to take sometime after the meeting to explore the beauty on this beautiful island and enjoy our hospitality and friendship.

I would also like to thank Taiwan Insurance Guaranty Fund for organizing this conference and invited many excellent speakers and panelists to discuss how to enhance public governance and prevent the collective risks. From my understanding, today's speakers come from many different countries. They are the best representatives from academic professors, research institutions, and experienced specialists in the fields of economic, financial, and public administration. Therefore, we can expect a very wonderful intellectual discussion today.

As we can see, public governance and collective risks have become a very important global issue. For the past few years, we have witnessed many significant global changes, including climate changes, technology change, the fluctuation of economy and capital market, and demographic ageing. These changes have presented more risks and challenges for the government and insurance systems around the world. However, because natural catastrophes, financial crises, and demographic ageing have become more severe and are usually beyond the domain of social insurance and the government budget, I believe financial market and private insurance company will play a more important and indispensable role in response to these risks and challenges in the future. In addition, insurance companies can help to fulfill corporate social responsibility by supporting products such as micro-insurance, long-term care insurance, annuities, and catastrophe insurance. Therefore, how to enhance the stability of the financial market and prevent the bankruptcy of the insurance companies has also become an important task of the government. I am very happy to see many of these important issues of public governance and collective risks are discussed in today's conference. I believe with all your participation and wisdom, today's conference will come up with many excellent professional ideal and strategies to cope with the challenges we face.

Taiwan's financial industry has been developing for more than a century. The financial development has always supported our nation's economic growth. We realize that Taiwan is currently facing rapid changes in technology and the economy. Therefore, to respond to the intense competition of rapid globalization, the development of our financial industry also needs to be accelerated. In this year, the FSC has launched many new policies and relaxed restrictions from the financial institutions to improve their operating efficiency in order to enhance the development of the capital market. Looking to the future, the FSC will keep refining all the policies and strategies to create a more favorable environment to spur domestic capital market.

I am very confident that today's conference is going to be a huge success. I would like to once again thank the outstanding preparation of the Taiwan Insurance

Guaranty Fund for hosting such a wonderful conference. I would also like to thank all the speakers and panelists for your great contributions in sharing your knowledge and expertise. I believe that this sharing has brought us deeper understanding of how to build a better public governance and insurance system.

I wish you all have a productive conference. Thank you!

SPEAKER: Chairman Chu, TIGF

It's a great honor to have everyone here and I would like to welcome everyone to this conference. This conference is one of a series of conferences that we have had over the previous years and we are mainly concerned with security and other risks associated with the overseas investments made by our insurance companies. As you are all aware of, the returns on assets in Taiwan for example the interest rate on government bonds is very, very low so most of our insurance companies particularly life insurance companies invest a substantial amount of their assets overseas in the forms of equities, fixed income assets and so on and so forth. The average ratio is about 40% which is large because the size of the investable funds is very large as they have accumulated over the years.

We have had conferences or seminars on the European sovereign debt, how international hot money impacts global economies, politics, and financial markets. Last year it was on economic management and country risk and this year the title of this conference is Public Governance and Avoidance of Collective Risks. This year's conference is organized into three parts. The first part will be an assessment of the financial system in important countries throughout the world so that it's possible for scholars to assess the possibility of having major crisis that we saw in 2008 and 2012--namely the financial tsunami which nowadays is also called the Great Economic Recession triggered by the US and then the 2012 crisis triggered by the European countries. The second part will be on the experience of foreign countries dealing with financial institutions that are in trouble that include the insurance companies of course. In Taiwan, we do have this problem. In 2012 we sold a company we took over in 2009. In August of this year again we took over two

insurance companies. So we would like to know what the other countries did when their insurance companies were in trouble so we had the pleasure of having guests from Japan, for example, to talk about their experiences in Japan. The third part of this conference is concerned with the more fundamental issue of public governance because we think that sovereign risk is a reflection or outcome of the general framework of public governance in any country. There have been problems in public governance everywhere and the democratically elected governments in Spain, Greece, Portugal could not avoid the upcoming major crisis in these countries and we will take a look at this issue and we will talk about alternative models for democracy that have prospects of avoiding public governance in association with the rising of say, for example, of populism. These are the major issues of this conference and as I said we had the pleasure of inviting these honorable guests from overseas and in particular we will have two keynote speeches. One is by Richard Werner from the UK and his speech will be on the financial crisis issue and tomorrow in the morning we will have another keynote speech from James Fishkin from Stanford University speaking on the prospects of deliberative democracy. So welcome and thank you again for joining this conference and I hope that you have a very fruitful experience. Thank you!

SESSION 1: Public Governance and Avoidance of Financial Risk

MODERATOR: Dr. Jia-Dong Shea

The subject of this session is public governance and the world of financial risk. It's divided into two parts. In the first part we will have one keynote speech followed by one paper presentation. The second part consists of two presentation discussions and this will be quite a long session so please be patient. We are quite honored to have Professor Richard Werner to make the keynote speech.

(I) KEYNOTE SPEECH

SPEAKER: Professor Richard Werner, Professor of Southampton Management School, University of Southampton, UK

Thank you Chairman and Professor Chu for this kind invitation and it's always a pleasure to come to Taipei. I would like to talk to you about public governance, particularly the key issues of public governance and the link to financial stability. Now, many of us have been presenting on what has been the cause of this major financial crisis. It's usually not called global financial crisis because in Asia we know it was really the North Atlantic Crisis. But still it was a major financial crisis. So what was the cause? Was it these newfangled financial instruments which is a whole lot of acronyms and abbreviations that credit-derivatives and the structured financial products that were built on them in often very convoluted investment vehicles that were asset-backed, structured, sliced and diced. Is that the reason why financial engineering became too complicated and got out of hand? Was it the rating agencies who clearly were complicit in the mis-selling or mislabeling which resulted in mis-selling of financial instruments that had a AAA rating but soon after the crisis which is referred to as toxic waste and its value went to zero very quickly. Is it this whole industry of speculators, hedge funds and equity funds highly leveraged and engaging in speculation? Is it more general? Is it human nature? We have had financial bubbles and crisis since the 17th century rise of modern bank-based capitalism or could it be that inappropriate regulation and public governance may have been a factor?

Now its very easy after a crisis to come up with some smart commentary and I would like to quote a warning from my book Princes of the Yen 2001 looking at the US market. One of the final chapters of the book. In 2005 I warned about the European situation, banking systems are prone to credit cycles that affect macro economic stability and less than pleasantly relevant for the UK housing sector. In 1991, this was actually my first publication and it was the very one that when written up in The Economist. So I was writing here about Japan that we basically face a reverse in the asset price spiral and product a depressive credit crunch of historical proportions and international repercussions cannot be dismissed and Japanese banking facing major financial crisis following this. Why was it possible and not difficult to give these warnings? In particular I want to focus on public

governance aspects and the link between public governance and financial stability. In this context we have to look at the role of the most influential institutions of public governance and financial markets and these are the central banks.

What's the current paradigm or the prevailing thinking about central banks? Well concerning public governance, the status of the central bank that is considered appropriate is as follows. Central banks are told to be independent and that is the right public governance arrangement of well the monetary system. Here's a quote from Yasushi Mieno who was the governor of the Bank of Japan. "In many countries today, monetary policies are entrusted to independent central banks..." Already by 2000, commentators pointed out that something very unusual and interesting in history has happened. That is why I was so pleased to know that this conference makes a link to the democratic conference which has been missing in this debate. So I think that this conference is quite an important event to make this link. Occasionally like in this comment, you are seeing the link being referred to but its being left out of the analysis.

Let's examine how the central banks themselves describe what they are doing and their arrangements for managing the monetary systems and financial markets. These are the claims made by central banks about what are they up to and what is their goal of the policy and how they are going to achieve these goals. Number one, their claim is repeatedly and you could list dozens and dozens of central bank publications on this. Their aim as I've been told is the stability of prices, the stability of economic growth and stability of currencies. In fact if you do a word search by speeches of central bankers, for the word stability it is quite extraordinary and it is very high numbers as they always talk about stability. Strangely that seems to be something that were not getting. Secondly, how do they argue their going about achieving this goal of stability of prices, growth, and currencies? They say, and again and a very long list of publications could be cited to underline this. They use interest rates as the main monetary policy tool. Thirdly, why interest rates? They do have justifications for that because they say that interest rates are the key tool in the financial markets. They're driving exchange rates, profits, growth, stock markets

and of course the nature of the relationship, we've heard it so many times, higher rates with slow growth and lower rates will stimulate growth. So what we are being told is the correlation between interest rates and the economy is negative. The causation runs from interest rates to growth. Interest rates are the tool and the financial markets follow.

What are we going to make from these statements? As researchers we need to examine them empirically. We can already tell that the central bank has not been doing a good job by this measure because we aren't getting stability. But what is the empirical evidence for such claims and let's start with the third one, the role of interest rates. When something is repeated so many times we assume that it has been tested innumerable times. We've heard about interest rates so many times that surely there are studies that prove this. The fact is, there is not a single shred of empirical evidence to back this assertion.

Let's examine the facts, we can pick the US and Japan. Let's look at the facts between interest rates and economic growth because we live in a nominal world where prices and interest rates and money are all nominal and its nominal growth which is a consistent measure. On the left-hand side you can see the correlation and on the vertical axis we have interest rates in Japan and short-term rates and here we have nominal GDP growth. Here we find that there is a positive correlation and the same for the US. These are ten-year treasury bond yields, benchmark bond yields, and nominal GDP growth and we get a positive correlation and not a negative one. You might say it must be in the timing so let's look at the leads and lags. What's the timing?

If you look at these graphs, for the Japanese case it's obvious that first nominal GDP growth were covered in the mid 80s and then interest rates followed. Nominal GDP rates fell first and then interest rates started to fall. Come to think of it we know that this is always the case. The central banks are behind the curve. They move interest rates in response to the economy. That's for short rates.

Maybe that's different for bond markets. Surely for the most liquid bond market in the world, the US treasury market, surely the treasuries are smarter than that. They don't just follow the market do they? Well think again. Here we have the ten-year benchmark yield. The black line is US nominal GDP growth. What we find is that the economy that moves first and then interest rates follow, sometimes a year later. So long-term interest rates follow. There is no evidence that interest rates lead the economy, whether they are long-term or short-term rates.

Therefore we find that this official story where lower rates leads to high growth and visa versa is just not supported by the evidence. The reality is the opposite. High growth leads to high rates and low growth leads to low rates which is a very different story. It's different in two dimensions. The correlation is positive and the causation is from growth to interest rates. Now, we sort of are aware of this but we just don't put these things together. Psychologists call this cognitive dissonance in the sense that we understand the story but we choose to ignore it and we are trained by the central bankers.

Since interest rates are the result of economic growth they can't be the cause. That raises a number of questions which we cannot answer all today. If it's not interest rates that drive growth then what is it that drives the economy? It must be something else. Why do central bankers keep going on about interest rates being so important when clearly interest rates seem to be useless as a monetary policy tool because they follow the economy and do not lead the economy. What are central banks really doing when it comes to monetary policy?

Trade secret number one is that central banks don't actually use interest rates to run the economy. There is no empirical evidence for that whatsoever. They do something else. Looking at these three claims, claim number three is not backed by interest rates and claim number two it turns out is also not supported. Let's look at claim number two more closely. What exactly are central banks doing?

Let's look at the Japanese central bank in the 1980s. How did the bank of Japan implement monetary policy? Many publications told us the interest rate story that

we are using the official discount rate or the overnight -- call rate as our intermediate target and with this we are moving interest rates and we are through this making our monetary policy. You can examine this using econometric techniques and you will find that the official policy tools are not able to explain what happened to Japan in the 1980s. I did a lot of research on this particular question and thought that we need to ask people. Central banks are consisted of people and we should just ask the people what is happening. Therefore, I did a lot of taped grass root interviews of central bankers and bankers of counter-parties and found out about available data that backs up what I heard. The conclusion is that the bank of Japan used the monetary policy tool called Window Guidance which is the informal guidance of bank credit. This is the aggregate of bank lending that banks do during a month or quarter and the central bank will just tell the banks how much bank credit to create. Also sectionally, who to lend them to. If you haven't heard of this you might think that this won't work out effectively but I found out that there is data available. It was never published in the official publications of the Bank of Japan but you could call for the public information of the Bank of Japan and they will tell you orally on the phone monthly and quarterly what the Window Guidance long growth quotas were that the banks had to stick to. The Numeral Research Institute compiled this going back to the 70s and this is the data for the growth rate of bank credit as given as a quota by the central banks to the banks. I will press the button now and you will see another line and this is line of the actual bank lending after the end of that quarter.

Three months later, the actual lending results from the banks. This is what banks have done. Of course banks have followed Window Guidance very closely. Now this is actually from Germany and many countries copied it. The US referred to it as credit controls while other countries have their own terms. The central bank of China is the only bank that admits to using this policy tool quite openly. Most other central banks who engage in it officially deny it. I can prove that this official story of Japan denying it is not true.

It makes sense that central banks don't use interest rates to run the show because interest rates follow the economy. But why do they use the quantity of credit which seems to be a key variable, bank credit. Why are interest rates not working? We can safely cross out claim number two from the central banks.

Very briefly, a slight diversion-- some of you are wondering: you referred so much to interest rates and I nonchalantly dismissed them as not being relevant in the macro economy as a monetary policy tool. Where does the idea come from that interest rates are so important? It's interesting for those in the insurance business and those that are trained as actuaries and are trained in probability. You see on the vertical axis there is a price. It could be the price of anything such as goods or cars or money (interest rate) or labor (wage), etc. On the horizontal axis we have a quantity that corresponds to this such as price of cars, labor or quantity of labor going with the wage, etc. Then we draw a downward sloping demand curve and upward sloping supply curve. The key is that where the two intersect we have equilibrium and prices in this scenario are key because if prices are higher than equilibrium there is more supply than demand then they can't sell those things and then the prices are driven down and visa versa. It's a very convincing story isn't it? Now let's read the small print of this story. This works if eight assumptions hold. So you have to assume perfect information that everyone knows everything. Markets are complete in that there is a market for everything. Perfect competition means no monopolies or oligopolies, instantaneous price adjustment, zero transaction costs. No time constraints. Profit maximization of rational agents. People are greedy, only think of themselves, and only want more of goods and services. Nobody is in any way influenced by others. If these assumptions were true there wouldn't be mankind. There wouldn't be people because babies would die. This is the theoretical dream world that economists have created.

Let's give a probability to each assumption. Let's be generous and give that the probability is more than half that each assumption holds true. I think that is a wild exaggeration. The probability is clearly less than 55% but let's say that 55% of one assumption holding true. What they are saying is that we need the conditional

probability of all assumptions holding at the same time. What is that? We will get equilibrium, if all these assumptions hold at the same time. We are assuming that one has a probability of 55%, what is the joined probability? With insurance experts that is an easy question to ask. We take 0.55 to the power of 8 which is less than 1%. This again is being generous because the probability of perfect information is not 55% but in itself less than 1%. In other words we know for sure that there is no equilibrium. Markets can never be expected to clear and therefore prices are not key and therefore interest rates are not as important as we are being told. We have to expect that all markets are rationed at all times. There is no equilibrium. It was a nice story.

The emphasis on interest rates is not based on empirical evidence but is in fact based on a theory which is a wild and crazy theory that is based on a wild and theoretical dream world that has nothing to do with the planet that we live on.

Markets are rationed while rationed markets are determined by quantities. It's very simple. There is only one rule-- the short side principle. What quantity of demand or supply is smaller determines the outcome. The short side has power which is why economists don't like to talk about disequilibrium because they don't like to talk about power and the politics and they want to exclude any discussion of politics and for example democratic decision making. The reality is that the short side has power to impose its will on the long side. The short side is the limiting factor and can pick and choose who to deal with. I tell my students they will learn about this when they are trying to apply for jobs. There is always more than one applicant for each job and the selection is not done on the basis of who is working for the lowest salary which is what this model is suggesting. So how is this selection taking place? All sorts of factors will be relevant. Think about how Hollywood stars are being selected. For example, the abuse of power in this market place.

Trade secret number two is that the short side has allocation power and intends to use that to extract non-market benefits. The textbooks tell us that we don't know what money is. Is it deposit aggregates M1, M2, M3? The Federal Reserve says that

there is no definitive answer in terms all its final uses to what is money. The most widely used textbook and the leading textbook in advanced Master-level economics at leading British and US universities on page 3 states that "Incorporating money in models of economic growth would only obscure the analysis".

The economists say that we can drop money because its neutral and doesn't affect the economy but of course empirically we know that this is not true. Economists are always puzzled by this. Now we know that answer is that we don't live in this theoretical dream world that they are assuming.

Let's apply the rationing, short side principal to the market of money. Which is smaller? The demand for money or supply of money? Or which is larger? When I was an undergraduate at the London School of Economics, the professors talked about the money demand function and would draw nice charts on the board and I would think this is so strange. Here is the money demand. Supply and demand functions are horizontal additions of individual demands and supplies and because I am very greedy, my demand for money is infinite. That means the aggregate result is also infinite. The demand for money is infinite because of me because everyone else is not as greedy. So we know that the demand for money is off the chart. What is the short term side? What is smaller? It's the supply of money which is the key factor. So the question then is how is money supplies? Where does money come from? Who creates it? How is it allocated?

Money can be defined and measured. Its creation and allocation is more important than interest rates. How is it actually created and allocated? Well, that's easy the central bank creates money. I did a survey at Frankfurt of over 1,000 fairly randomly selected people passing by on the streets with the help of students and 84% thought that the money supply was mainly created by the central bank or the government which is a reasonable answer given what we are being told but it's entirely wrong. The government doesn't create money and the central bank only creates 3% of the money supply. Who creates 97% of the money supply? It is the banks.

What do banks do? It's time to read more trade secrets. These are the secrets of the banking trade. These are the legal facts of banking. Banks are not deposit taking institutions. Banks don't lend money. When deposits are made with the bank the customer does not actually own the money anymore and you don't have the deposit anymore at the bank. The money is owed by the bank and you are just a general creditor in that you have lent money to the bank. It's on deposit. Therefore banks are not deposit taking institutions. But banks also don't lend money. Why? What do they do legally? Well the loan contract you have signed is considered the promissory note which the banks purchase. So they are purchases of securities. As a borrower you will say I don't care I want the money so well the truth is that you will never get the money. Banks owe money. This is what we call deposits. If they borrow money they purchase the loan contract as promissory note owing you the money. How do they do that? They will say that they have opened an account with you which they call a deposit account and you will find a number in there which is a record of their debt to you which they have invented. In other words, the borrower gets the credit of the amount of money borrowed as a deposit but the borrower didn't deposit it and the bank crucially also didn't deposit it. No one deposited it. This is how the money supply gets invented. This is the trade secret of how banks create money out of nothing.

Let's say you get a one million dollar loan. The bank purchases the loan contract from the borrower and records this as an asset. Step number two is that the bank opens an account for the borrower and credits the borrowers so-called deposit account with the one million. Actually it's an accounts payable item meaning the bank has to pay the borrower but they misclassify it as a customary deposit and this is how the money supply gets invented. No money is transferred to the account of the borrower. It's just a number that is written. The bank doesn't give up anything.

This may sound strange but I can give you a stranger example with real figures and real bank names attached. It's a matter of public record and also a serious fraud office investigation. A matter in the UK in September of 2008, Barclays Bank like other big banks was virtually bankrupt and it needed capital. It didn't want public

money and it needed 5.8 billion in new capital. It said that we have good relations with the Gulf Region, we are talking to the state of Qatar and they will lend us money. So they found an investor to buy the preference shares. The Qatar Sovereign Wealth Fund will buy preference shares newly issued shares from Barclays and therefore Barclays will raise new capital. But Qatar said we will do this however September 2008, the stock market had fallen by 30% and we are mostly invested of course with our billions and we don't want to sell those stocks now. Where do we get 5.8 billion from if we don't want to liquidate any other investments? Barclays had a great idea. We lend you the money. So let's look at the balance sheet. There's a loan contract between Barclays and Qatar which Barclays Bank purchases and therefore puts it on the asset side of the balance sheet. Now Barclays owes Qatar the money that they have to pay out which is an accounts payable item which then the accounts payable on the liability side is reduced to zero and the borrower Qatar is given a deposit of 5.8 billion. So we have a liability swap. Then you issue your preference shares which are also the liability side of the balance sheet 5.8 billion in equity and again you have another liability swap. You draw down the invented, imaginary deposit from Qatar to purchase the newly issued shares and presto Barclays has invented its own capital of 5.8 billion. No wonder the fraud office is investigating but its going to be a white wash.

So banks are the creators of the money supply. Bank credit creation has got to be the key factor in explaining what is happening. Speeding up quickly showing the moving markets.

We are all interested in what moves stock markets. Now stock markets, this is the Japanese equity market, is driven by, the pink line is the equity market, is driven by corporate profit. But by the time this data is out, it's too late so we need to forecast profits. We can do this if we forecast the economy because profits move with the economy and in fact it's the acceleration of GDP. This is the GDP growth rate, the pink line explains corporate profits very nicely. If you forecast GDP you can forecast the equity market. It's not interest rates they follow but it's the quantity of bank credit created for GDP transactions so this is bank credit, that rises first then GDP

follows, credit falls, then GDP falls. So bank credit for GDP transactions explains the economy. This is the quantum theory of credit.

There are three cases. If credit is created and used for non-GDP transactions then you get asset inflation, bubbles, and banking crisis because it's unsustainable and unproductive credit creation. Financial transactions are not part of GDP. If you create credit that is used for consumption that is part of GDP but that is also unproductive and unsustainable. These are not good cases.

There is another scenario. When credit is created for productive purposes, for the production of goods and services or creation of new technologies and of course productive has to be defined correctly to include the environment you will find that you will get growth without inflation even at full employment it is sustainable credit creation. You need to split the bank credit flows into these different types and when you do that it explains asset prices and real estate credit explains real estate prices and GDP transactions. It also explains when you have financial crisis it's always because financial credit asset credit rises. This is the percentage of total credit going for financial transactions. In Japan in the 80s it doubled from 15% to 30%. The total credit was out of hand, way ahead of nominal GDP by definition therefore not used for GDP transactions which turned into bad debts. The banking system had less than 10% in equity you just need a 10% drop in the value of those loans and the banks can do this very quickly.

In Europe, in Ireland, Portugal, Spain and Greece, bank credit grew by 30%, 40% even which was way ahead of nominal GDP growth. You know of course that you would get a banking crisis and a recession which was under the watch of the European Central Bank. In particular when you have concentrated banking systems you tend to get more bank credit for financial transactions. Banks maximize their profits, they aren't supposed to worry about the stability of the economy but turns out that they can maximize their profits best if they mainly create credit for non-GDP financial transactions so that's what they focus on, especially the large banks.

Germany was doing better in the financial crisis because its banking system is dominated by small, local banks that mainly engage in productive credit creation as a result buying credit was in line with nominal GDP growth. It was affected by the downturn but not very much and that's because 70% of banking is either cooperative, mutual banks or public savings banks, local banks that are not for profit seem to create more financial stability. So one of the ideas for public governance is to design banking structures so that we have many small banks which are local banks part of their local community, preferably not for-profit banks because banking is a public utility that is creating the money supply. Let's go back to the story about central banks.

The official story is not true. The fact is that the central banks often cause and exacerbate crises and I want in 2002 in my presentation on central bank risk about this. Central banks pursue their own political agendas because they are major bureaucracies and in political science there is the theory of bureaucracies that bureaucracy wants to increase its power and central banks have found that if they create stability they aren't increasing their power. If they create instability then they can increase their power. The central banks pursue their own political agendas which may include the intentional creation of vast bubbles and downturns. Central bank risk is the risk of the intentional creation of price output and currency swings by central banks. Central bank risk has increased significantly over the years and is now at a historically unprecedented level higher than it was over a decade ago. With the rise of the central banks we have had higher frequency and bigger amplitude of financial crisis. There is a correlation here and central banks after each crisis have been made more powerful although I've been warned about this and it happened again this crisis. The bank of Japan, bank of England, and the other country's banks all became more powerful.

The implication of public governance we need to reconsider central bank independence. It's not such a great idea are independent nor is it accountable to democratic institutions. They need to be made democratically accountable and that

is where new approaches to implementing accountability in democratic processes will be very useful and I think this conference can contribute to this.

I would like to give you two minutes on a wider topic and perhaps at a future conference we can focus more on this more broadly. We have this broader topic of instability and we have mentioned these key factors here but there are broader problems with our system. Environmental problems and resource constraints are also connected to instability and crisis. Our financial system is based on debt created by banks. That is the money supply and this debt has to be repaid with interest. For the majority of recorded history, leading thinkers have been saying that it is bad to charge interest and they have said we should make interest illegal and interest was illegal in Europe until 250 years ago in all countries. Now economics is being created in order to justify the charging of interest. We had seven justifications for why we can have interests and charges where we should have interest and why it is justified. But all of them are based on a world where the money supply is very different from the money supply that we have. Think about opportunity cost, the fundamental argument. You are a lender and you have to give up something. You give the money to someone else and then you cannot use it. This is the idea that money is a physically limited item. But that is not the money we have. Banks invent money out of nothing. So the opportunity cost argument goes out of the window.

The other arguments also go out the window. Interest is just a transfer payment and it is not justified in the economy but there is actually a reason why there is pressure on everyone to create growth. We have been told that growth is necessary for our lives which are not true. Growth is needed to service the interest of the debt but if we had a different monetary system we wouldn't need this so-called growth and as the physicists tell us, there is no growth. There is no real growth. Growth is an illusion created by accounting. There is no growth. Planet earth has a constant stream of energy coming in from the sun and that's it. The rest is a closed system and we have created the accounting illusion of growth by not counting the depletion of existing assets. We just don't include that. So the environmental distraction is not counted and then you get growth. That actually is a fiction to perpetuate the debt-

based monetary system and transfer wealth from the many to the few. There is more work in my books that I mentioned. Thank you very much.

MODERATOR: Dr. Jia-Dong Shea

Thank you very much for your speech. I am sorry that because of the time restraint we were unable to continue discussing this topic and finish your speech. Since I have served at the central bank for some years I really admire your research and agree mostly with your comments on the central bank. Especially when you talk about central bank risk. Let's welcome Dr. Sebastian Schich.

(II) PRESENTATION

SPEAKER: Dr. Sebastian Schich

Let me thank the Insurance Guarantee Fund for the invitation and for hosting this conference and there is a promising line up of distinguished speakers and I feel honored to be part of that group of speakers. I will talk about some of the work that we have been documenting for the OECD Committee on Financial Markets. I support the OECD Committee on Financial Markets but its insurance private committee. The committee consists of many central bankers and finance ministry representatives from all the 34 OECD member countries. The usual disclaimer applies is that what we are going to talk about is not necessarily representative of OECD or its members.

There are three lessons from the financial crisis. It's a reminder that a safety net is not afforded alone by deposit insurance. The whole financial safety net with all the different functions comes into play. Deposit insurance was never meant to be an arrangement that by itself could deal with this financial crisis alone. Another lesson from the crisis is that the safety net was extended to a larger set of institutions. Previously mainly focused on deposit taking banks but in this case it was extended to a lot of access to its functions. To investment banks, insurance companies. Third, in terms of the functions provided by the financial safety net there has been a major change in the sense that one function that to some extent has always been implicitly there has become a more explicit element of the financial safety net and that is the

function of the Guarantor-of-last resort. Now that function is now added to the traditional functions which consist of the lender of last resort and the deposit insurance. In order to counterbalance the metrics rising from access to these functions there is also regulatory and supervisory framework that rains in the risk taking of things. The new thing in this crisis is that the financial safety net effectively has been extended to also include in a more explicit way the function of the guarantee of last resort. That has had some undesirable consequences.

First of the undesirable consequences is that it has further entrenched the perception of that bank that is special. That perception was already there but it has certainly become stronger as a result of the policy response to this crisis. The perception that benefits from the guarantee provided by publicly supported institutions all by the government directly and while that is only a perception, that's why the guarantee is only implicit, its not an explicit guarantee and it's not legally enforceable, its an implicit guarantee but nonetheless it has a value. It has a value because banks can fund themselves at lower funding costs compared to other issuers.

There is a host of different costs that come with the existence of implicit payment guarantees such as too cheap funding generates incentives to take additional risk. These differences in funding costs that also give rise to competitive distortions. For example if some banks, bigger banks that benefit from more favorable conditions than say smaller banks or systemically more important banks benefit from larger funding cost discounts then non-systemically important banks. Governments are encouraged through these implicit guarantees potential liabilities. In fact rating agencies do take that aspect into account when rating sovereigns.

In recent work with the committee of financial markets we have also looked at the macro economic consequences of the presence of a bank with implicit guarantees and we have looked at ---. What we find is that typically in countries where banks do have more benefit from higher risk guarantees in general the trade off between finance and growth is less favorable in the sense that. First of all we find that finance

is beneficial for growth but this is only true to a certain point. The OECD to a large extent has already reached that point in the sense that more finance doesn't necessarily add to more growth. In those countries where we see the largest implicit bank guarantees that trade off is most unfavorable. This suggests that the banking sector has grown too much simply because of the presence of implicit guarantees.

Now implicit guarantees are just one of several factors that explain systemic risk. Policy makers have recognized these costs and they have announced their attentions to reign in the value of implicit banking guarantees. In order to support these efforts we conducted a survey in 2013 among its member countries covering three different aspects: measurement, analysis of the determinants and the third one is the policy response to this situation. 35 countries have responded to the survey and these two publications have been released.

The first aspect measurement is how is the value of implicit bank debt guarantees measured? A very important point is that there are no official estimates of the value of implicit guarantees. In fact one of the difficulties we have in doing this survey was that especially these days this is a sensitive issue to argue that some types of financial institutions are benefiting from preferential funding and especially when compared to other financial institutions and compared to non-financial institutions. So we were very careful in revising the survey so that it wouldn't give the impression that the government is intending to subsidize banks. For example in one of the questions rather than asking how governments estimate the value of implicit guarantees we asked whether they are aware of any credible estimates of such things such as implicit guarantees. This is a disclaimer one has to bear in mind which is that there is no official estimate of the value of implicit guarantees.

Different methods are nonetheless being used. Several respondents say that several of these responses are leading to credible results and whenever these methods are used. For example even when studies that look at credit rating agencies or look at the difference between the all-in issue rating and the bank intrinsic strength rating all other studies that try to filter out from observed yields by controlling for risk

factors, all these studies show that the value of implicit guarantees is substantial. It is often estimated to represent the equivalent of 1% of domestic GDP. In crisis situations, this value could rise to close to 3% of domestic GDP.

Here is an example. If you look at this chart in the package you can see estimates that were compared to the survey responses you can see for different periods. The first period is the left hand side is the period before the financial crisis. You see already that this bank of guarantee has been involved and that each of those dots is the estimate for say one to three years in one of the member countries. They have all been mixed up together and because we are going to keep their neutrality we didn't keep all of the periods. The individual dots represent estimates for different countries and what one can see clearly is that we are moving from the left column to the second column which is estimates during the financial crisis. When moving to the second we find that rates have increased. The axis gives the basis points of interest rates. So this is the funding cost of that banks benefit from.

Now after the peak of the crisis, in the period of 2010 these implicit guarantees have gone down in value a little bit. Nonetheless the last column shows long term average estimates and they are still substantial.

Then coming to the second aspect which is what drives the value of implicit bank guarantees? One important finding that has been highlighted especially by the European Crisis is the close relationship between the strength of a sovereign and the strength of banks. What we have seen is that in many cases the observed decline that we saw in the previous decline, in many of those cases it reflected just the fact that the sovereign behind the banks did itself suffer a decline in credit strength.

Our work suggests that in order to explain the strength or extent of implicit guarantees you have to look at the strength of the sovereign. The other aspect which has to do with willingness or capacity of the sovereign and of the financial safety net in general allows for smooth failure. The other aspect is of course how smooth exit strategies for banks. What we have found so far is that there are various methods taken to make bank failure resolution more effective have not been very much

reflected in the estimates for implicit banks of guarantees. What has however had a major effect is when new resolution regimes were introduced and when those new instruments available from those regimes were used in practice and in bond practice did actually incur losses.

This is a slide that should be right before the end of the package and which is essentially where we stand after the policy responses which go afterwards. Essentially credit rating uplifts are still very substantial. Here in these charts what you can see is the credit rating uplifts. Credit rating agencies typically set a variety of different ratings and one of the ratings of course is the ratio and another is the standalone profile. By subjecting one from another when you get an estimate of assumed external support and the difference is that it is expressed in credit rating notches. Notches is the difference between one rating category and the next rating category and of course one could hear just the credit rating and that one could just transform them of course also in yield advantage just by projecting them onto the yield advantage of each of those additional rating uplifts corresponds to.

Coming to the third item is the policy response. Essentially what we consider is that with the introduction of this new function, the function of the guarantee of last resort and that is now being perceived by market participants even more strongly to exist even more so than before the crisis. What can we do to reduce it? Essentially there are three different ways. There is one possibility which is to make the base stronger which is of course the obvious choice because the stronger the bank the higher cost of the value of the guarantee. Simply the guarantee doesn't have value for a strong bank. Another possibility which is to strengthen the capacity to withdraw the guarantee and here in this particular context what we mention about bank failure resolution, regimes etc. And then there is a third possibility which is charging for it. Now charging for it is somewhat complicated. Charging is a little complicated because to some extent at least if charged explicitly that also means that there is recognition that the implicit bank of guarantee does exist. So we have at least a few months to come up with a very lengthy questionnaire which looks at the whole range of bank structure reform measures which have been undertaken. There

has been the acknowledgment that not all of these bank regulatory reform measures will mend or directly affect implicit bank guarantees. But there are several responses expected that the whole penalty of bank regulatory reform would actually have an affect on the value of implicit bank guarantees. These three different categories. There is the category that goes up to here, which is strengthening banks, so all of these measures have to do with strengthening banks. You can see the two shaded parts. The dark shaded parts are the measures that have already been implemented and the lighter shaded ones which are either being implemented or are being considered for implementation. So you see that there has been quite a lot being done in terms of strengthening base. For example, is Basal 3 and then there's another group of policy measures which are trying to withdraw the guarantees. That starts from here and goes down to here which has a lot to do with making exit for the off banks more smoothly functioning. Finally there is a category which is charging for this advantage. There is much less enthusiasm among policy makers for this choice of policy. In order to incentivize to use these guarantees less and undertake measures to become less involved etc. in order to reduce those surcharges. That's not very popular as you can see. However as one can argue implicitly to some extent, some part of regulation is doing exactly that. Such as the technical surcharges of Basil 3 are effectively penalizing banks that are becoming susceptible more important than others.

This is now aggregating these three things that I just showed. Here again there are 33 individual policy categories and this is just giving the overall result for each of the three different categories. One can see that other strengthening banks or strengthening capacity to withdraw guarantees is very much accepted as a general, standard approach. This chart shows the result of a question pointedly asking "How would you describe the whole mix of policies in terms of its overall effect. Here one can see that most respondents clearly thought that what they the bank's regulatory reform policies that were happening in their country were doing is trying to first of all strengthen banks. Also there is a large group of respondents who consider that strengthening the capacity to withdraw the guarantees sounds like something that

very well describes the other policies. But charging a user fee was not part of the description of the policy put in place. On the left-hand side you can see the measures that have already been implemented and then on the right-hand side the measures that are being considered. As one can see that in regards to the measures being considered, there is a little bit more emphasis or more people believe that moving forward more will be done to strengthen the capacity to withdraw guarantees.

Here are a few examples of those and in particular measures to withdraw the guarantees. The first one as I already mentioned is to make the -- resolution more effective. Another one that is currently being discussed is the idea of so-called structural reform of banks which essentially means that proposals or in some cases already being implemented to either prohibit altogether certain banks undertaking certain activities or at least require banks to conduct them in ring-fenced parts of their overall goals. Examples of those proposals or actions already taken are the Vickers Report in the United Kingdom and the Liikanen Report in Europe which is now being followed up across the benefit analysis of the various suggestions. The update report has been done and the OECD has actually largely contributed to that analysis and we are also helping the IMF and FSB in looking at how these various structural measures which have unfortunately been conducted at a national level and how consistent they are across countries. The groups that they have been applying to, i-international groups and as we know before the crisis the regulatory arbitrages is a big issue. What we are trying to find out is to see whether the fact that national approaches have tainted slightly different lines whether that actually creates some inconsistencies. The FSB has already published their first report in October and we will update that report in a year from now. In particular we will also look in this context at the consistency of these areas reformed, measures on the OECD authorization.

That seems to be it already. I had also prepared a few questions but first I will briefly summarize. The findings regarding bank regulatory reform. One key point is that we have seen a reduction in the value of implicit bank guarantees. However that reduction has not necessarily been achieved for good reasons simply because of the

weakness of the sovereigns. That's not something we can be particularly proud of. Another finding is that going forward, the main focus on bank regulatory reform, is really to try to withdraw the guarantee and policy makers feel very comfortable describing their policies to reduce the values of implicit guarantees as either policies that I aim to strengthen based on or want to increase the capacity to withdraw the guarantee. This raises a communication policy issue because this is a tricky business. On the one hand, policy makes explicitly stated that they want to take away these benefits so its difficult to come up with estimates because these estimates are based on models that make assumptions on reactions. This is a complicated issue because it's not necessarily a finding but more of an open question. We want to figure out whether or not our communication can be improved in some way whether policy makers should not be more upfront about the value of implicit guarantees and also thinking about what value it should go to. Should it go to zero? It would be helpful if policies would help us address these particular issues upfront.

I wrote down some questions we can consider in this conference during the remainder of this meeting as well as provide names to insurance companies as well as policy or protection schemes for insurance companies. Thank you for your attention.

(III) PRESENTATION

SPEAKER: Dr. Nobuyasu Uemura, Managing Director, Capitas Consulting Corporation Japan

Good morning, my name is Dr. Nobuyasu Uemura. I'm very happy to have this opportunity to speak at this TIGF conference. My presentation is focused on sharing our experience of life insurer's bankruptcies in Japan and I will tell you about the developing of solvency regulations for insurance companies in Japan. Before starting, I would like to introduce myself and explain my background.

I belong to Capitas Consulting Corporation as a Managing Director where I am responsible for supporting and encouraging enterprise risk management for ERM framework for insurance. Since November 2012, I have had experience analyzing and assessing life and non-life insurers' management as a credit analyst and regulatory officer for about 20 years. From 2010-2012, I was working at FSA Japan as a specialist for ERN and primarily in charge of monetary and encouraging insurance ERM as well as upgrading solvency regulations. Before joining FSA Japan, I was with Rating and Investment Information Inc. (R&I) which covers mainly insurance companies in both life and non-life. I had been working as a credit analyst, mainly covering insurance companies in both life and non-life. Also, I was fortunate enough to attend Japan's Waseda University and received a PHD in 2008. I studied mid-size insurers' bankruptcy in Japan.

Today I will talk about a series of mid-sized life insurance companies who failed from the late 1990s to the early 2000s in Japan. I believe that our experience is something universal and I hope that by sharing our story we can help the overseas insurance industry. In my presentation I will also introduce the current trend in solvency regulations and my viewpoint based on my regulatory experience in FSA Japan. Of course it is based on experiences from a series of bankruptcies.

First, in Japan from April of 1997 to March of 2001, seven mid-sized life insurance companies failed in just four years. All of these seven combined assets of these companies accompanies for over 10% of the total industry in Japan. First of all, some of the midsize life insurers suffered from solvency problems. As you know, life insurance liabilities are is very popular, especially in Japan. They seem to have a huge gap between the duration assets and liabilities. The life insurance's top management priority is to cover the long time coverage requirements because they have significant risks to change in the financial market, in particular interest rate. Market and credit risk are also important for life insurance. Depending on asset portfolio.

The Japan life insurer's bankruptcies crisis is characterized by mid-size life insurance companies with a big history and large customer base went under, not newly established or small-scale companies who are generally financially burdened. On the other hand, a few mid-size life insurance managed to maintain their financial health which suggests that the payout of Japanese life insurance was not merely caused by the external factors common to all industry players.

However, many observers believed that these bankruptcies series resulted from structural programs and not these individual insurance companies. We cannot deny an explanation for this situation. These bankruptcies have resulted from the economic situation in Japan such as declining interest rates, stock and land prices. Let's show interest rate history. Here on the graph the x-axis shows the time period over about ten years and the blue line is the assumed interest rate or I mean the guaranteed rate. Many insurance companies declined such a way, but it's a new contract case that other these insurance companies use.

We should also take into account the business environment in the 1980s. Assumed interest rate or the guaranteed rate raised and there was burden from dividends to policyholders. In the 1980s, are these the only external factors accounting for the bankruptcies themselves?

In my studies, I took the oral history data through in W with formal executives, actual leads, investment managers, or failed companies. I have determined that these bankruptcies were not only caused by external factors but also internal factors unique to bigger companies. I have included three types of internal factors Related to business models, related to management team, and related to management structure. Both these internal and external factors drove those insurers to bankruptcy.

Let's look at the example of Nissan Life. The total assets of Nissan Life expanded rapidly by sales of high interest rate, saving type programs through bank Ag models shown on this chart here. You can see that their total assets in 1989 amounted to nearly four times in 1986. What happened in management. Actuaries warned

management but couldn't retrain the sales division and warnings fell on deaf ears. The only information that reached the president was that "things were all right". The nominal data was good but it did not reflect the actual state of business.

The next case is Chiyoda. Chiyoda suffered a large number of bad loans but strangely enough their bad loans consented the lending in the 2.5 years between 1988 and 1990. for my examination I found that Chiyoda Life's president Mr. A was his right-hand partner but had no experience in asset management. I introduced some testaments. He was backed by the president and after the unusual transfer of several objectors no one would dare to speak up. To reduce criticism, the number of participants in asset management was reduced while later leading to a system in which plans were directly brought only to Mr. A.

The next case is Kyoei Life's case. They had a unique customer base including teachers union. In mid-1980s, they shifted to active sales of long-term saving-type products following other insurers in the mid-1980s. They also suffered from a serious negative spread problem because Kyoei continued sales after its rivals had already stopped. They suffered from a serious negative spread rate compared with their rivals. Look here is the industry average of asset increasing and here is Kyoei increasing. Comparing industries, Kyoei is increasing small in the 1990s. I could get the testimonials. Mr. B, who is the founder of the company, had told himself that he had retired in 1992. But his successors depended on his business judgment. Despite he merely expressed his feelings. Why ask Mr. B? Also in the company I found that through certain members of them management team know the real business status.

What can we learn about these failed bankruptcies in Japan? These failed insurers had "self-discipline", "solvency regulation" and "market discipline" not work properly. The most important internal factors are related to managers. The most important internal factors were related to program of top executives, inappropriate behavior around top executives, and a dysfunctional management team. Even if a company advised risk management system, it won't work as long as it is used for top management.

Next I will show you the trend in solvency regulations based on the series of bankruptcies shortly. Before the reform of the Insurance Business Law 1995, we had a complex system for insurance industry. Ministry of Finance had strict regulations however could not prevent worsening life insurer's solvency. The features of current solvency regulations include introduction and revision of solvency margin regime, promotion of self-discipline, and enhancement of market discipline. I should also say that there was a response to international prudential regulations from FSA and so on.

Here is a calculation of solvency margin ratio. FSA uses this ratio in Japan for prompt correction action. FSA also has an early warning system and they are monitoring insurance on a constant basis even when the solvency margin ratio is 200% over. See here it's over 200%.

When Japan introduced SMR, many insurance companies already suffered from their financial difficulties. Several insurance companies raised over 200% solvency margin ratio. Therefore FSA formed a committee in 2006 whose members were mostly FSA members and I was one of them. The Review Team proposed a two phase review in their report as a short-term solution and the ratio will be applied more smoothly, as a current scheme, economy value-based solvency regimen methods will be included. Based on their report was a current scheme and they are preparing for a mid-term review.

I would like to introduce promotion of self-discipline. Though there is no clear cut definition of what ERM is but we believe that the purpose is for sustainable enhancement of corporate value while maintaining health under their risk appetite. It is different from traditional "silo" risk management systems. They attempted to control corporate values and comprehensive risk management. Why are the regulators paying attention to insurance ERM? I think if FSA believes that steady improvement in corporate value will help policy holders.

In 2011 I was in FSA who revised the insurance inspection manual for their outside inspections. In early 2014, they did design supervisory guidelines for insurance

companies including introduction of ORSA (Own Risk and Solvency Assessment). It's also a response to international trend in supervision such as ICP16.

I introduce some ERM related information. T&D is a major life insurance group and insurance company. They want to stable growth through corporate value.

(MS&AD) is one of the major insurance groups including life insurance business. This portfolio disclose MS&AD's risk appetite and also disclose misplaced management framework. In Japan many insurance companies develop their ERM framework and the regulator is also encouraging this framework.

Finally let me talk to you about the difference between banks and insurers. I think that the international banking system becomes more and more tough. It is effective in the insurance sector but in general, risk categories are much more diversified than the banks. The major risk categories including, underwriting risk, ALM risk, market risk, credit risk, liquidity risk, and operational risks. Furthermore, liquidity risk is limited compared to banks especially in Japan because many insurance companies focus on protection type programs. We saw a mass cancellation after a series of insurers bankruptcy. However, there are no insurers who failed by liquidity crisis from cancellation according to my observations. Of course, maybe the effect depends on the main products and distribution channels, but it seems to be substantially different from banks failures. I believe that it is more effective to encourage insurance ERM to avoid a series of bankruptcies by introducing hard regulations. This concludes my presentation and thank you for listening.

Thank you Dr. Uemura. In Taiwan we always say that its development is lagging behind by ten years. What he described in how Japan deals with life insurance bankruptcies is really important and helpful for our Taiwanese audience here. Next let's welcome Professor Yeh Yin-Hua.

(IV) PRESENTATION: Prevention and Response-Exploring a new global approach to financial stability in Taiwan

SPEAKER: Professor Yin-Hua Yeh, Professor of Finance, National Chiao Tung University

Ladies and gentlemen it's my pleasure to be here to talk about the prevention of the financial crisis and response. I will discuss a new approach to financial stability and also use Taiwan as an example to describe the importance of the prevention and response to the financial crisis. I will use a frog as a metaphor for financial stability. As you know, if you put a frog into hot water the frog jumps out. However, if you put a frog into a pot of cool water and gradually increase the water's heat, you can boil the frog before he knows what's going on. I ask you a question. Who is the frog in the financial stability system. Regulators? CEO? Financial institutions? What is the heat? Economic growth continuously economic growth and the management team of the financial institutions become overconfident. Then the economic system becomes the irrational explosion. I can use a sentence to describe the financial crisis. What is the meaning of privatized profit, socialized risks, what's the meaning of privatized profit? Before the crisis, the managers of these institutions designed high-return and high-risk financial products. They earned their own compensation. The financial institutions had excess risk and some big financial institutions finally went bankrupt. The government used the tax revenue to bail out these financial institutions we call socialized risk. Therefore the operations of the financial institutions created the external costs. We need to build up the financial stability system to internalize the external cost.

After the financial crisis, it became more important to enhance prudent supervision. Before the financial crisis, the financial institutions required the supervisory authority to deregulate the meaning which focused on the short-term return. However, after the financial crisis, the supervisory authorities regulated again. We called this deregulation or re-regulation. These are not true-false question. The financial stability system needs to encourage prudent balance between risk and search for return in the broadly-defined financial system including shadow financial system. The two are restoring confidence in the financial system.

The fourth part of my presentation will be focused on the prevention of the financial crisis and explore a new approach to financial stability. I used this slide to emphasize the importance of the financial stability system. I will approach the macro-prudential approach in order to achieve systemic stability on a global level. When the Neiman Brother went bankrupt in 2008, the overseas financial institutions were shaken so the Basil 3 for the banking industry globally. The Basil 3 risk and the BIS Ratio and also increased their requirements and also required the financial institutions to do the stress test and increase the monetary strategy to resolve the gap. It's at a global level to establish the Macro-Prudential Approach in order to achieve systemic stability.

Second, as you know after the financial crisis, many countries adopted loose monetary policies and the QE create the excess bubble. Each country also needed to establish the Macro-Prudential Approach to achieve stability in a country that has a high level. The central bank and the financial supervisory authority needed to cooperate to manage the risk of the whole financial system in their country. For example, in Taiwan we require the banks to raise the permission of bail out real-estate related loans.

Then we talk about the Micro-Prudential Approach. Every financial institution needs to establish a sound government and risk management system. The most important aspect of the financial stability system is the financial institutions really need to enforce the corporate government and risk management system to self regulate. I will use the financial supervision framework to emphasize the importance of macro and micro-level approach. Every financial institution needs to establish this sound government system, risk management system, and internal auditing system. The financial supervisory authority prepared the practical guidance related laws and relations for the financial institutions to follow. However, I would like to emphasize the importance of information transparency. As we know, the financial reporting before bankruptcy usually does not show the sure signs of financial difficulties. If the financial reporting is not transparent, any supervisory tool will be useless. So we need external auditing conducted by the CVS firms and the financial explanation

adopted by the financial supervisory authorities to ensure information transparency from the financial institutions.

Then I used the BIS Ratio. If the BIS ratio, the capital enterprise ratio is too low, the authority might require the larger share holder to inject capital. If the BIS ratio is below the 2% the authority might take over. The BIS ratio raised the capital ratio and the provision for bail out. Let me introduce the importance of prompt corrective action. If the BIS Ratio is below the 2% the bank can take over.

Now I would like to use the OECD Strategy to emphasize the important of the compensation scheme. The compensation scheme is the main root of the financial crisis. I would like to emphasize the importance of the compensation scheme should be linked to risk over a long term performance. If we want the compensation scheme linked to long-term performance, the evaluation process needs to take risk and long term performance into account. If the evaluation process can consider the balance between the risk and the return. We use the risk adjuster return on capital to evaluate the performance of every department. The financial institution staff will consider risk and long term performance when regulating banking activities. All the staff and managers dedicate themselves to balance the risk and the return when operating. This is OECD Strategy which is based on risk management and corporate governance.

I used the dolphin phenomenon. What is the dolphin phenomenon? The manager of the financial institutions designed high risk and high-return and use high commission to motivate the staff to invest in them. Later the financial institutions bear excessive risk. this is the dolphin phenomenon. We need to apply the OECD Strategy to financial institutions. There are three tools that will ensure the compensation scheme is linked to risk and long-term performance. First the risk return on long-term capital. The return divided by the risk. The second is deferred payment and the third claw back provision. These can all push the managers to consider the risk of the long-term performance and risk.

We will talk the fire extinguisher to deal with this issue. I will use Taiwan as an example. The central bank of ROC (Taiwan) stipulates that maintaining financial stability is one of their objectives. Our central bank established financial stability framework and adopted the financial assessment framework to monitor financial risk in Taiwan. As we know there is a real estate bubble in Taiwan. More than 30% of the total bank loans are for the real estate industry. So the central bank says that there is some constraint. They use the loan to value as an indicator to constrain the real estate related loans. Taiwan introduced luxury tax to impose the tax burden for the short-term real estate transaction. Taiwan plans to introduce capital gain tax for property income. The financial supervisory commission also made plans to increase the provision for bad loan related real state. The central bank and the financial supervisory authority cooperated to build the Early Warning System.

I want to describe the fire extinguisher of the stock market. Our country set up the Joint Settlement and Clearing Fund (JSCF). It's from the trading commission. The total amount of the fund is 6.5 billion NTD. If the investor purchase or sells stocks without sufficient settlement funds or stocks we compensate the shortfall.

The second fire extinguisher is the Investor Protection Fund was established along with the Investor Protection Center. The total amount is 7.2 billion NTD. There are three functions. First there is the legal recourse just like the class action suite When the corporate malpractice occurred, and more than 20 investors occurred, the investor protection fund was launched and the class action suite was launched against the insider or the stock price manipulation to compensate the investor's losses. The corporate malpractices include the fraudulent reporting, inside trading, and stock price manipulation.

The bank market has two fire extinguishers. Our government established the Deposit Insurance System and the Central Deposit Insurance Corporate. When the banks go bankrupt, they will compensate the shortfall to protect the interest of the depositor. In the year 2000, the corporation had another fund to resolve the problem banks so our government also established a new fund in 2001 which was a

financial restructuring fund. There are two sources of this fund. The government financial business tax revenue from banks (17 billion NTD per year) which is due in 10 years and the second source is the deposit insurance premium income. 8 billion NTD per year.

Last but not least is the insurance market. Our government built up the Taiwan Insurance Guaranty Fund. When the insurance company goes bankrupt, this fund will compensate the shortfall and they will take over the insurance company. The fund resources. The funds are resourced by the government, from the non-bank institutions (8 billion NTD per year) which is due in ten years. Another fund resource is the policy premium income which is about 3 billion NTD per year. In Taiwan we built up the financial safety system.

Finally the financial stability system is supposed to enhance their confidence. How do we prevent financial crisis is the most important and more important than the response. How do we prevent the financial institutions from this crisis is by ensuring information transparency, early intervention, timely resolution, and sufficient funds. Thank you for listening to my presentation.

(V) DISCUSSION 1: Dr. Cheng-Mount Cheng, President of Taiwan Academy of Banking and Finance

Thank you for the invitation to be here and all the participants all have great things to contribute with excellent ideas. The first slide shows the relationship between Taiwan's bank loans and housing prices. You can obviously see that since our central bank began to adopt this macro-prudential policies and limit capability of banks to expose credit on mortgage loans. The percentage of mortgage loans has been on the decline over the past few years. We don't see that as a significant impact on the housing prices which seem to be increasing. Why is this situation? Why the central government's policy does not include housing prices. Some of the reason is regarding the capital flow. This chart is coming from the balance of payment. The other investment is not the portfolio investment so it's called the other investment. The majority of this other investment is bank loans. I also exclude the bank loans.

This is other sector and other investment. I use this to become a proxy to describe the current money inflow into Taiwan. That money is not accounted for in portfolio investment or direct investment. The blue line is conducted by the local people and you can see the blue line has a peak which is when the government reduced inheritance tax. We continue to have a very positive inflow after 2008 from Taiwanese people which is a very important factor as to why the central bank does not close down the housing prices. In your presentation do you think about the government policy response to the capital flow?

In particular, I find Dr. Werner's paper very interesting. I applied some of his data. This chart shows the relationship between bank loans and nominal GDP. Dr. Werner's presentation mentioned that if the bank loan grows too fast, this might be signs of indication that the crisis is ahead. So you can see where this is happening in Taiwan's case. For example 2009, in 2008 we see the bank loans growing fast. In 2009 we have a crisis. In 2010 we have a quick recovery in bank loans. We see a match in growth and we are confident that we won't have a crisis in Taiwan this year.

Coming back to the four presentations I think they are all very wonderful. I will spend more time on Dr. Werner's paper. He has a doubt about the central bank and thinks they should be responsible to the government and democratic process. In Taiwan we have a similar situation. If you look at global bank, we think about how dependent are these central banks? I always say that Korea's central bank is more independent than Taiwan's central bank. The one question is that what do you expect? I heard many stories that it's not just a great central bank but it's also a great politician to be able to allow this fact to be independent and this is his great achievement. Under the current Taiwan situation, if we want Taiwan's bank to be accountable but we know that congress is divided. If you have a divided congress and don't have a consensus on how these banks should write this policy, what should be the result. That is my question. Doctor Werner also mentioned the role of the interest rate and suggested that banks should not charge interest and the banks should have a full deposit. If the bank cannot earn the interest and if the deposits are

real deposits what is the function of the bank? You mentioned that the sovereign right to allocate the money supply should be converted to the local community and issued as community work undertaken. How do you create this local community and how do you guarantee that this local community performs the function that you mentioned?

To Dr. Schich, I find that this topic is very interesting and he mentioned the guarantee for bank debt. He mentioned the costs were different during different periods and he mentioned that the current issue is what are the costs and benefits of debt bank guarantees. The suggestions from the western and eastern world are different. In the western world they have already experienced the financial crisis so they can see the negative repercussions of the increased guarantee bank debt. However, in the east such as China just established their guarantee mechanism last week. In the beginning of this experiment, what do you suggest for China when they establish this loan guarantee fund?

Dr. Yeh had a wonderful presentation on the mechanism regarding the financial stability assistance in Taiwan. My question to him is that you mentioned the early intervention and the resolutions of insufficient funds, but I think in Taiwan's case these are not performing efficiently so how do you suggest that this will work.

Dr. Uemura, you mentioned the suggestion that these life insurance companies in Japan and you see that their situation is improving nowadays. My question is that with these improved policies and with Japan treasure yield dropping to 5%, how will Japanese insurance companies continue to buy the Japanese trading when the yields are so low and the Japanese inflation rates are so high. The real return is negative. If the VOT continues to print more money, the yield will become much lower so will that be another crisis for your life insurance companies?

SPEAKER: Professor Kuo-Bi Lin, Professor of Law, National Taipei University.

Good afternoon ladies and gentlemen. I did not prepare slides and I am honored to be here. I got my JD degree from the University of Pennsylvania and I am one of the directors of TGIF I said as well as Dr. Uemura is also one of the members.

Today I am personally really enjoying the presentations from these great professors and doctors and international colleagues. For our international friends to use the translator machine, I will use Chinese to make my comments and discussions. Thank you for much.

I personally want to share my experience based on laws as well as my work experience to analyze my opinion. We talked about the different bank situations. The bigger problem is that we see interest rate decrease in banks throughout the world, but when this interest rate decreases we haven't found a way to protect this industry. A lot of companies have a higher interest rate, but we need to look at these older banks to talk about insurance

(CHINESE AND NO ENGLISH SO I AM NOT GOING TO RECORD THIS PART)

SPEAKER: Professor Werner

You made great comments. Number one was the complete question of how to make a central bank accountable if we don't have a system where the central bank is completely independent. Here is it important to distinguish between the government's ability to influence a central bank and the ability of an impractically elected assembly to influence the structure and functioning of the central bank. I don't mean to suggest that Parliament should decide the day to day monetary policy, but we have many examples where Parliament intervenes to change the setting and goals and the design and principals of central banking. They can interfere successfully. The ECB and its structure is a key example. It is often said it was successful because it was modeled after the bonders bank. If you want to understand the success of the bonders bank you need to understand the Icebank which was the least successful central bank in history that wasn't accountable to government or Parliament and outside any reach of Germany. It was an illegal entity

and was essentially a foreign institutions accountable only to the Reparations Committee which was later renamed the Bank of International Settlement. The central bank created bad policy because there was nothing that anything anyone could do. When the bonders bunk was created, it was made less independent. It was independent from government but it was responsible to government. It had to have lower inflation but also lower unemployment and a stable growth. The other point is the alternative monetary system and what is the role of banks and of course this a profound and good question. The alternative to our system is that banks don't create the money supply but act as financial intermediaries meaning collect funds and lend them out which is what many textbooks erroneously claim they are doing now but they're not. This is what banks could be doing. Who would create the money supply? It should not be based on debt but on the services rendered to the community. When you do something for the community (government) then you get credit that will not incur interest rates or debt. The last speaker pointed out that there is a transfer going on with the insurance agency who are made to pay effectively with lower interest rates and that is true. It's an important recognition but it's not just affecting insurance companies but also banks suffer. The interest rate policies are counter productive. They claim lower interest rates stimulate the economy but that doesn't work. When the lower interest rates are low, this puts pressure on other players. Central banks in Europe are also lowering long-term interest rates through their bond purchase operations so we get a flat yield curve which hurts banks. In Japan this is the situation, the bank profitability will depend on the yield curve. In the current system we won't get a recovery. In fact this is very counterproductive in most places. Thank you very much.

SPEAKER: Dr. Schich

First of all I would like to thank the chair for his excellent steering. I don't have much to add. I would like to add as a reaction to something Dr. Cheng said. The implicit bank guarantees are different between Europe and Asia. But this is relevant in Asia, and in Korea. We have measured a consistence of implicit guarantees in this country. Another big issue is the issue of China which you rightly pointed out. The

issue is extremely serious in China because the whole system is based on the chain of implicit guarantees but guarantees that goes beyond things like wealth management projects. The introduction of deposit insurance in China will be helpful. Only with a safety net with borders is there only way to impose some losses.

SPEAKER: Dr. Uemura

I would like to explain our insurance situation. In Taiwan, its guaranteed one hundred percent but in Japan it's not such a good system. In Japan our guarantee fund, 90% is guaranteed. Under the bankruptcy situation, the guaranteed rates for insurance companies declined. The benefit cut is very high if the time is so long. There are so many Japanese that if the insurance companies are cut out, they are also cut out. We have a scheme of influence of public fund but we don't have the experience of using public fund. Bank and insurance is a little different in the Japanese economy. Japanese insurance companies don't like to write such a low interest rate, but insurance companies have a long duration of very lower interest rate liabilities. Life insurance companies, liabilities, interest rate risk, already purchased a long time ago but they also have the right interest rate risk. For example, here are the ERM. The purpose of ERM is appropriate risk management.

SPEAKER: Dr. Lin

(CHINESE RESPONSE)

SESSION II: Public Governance and Avoidance of Economy-wide Risk

Moderator: Professor Chen-Min Hsu, Professor of Department of Economics of National Taiwan University

We have two presenters, one who works in political science at HK University Dr. Hye-jee Cho. We also have a graduate of University of California Los Angeles. She worked in the University of Rochester. The second speaker is Dr. Chung-Shu Wu who is now the president of economic department of Taiwan National University and research fellow at Academy of Economic Research Fellow. His presentation is

on investigating the economy based on Taiwan's life insurance industry. After the discussion we will discuss two papers and then after the discussion we will have a Q&A. The first presentation today is Dr. Cho.

PRESENTATION Dr. Hye-jee Cho

My argument is very simple. I will share my findings on my research that is part of a book project where I examined the effects of political institutions (domestic and international levels) on sovereign credibility. But here I am taking about political institutions effects on perceived credit worthiness on developing emerging economies.

I started the project with two questions. What are the consequences are losing credibility? What makes these emerging market countries improve credit worthiness? These are important because the financial crisis leads to financial disruptions, political instability, etc.

The importance of perceived credit worthiness or the sovereign credibility is recognized by many people. I also interview financial experts, and they say that perception is everything. The way that they receive credibility, that is important. Losing investor confidence results in market flotation, political instability and disrupted economic growth.

To summarize I argue that governments need a commit mechanism to build policy predictability and credibility. They need constraining political institutions commit governments to policy credibility. Here I talk about the defects of the democratic system and the system of checks and balances.

The common feature of the IMF is that they are political institutions that try to provide restraints on political leaders. Here I look at the domestic institution and I find them to be democratic. They impose political constraints on political leaders. What I further argue is that the credibility-building effects of political institutions are conditional on domestic political conditions. If the ideological orientation of

governing party affects the effectiveness of political institutions, then there is greater risk and perceived risk.

Some argue that the right and left distinction as seen in advanced democracies is not found in developing countries but there is a general agreement that there are parties that do support this and support workers' interest, have more government spending, while other groups of political parties are more right-winged and favor business interests or are more market friendly. I argue that the effect of political institutions in building credibility is a creator of left-wing governments because they pose greater risk.

Why do the emerging markets need credibility? They need this because they rely on foreign capital. They rely on foreign investment, foreign aid, etc. The financial crisis, the Asian financial crisis shows that these countries suffer a lot by losing investor confidence. If something happens in South Korea, Thailand, it will affect investor confidence. It is a rational thing to withdraw their money. If they as a group work together they can prevent this from happening.

Another problem is that the emerging market countries, as they integrate more and more they actually are more exposed to external funding conditions. What I mean is that in other countries it affects you much more than before. Now that there are a lot of dispersed private investors all over the world, causes a lot of challenges to emerging market countries.

From the perspective of investors, emerging markets pose greater risk. Many of them have very short history of being in a democratic system and have less transparency and don't know what is going on. Many do not have reliable data and it's hard to analyze their policies. Emerging markets pose a lot of risks such as interest rate risk and others. What has become a prominent risk is political risk including confiscation, nationalization, and corruption. I interviewed a lot of investors and a lot of them say that corruption is one of the biggest problems they see in developing countries and there is a lot of political risk.

The default risk is that determined by their ability but also willingness to pay. Sometimes a country has the ability to pay but decides not to because it can be costly. Sometimes they citizens are not happy about paying the debt. Sovereign default risk can be political risk. This is president Oklara in Ecuador. He said that he would repay the debt but once he got power he defaulted to foreign debt and said payments to foreign debt was illegal. He didn't hide his hatred to the institutions in the U.S. This happens a lot and people say that developing governments pose greater risk than others.

Political institutions are the roots of the game that shape the behavior. There is huge literature build on this that is about democratic advantage. If you are a democracy you will respect the system and create financial credibility in financial market. Institutions affect financial outcomes. Governments can try to convince investors about their policies by making promises or trying to manage economies in a prudent way with laws and regulations. At a more fundamental, it's really the political institutions because they cannot find the actors. They hide the hints from the political leaders like what happened in Ecuador. A political leader will promise something and then later do something else which creates inconsistency.

I examined the effects of democracy which is believed to better respect property rights, better deal with corruption problems because it has better transparency and has checks and balances systems. I examined one important aspect of democracy which is the system of checks and balances. Some call this a veto player meaning the number of individuals are necessary to make a policy change. There are things that we need to understand about this concept of veto player. If we have a lot of veto players that means policy stability because too many will veto policy suggestion. It might also indicate policy change lock. On the other extreme if there are too few industry players then it can be efficient because there are less people who veto but it might lead to problems of arbitrary policy changes. I expect too little constraints and too much both undermine confidence. An intermediate level of political constraints in a country is best.

As I argue, the effectiveness of political institutions is conditional because they pose perceived greater risks. Political institutions have greater credibility-building effects on left-wing governments. The developed democracy's negative reaction or shock is shorter compared to developing economies.

I did an empirical analysis to test the argument and used data analysis of sovereign credibility. I present the result of fixed effects and I test the two stage model especially for the effects of democracy on country rating. Democracy, countries do not randomly become democracy random. I address that issue but I do not find any major problems between democracy and sovereign credit rating.

Here I present the Fixed Effects OLS Model. For the credit rating data I used institution investors credit rating. I also used other alternative measures such as Euro money and institution investors as the main favorable because it has the largest number of countries and is highly correlated with other vendors. I used institutional investors based on evaluation of bankers in financial institutions. We have 90 countries from 1980 to 2006. For makers of democracy I used two different measures. First one is a dichotomous variable because I am interested in comparing democracy and non-democracy. I used data by Cheibub, Gandhi and Vreeland who rely on simple definitions of democracy; whether the country has contested elections. Some countries have elections but they are not necessarily contested because you know who will win and there are vote rigging. They see whether there are two parties running for election and if there is an election for chief executive and legislator. Also policy measure. There they have broader coverage of institutional aspects and civil liberties. They examine if people can choose leader and civil liberties.

To estimate the political constraints I used the World Bank's Database of Political Institutions. They essentially measure the number of veto players and consider the ideology between these veto players. For party ideology data I used the data by World Bank's Database of Political Institutions.

She is focused on left-party credit ratings. I also control for other economic determinants such as budget balance, foreign reserves, GDP growth, capital account openness, exchange rate system, debt service, current account balance, and investment. One thing I wrote about government partnership, a party will claim to be leftist but when you see what they are doing they aren't. What I am trying to study the effect of is how the party label itself effects investor perception to see how investors react to the name of the party alone.

This table shows the effects of democracy on sovereign credibility. I do not include other controlled variables. We see the left parties tend to be perceived as risky compared to right-winged governments. But if they are a democracy, they have better ratings. The democracy improves credit ratings of left-wing governments only. The stars show the statistical significance.

If investors react to democracy then they will probably respond to deterioration of democracy. When the democracy deteriorates what happens to the credibility? Usually countries do not just become non-democracy overnight. I used an alternative method which is a Polity score of 0-20. Deterioration of democracy worsen the credibility of both left and right, the investor reacts more sharply to the deterioration of democracy in left-wing governments.

Let's look at some cases of political leaders. Here is a picture of Chavez from Venezuela and Fujimori from Peru. They were both populist political leaders but Chavez is very typical extreme, leftist political leader. He is a strong left-wing populist leader where as Fujimori is new populist. Chavez is populist from left and Fujimori is populist from right. Chavez changes the constitution and tried to change the role of government. He tried to do many drastic things to threaten investment. They both undermine democracy in their own country. They try to circumvent institutional checks and try to reach the people directly which undermines credibility institutions. Fujimori was more market friendly. When these two undermine democracy in their country, the market acted so that credit rating in Venezuela dropped 3-4 points each time he threatened private investment whereas

in Peru wasn't as affected. This is how institutions differ in left and right governments.

Effects of political restraint on sovereign credit ratings. I tried to include the square terms. Investors are more interested in intermediate levels of veto players. I expect this kind of inverted U-shape relationship between the number of veto players and credit ratings.

Results suggest that there will be a concave relationship between middle players and sovereign credibility but the relationship is not as strong as democracy but its suggested that investors prefer intermediate level of veto players and political constraints.

The last thing I want to talk about is the interview findings. I interviewed 27 financial experts throughout the world. Many don't trust political promises by political leaders. The amount of time in government doesn't change this opinion. Political leaders may always go back to their root and pursue their left-wing policies if they feel they need to. They also told me that the risk of policy reversal is more costly in left-wing government. These investors, some told me that they don't believe in democracy and have different definitions. They perceive some that have elections are not democratic elections. They see the problems of fake democracies. On the surface they have democracy but its not a free election. However, they do value true democratic elections and civil liberties. Many told her that too many political constrains is worse and gave the example that in India there are too many governments that control which undermines their reform. Political factors play a greater role in developing countries.

Just do sum up what I found, I find that political institutions help to boost market confidence but the credibility-building effects are greater on left-wing governments than on non-left governments.

II. Presentation

SPEAKER: Dr. Hsin-Hui Chen

The presentation I will discuss today is about investigating the economy-wide risk and performance of asset allocation for Taiwan's life insurance industry. This is a combined work. I am the assistance researcher and in Zhonghua Institution. This paper is supported and funded by Taiwan Insurance Guarantee Fund.

I want to talk about asset allocation of insurance industry. The light yellow stands for bank deposits, government and bank refund, and the yellow stands for foreign investment. From these statistics, the domestic investments are divided into the following asset categories include the bank deposits, government and treasury bonds, financial bonds, certificates of deposit, bills of exchange and promissory notes, and loan to policy-holder, loans, stocks, etc. However, limited information about foreign investment is not disclosed. Even the foreign investment has accounted for more than 40% held by the life insurance company. We have limited information and we only have the numbers for investment of Taiwan's industry. Increased financial globalization and the consequent interdependence of asset classes has led to higher correlation between countries at times of crisis such as the 2008 financial crisis. The 2011 Euro debt crisis has had a big impact on global economic market. This detailed information needs to be published. Otherwise the authority cannot determine the potential return loss. The currency risk needs to be considered. We know that this document, the economic wide risk, the micro-financial risk--recently, the historical event of the 2000 dotcom crisis, the 2008 financial crisis, and the 2012 Euro-debit crisis. In August 2014, the Financial Supervisory Commission Policy ROC announced that they will tackle two life insurance companies. The Singfor insurance company and the Global Life insurance company. In June 2014, the book value of Global Life and Singfor Company is -25.2 and 23.9 billion respectively. From the news, they document that an inefficiency in asset allocation and the managing capability is the reason. The motivation for this paper is to provide more information to the authority for monetary challenges in insurance investment choice such that the regulatory intervention can be taken earlier thus we first conduct foreign investment survey for Global Life insurance company. Second a popular benchmark portfolio indexes, we further investigate the

historical returns of benchmark portfolio during 2008 financial crisis, 2012 Euro debt crisis and the 2013 termination of QE3.

The following presentation will be organized based on the following. The methodology of foreign investment held by Global Life insurance company, how we construct the foreign and domestic performance index. Of course according to their ways, we will combine this index to an investment performance index for Taiwan companies.

The methodology. First I want to tell you how we collect data. We use survey data and we need to provide questionnaire and we submit many financial market websites such as Global light and even Google Finance to see how they divided the assets into different classes. Then we complete a trial version of the questionnaire and use this draft to provide and ask some CIO in the life insurance industry to reviews and give suggestions. We ask participants to give us feedback.

After combining this information, a final version of questionnaire is complete in January 2013. As you can see in this flowchart, it's divided into five categories. Among the insurance companies in Taiwan, we select the top 13 insurance companies and we send them questionnaires to ask them to help us. All of them returned them and we can use this information to compile the foreign investment index. This pie chart shows the major classification. We also consider the markets such as the development markets, and emerging markets and the credit rating. We will ask insurance to report in what kind of currency the assets are dominated. The currency risk can be taken into considered.

Our questionnaires can be divided into five categories as shown in the chart. After we have created the final weightings, according to the selected weightings, we will use this to choose the appropriate benchmark index. Here are the selection criteria for choosing appropriate benchmark index. We will examine the trading volume, and the outstanding shares and the liquidity of the candidate of the index because the trading volume in the outstanding shares stands for reliability. Second, we will also examine and review the limitation of regulation. Insurers in Taiwan can only

put their money with foreign analyst's who have triple B credit rating. The second criteria is the data length and frequency. Higher frequency data is preferred. We need to make a decision because there is a tradeoff between the capacity and the understandability. Here are the tables that record all the candidate's performance. Two candidate benchmarks for each of the classes. These are the candidate benchmarks for domestic investment. And we also report where the data source is, the frequency, and the sample period. This is the foreign investment candidate performance benchmark. After we choose the benchmark we need to calculate the benchmark return. We propose full return calculation methods in this paper. The total return, the price return, the coupon rate weighted return and year weighted return. What is the best? The best is the asset characteristics will leads to the different calculation methods. For example, for recent assets, if this benchmark index is presented as an index, equation one will use it to calculate the benchmark return. But if this is a risk free asset, such as the deposits, then the returns will be presented as an interest rate and we use the equation to calculate the return. After we calculate the benchmark portfolio return for the corresponding assets, we will use equation 3 to calculate the foreign investment performance index of the aggregate Taiwan life insurance.

I have highlighted some confirmation assets such as the government bonds, corporate bonds, financial bonds, and most of these assets are the fixed-income assets. Here are the details. When we use failed value to calculate the return, then all the gains and losses are considered. This means that it is a market to market variation. We will use the total return which means the total return price, the capital gain and the interest of the dividend. However, some may argue that if I bought a very high-grade treasury bond or government bond, if default does not happen then the failed evaluation is appropriated because we hold this asset to maturity, the return should move. This kind of asset might be confirmation. That's why we propose that the year-weighted return. Since we cannot observe exactly which insurance currently purchased these bonds or the purchase price or the exact year performance portfolio performance. Thus the average year group on rate and the

maturity in years of the benchmark ETF is used as a policy of the required returns. We will consider this commission assets as a risk-free asset.

I will only focus on the total return calculation methods and the year weighted methods. The first thing about the total return calculation methods is that well the total return just means it's a price return across the income return such as the dividends in the interests. This kind of return calculation has the foreign advantages. This type of return is like a holding period return including capital gains and interest income. In this way the authority can gauge the potential return loss the insurers may suffer in a financial crisis. This idea is very similar to the Taiwan stock exchange capitalization weighted stock index TAIEX. Insurers can consider this index as a comparison and consider this performance to the benchmark portfolio.

The return calculation will also have the following disadvantages. First the market price fluctuates from time to time, a negative return may occur. But if you hold the fixed income asset such as the government bond without default risk some may argue that they will not suffer return loss if they held the fixed income asset to maturity. Another disadvantage is that if you use the total return to calculate the portfolio return, the different selected base year will result in different subsequent index trends. Due to this concern, we propose year-weighted return methods.

Here is the demonstration of these methods. Well, the first column stands for the years. The year 1-year 8. The second and third columns stand for the maturity in years from yield to maturity of the benchmark portfolio. For example, A means that in year 1, the market portfolio, the bond, the maturity in years are 8 years and the yield to maturity is 4%. Then this means that in year 2, the market portfolio we will choose the benchmark portfolio, the maturity in years is 7 years and the yield to maturity is 5%. Then the yield weight return will be calculated as follows. In year 2, the return of the bench mark portfolio will be 4% which is simple but when you go to the year 2, we assume that what else of the year 1 benchmark portfolio matters. All the category funds such as the principal that dividends and interest rates will be put into the year 2 benchmark portfolio. During year 3 you would assume that there

is another $\frac{1}{8}$ of the benchmark portfolio purchased at $T=1$ and $\frac{1}{7}$ of benchmark portfolio was purchased at $T=2$ and a 5% maturity. Please see from this column that the weighting of the year 1 portfolio decreased from year 1 with weighting 1 to year 2 with weighting $\frac{7}{8}$. As the follows we will calculate the year weighted returned methods. It should be noted that the return in the above example is calculated by years but in our paper the portfolio return are calculated on the monthly basis.

In February of 2014, 13 selected Taiwanese life insurance companies replied to the questionnaires and the response rate was 100%. As you can see from this table, on December 23rd the market value of the portfolio held by these 13 insurance companies was approximately about 432.8 billion US dollars on account for 85.6% of all Taiwanese insurers' holding. This implies that these characteristics of these 13 insurers can represent the aggregate Taiwan life insurance industry.

We made a chart to show the weighted foreign asset allocation. As you can see from this diagram we find that most of the foreign investment are focused on the corporate bonds, financial bonds. It's accounting for more than 70%. Following this, are the government bonds and the secularized products. Based on these weightings, we can calculate the foreign investment performance index.

This is the foreign investment portfolio index and they are responding to 18 assets based on the survey weight of the life insurance industry. We calculate the return on each asset classes. From December 12th to December 22nd to May 2014 we also drew the time series figure to show various assets trends. As you can see from these figures, the risk free assets which goes with a positive slope. We also calculate year-weighted risk return for individual assets. In the total index, it follows like this.

According to their weight, we will combine the domestic index and the foreign investment index together and we call it the foreign investment performance index. As I mentioned that to illustrate the practical revenues of these benchmark portfolios and to see to what degree the economic risk offered during the financial crisis, we will follow the historical return and use the same weight but to stimulate the return from 2008 to 2014. This period includes the 2008 financial crisis, the

2012 crisis, and the 2013 return. This return is the cumulative return meaning that for example the negative 17.55% means that in that month the past cumulative negative return is 30.55% during the financial crisis. This result shows that all of our benchmarks portfolio indexes provide some revenue information for managing the investment performance of Taiwan's life insurance industry. Of course they can use monetary strategy in insurance in investment choice such that the regulatory intervention can be taken earlier.

Here is the domestic investment performance index (DIPI). We chose 14 benchmark portfolios which correspond to 18 assets with sector weights.

In this paper we intend to provide some revenue information for authority for monetary strategy for investors. We first conducted a foreign investment survey and collected aggregate weights of industry foreign assets. Second, an appropriate benchmark index corresponding to their respective assets are selected and the weight of the benchmark portfolio return is calculated. To illustrate the portfolio revenues using the benchmark portfolio indexes we follow the investors historical returns of benchmark portfolio during the 2008 financial crisis, the 2012 Euro debt crisis and the 2013 termination of QE3. The stimulation result shows that the benchmark portfolio indexes we construct can provide some relevant information for measuring the investment performance of Taiwan's life insurance industry.

MODERATOR: Professor Chen-Min Hsu

These two presentations are quite great and I think that it's a very dynamic. Using empirical studies using questionnaire or survey to analyze the economic performance and the political institution constraint of either the debt performance or the life insurance industry performance. Now I have had some comments on these two papers. For the second paper first, the data that comes from the questionnaire used, I have a question for how you measure the idea portfolio performance index. What is the scale that you used? Maybe for example you can explain how the index idea should be explained and maybe like in a finance series and APT model, how do we construct this index from the theory rather than just as

an expert using the questionnaire. What is the theoretical foundation for this index you constructed? In this paper, you used 4 categories such as assets, market, credit rating, and currencies. These four areas try to find the information from these two kinds of relevant data. In a sense, it's something like factor analysis method. But I find that the weight for choosing these four kinds of variables, the information that you choose and the weight that you use in the presentation seems to be very arbitrary. I suggest that you try to use information and data from essays, credit ratings, and currencies.

The first paper from Professor Cho used a panel analysis to analyze how the institutional factors constrain institutions to affect the full risk of government bond. I think that this is a good issue that might be very popular in the international financial market in addition to Euro bond prices in the emerging markets. I have one question about the, when you talk about the democracy you give us a distinction between liberal and electoral democracy. I think that it's very good to distinguish between these two democracies. You mentioned Russia and it seems to be a electoral democracy and not liberal democracy to me. From your results you found that democracy is not significant to sovereign credibility. But I think that this is not a very surprising for me because I think democrats should be the common value. I think it becomes significant that democracy deterioration is significant to the full risk. That is very good and meaningful for your findings and as for the institutional constraint, especially against political leaders or other time-consistency policy, these elements are quite significant. The data from World Bank, you only used institutional data but could you use here that the world-wide government indicators. To me, maybe you can tell us what kind of regulation mission.

ANSWER: President Wu

Thank you for your comments and actually our main purpose of this paper is to find out the performance of Taiwan Insurance company and their performance in the market. Instead of figuring out appropriate portfolio allocation of this financial

institution. So the weights that we have in our table is just to survey access from those institutions so maybe there is a misunderstanding.

QUESTION: Dr. Schich

Financial Chief from the OECD asks a question to Dr. Cho. In terms of trying to test the difference between left and right wing government, I presume that some of the variables that you presented are control variables are a reflection of government choices so you could as well using a dictionary to see whether the roles of external balances had a different effect on whether that's a left or right wing government. I also had a question for Dr. Wu, as I understand you collected mostly data on assets or did you also collect detailed information of the currency composition of assets but what is particularly interesting but given the pressure to deliver returns but what is the currency composition of liability? Maybe they are all domestic currency but I was just wondering if you had more insights on composition of currencies of liability.

RESPONSE: Dr. Cho

Thank you very much for your comments and its a good question and I've been working on this project for a very long time so what you suggested is something that if I remember correctly there is not much difference in terms of these control variables. However, some people suggested that they wanted to do it again with all the control variables to see what will happen. I could have thought that would make it too complicated. I tried running left and right separately but the results are similar to what I got.

RESPONSE: Dr. Chen

You are right in that we did indeed survey which currency is the nominated they had hoped for foreign investment. But from my pervious presentation, you will find that most of the currency they hold is in US dollars. So for domestic investment we use NTD to calculate the return but for foreign investment we just transfer it from USD to NTD each month.

RESPONSE: President Wu

Our focus is only on the investment part so how the performance of this financial institutions. As you know in Taiwan, the availability of assets is not so much so they are separate considerations. So far we just focus on the investment part thank you.

RESPONSE: Dr. Chen

As President Wu just explained, our benchmark is to give a rough picture of how they invest in assets and we cannot calculate the exact return or exact risk.

QUESTION: Professor Chen-Min Hsu

But for the foreign exchange risk, maybe there is still some foreign exchange risk. In this study did you consider other asset risk or portfolio risk or maybe country risk?

ANSWER: President Wu

As I mentioned we only focused on the return part, not the risk part. As you know the different assets have risks and different companies have all kinds of risk categories. So the purpose of this paper is to roughly understand the performance. The background behind our investment ratio has been increasing rapidly and we want to find out risk behind this pattern. The first phase we want to dig out the return and these financial institutions can beat the market or are they underperforming? If they have been underperforming for some time maybe we should adopt some methods. As you look at some rating they always will adjust the record after a period of time. If you can monitor this type of index maybe you can get this kind of information.

QUESTION:

As you said with one of your risk free assets, and it contained domestic government points so from a domestic perspective it makes sense so of course after the union experience, even domestically, that is not considered risk free anymore. Greek bonds and portfolio of Greek life insurance companies are not risk free. I get that

Taiwan is in a different situation but conceptually there is an issue that there is no risk-free. Another category of bank deposits and I'm wondering what types of bank deposits? Are they also deposits that get an extra return and then to some extent exposed to a haircut if there was a case of resolution?

RESPONSE: President Wu

The name we give for the category under the risk-free but that's just categorizing different assets. But for those relatively low risks, we just use a different name for each class. You are right. They are not risk-free because they have some risk. The deposit include the money market and these kinds of assets. We just give the questionnaire to the financial institution and will answer what kinds of deposits they have. So we grouped them into different categories and assigned certain names so maybe we can change that name risk-free.

QUESTION: Dr. Hsu.

Dr. Wu, did you try to borrow the bank performance analysis so that you may consider other risk?

ANSWER: President Wu

As I mentioned we are not trying to figure out what optimal appropriate portfolio allocations. We are not trying to say this price is good and which strategies are better. We just want to find out what the performances of these financial institutions are.

ANSWER: Dr. Chen

So we mentioned that we have provided four kinds of returns. And you wonder that for government bonds might not be risk free so we calculate the market to market return on the market portfolio index so if the different rank is higher so the benchmark price will go down so is this of concern?

ANSWER: Dr. Cho

I have a question about what you mentioned. Do you suggest that the WTI as an alternative?

QUESTION: Professor Hsu

From public governance there are six kinds of data so you use at least 19 countries of data and from the public governance, the data of world bank, they had a divided into the data into middle, low, and high income country, and the individual country data.

ANSWER: Dr. Cho

I understand the WTI data is based on evaluation maybe a financial market or market participants. But I'm not sure. I try to use this data for other studies which were kind of showed how worldwide governance indicators control corruption. If I used it as a control variable, my concern would be measuring, estimating credit rating which is based on the evaluation of the participants and then this is kind of an evaluation of something I'm not sure.

QUESTION: Professor Hsu

In your presentation you considered the for example democracy, consistency, or the institutions. But in addition there are many other government variables. I think like public governance is a 1 to 1 equivalence to like policy transparency, supervision, check and control characteristics. Those are very similar to a stock company. Maybe if you think about whether the country wants just democracy or if there is there some concerned government institutions. Maybe you can choose more risk variable such as corporate governance. Government is the other sectors such as corporate firms so if you do not think about other factors then it looks like you implicitly assume that the others are very complete. This should be a complete financial market.

ANSWER: President Wu

To understand a financial institution performance you have to put together the risk parts to construct a risk ratio. Our project is first to understand the actual performance of these institutions in Taiwan. The next stage we will construct some index to combine the risk part. Thank you.

“Public Governance and Avoidance of Collective Risks” International Conference

Hosted by Taiwan Insurance Guaranty Fund

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SESSION III: Public Governance and Alternative Models of Collective Decision-Making

KEYNOTE SPEECH: Professor Fishkin

Thank you for the kind introduction and thank you for making this possible. Let's talk about what it seems to be a simple problem and solution but its significance explains its theoretical context. My simple problem is how to consult the public. Governments and NGOs and media organizations and various institutions around the world face the problem of how to consult the public. You might say this is simple. Keep in mind two questions: Who do you ask and what kind of opinion is solicited? We will often see that ordinary citizens have many reasons not to become informed and then those that are trying to manipulate others. Campaign advertising, social media, spreading misinformation-- there are impediments to becoming informed.

There are three problems with public opinion. Anthony Downs coined the term Rational Ignorance. If I have one vote or opinion, why should I pay attention to the complexity of public policy because my individual voice won't have much effect? So we usually find it rational to spend time where we can make a difference. In other areas we have a passing opinion and this is the condition for most people. It would be great for people to get informed and their thoughts would be part of the policy process but unusually that is not the case.

Phantom Opinions-- Phil Converse who called it the problem of non attitudes. If people don't have an opinion and you are doing a survey, they are usually reluctant say they don't know and always at random pick an alternative and seem to have an opinion. George Bishop at the University of Cincinnati did a study that showed the Public Affairs Act of 1975 in the United States. He had surveys asking about whether people approved or disapproved and people answered. But there was no Public Affairs Act. It was entirely fictional and the Washington Post later asked about the appeal of the act twenty years. Richard Moore split the sample and told half of the samples that President Clinton supported the appeal while the other half that the Republicans of Congress supported it. Not all, but some are phantom opinions and sometimes opinions are just top of the head impressions where people haven't spent time to probe more deeply and if they did they would have a different view. If they probed deeply, what would it look like? What are the conditions? Can they be made practical as a tool for policy making and public dialogue and this is what I call deliberate polling.

From the standpoint of democratic theory, even if people discuss these public issues they tend to be very selective about their sources and their intellectual people they talked. They choose people and website and new stations who have a similar viewpoint. People in similar social locations tend to have similar attitudes. If you talk about policy or politics you will talk to you coworkers or family and they will probably be agreeing with you. You can ignore those people online. You can confirm your viewpoint without hearing the other side. If you do know people you strongly disagree, it's easier to talk about the weather than some intense political conflict.

These are the debilitations of public opinion in mass societies around the world. Since the public is supposed to have an opinion on what the government does, how do we make the connection between public opinion and government? how are we supposed to have an opinion on what the government does? How do we overcome this?

My prescription builds on conventional polling because it is representative if its a good poll is done well. A poll should give you a good representative of this public opinion. It will have those issues that we mentioned but at least it will be representative. My question is slightly different. What would the people think under good conditions thinking about it and if we can deliver it in a balanced, transparent way we can find that out. That can have a recommending force as to what people really think about this issue. It can provide a root for responsible advocacy. We have found that this seemingly philosophical question, practical people ask well if people don't think this then what should we do? What would the people really be thinking if they were thinking? The basic idea is simple. What we do in a deliberate polling project is create an opinion group who sharply disagree with what should be done and we create a briefing document with great effort but a document designed to engage people in competing arguments. Here are some policy alternatives and here are arguments for and against all of these alternatives. All the information has been factually checked. One of the problems with public policy advocacy, we have inaccurate information or strategically misleading information. We need to get the competing sides and the misrepresentations and if there is something that is contested than we can have those statements. We need to make that clear and understandable. We have done this successfully with illiterate groups from Uganda in Africa. We are happy with this recent work because it shows that deliberation is not just for highly sophisticated societies. People are smart, especially when you encourage them. I have many colleagues who make money by showing that the public is stupid. They aren't stupid but they are just not paying attention and don't think their voice matters. If you make a context where they think their voice matters they will make the effort.

We have an advisory group, a briefing document and a questionnaire with all the policy options and explanatory information. Empirical premises and empirical assumptions about if you do this will happen. But these are often contested so we have to give explanation of casual relationships. About 70% of these polls change significantly. The initial opinion will often be quite different. We conduct the survey,

then we invite the people to come and we pay their expenses and draw them into this sample from various countries. In the first deliberate poll in the US, there was one woman who couldn't come because she had to milk her cow so they had someone milk her cow so she could come. There was another guy who came in a private plane. So all strata of society was involved in this group before. We had a microcosm of the society in demographics and attitudes. We want to compare the attitudes of those who come and those who don't. We usually don't need to make corrections of the results. Imagine 300-400 people who talk and discuss with moderators and clarify key questions who are directed to panels of competing experts who share different points of views. Once they see the experts disagree they are empowered to think for themselves.

The first deliberate poll we did in 1994, there were a few things that stood out. The issue was on crime. I didn't realize that if you have a good sample, you'll have criminals in the sample. In one of the groups there was a car thief. The diversity of the sample enriched the discussion. Usually we wouldn't be able to talk to a criminal about these issues. One woman tried to thank me. She was a spouse of one of the participants. She said in thirty years of marriage her husband had never read a newspaper. But after he started to come to the event, he started to read the newspaper. We had designed a process that incentivized individuals to get informed. If you have one group of millions, then you won't be incentivized. But if you have a smaller group, then your incentives are changed. We saw that the public was able to think for themselves under the right incentives.

We have done 20 countries and in many different parts of the world and with clear discernible policy impact. That is my friend Bow Gang Hang. This was very surprising that we were able to do this in China at the local level. Zhujiang Province is a place near Shanghai. We were invited to speak at a conference in Hangzhou and we spoke to Mr. Jiang the local party leader. That area has a lot of experimental conversation. There were many local or town meetings where the people turn up and discuss issues like the budget and Mr. Jiang said the problem with this province is that they are dominated by the local notables. There is no clear decision process

and they are self selected. Mr. Jiang said he wanted to do the deliberate polling and Baogang and I helped him and it has been repeated years since and now it has spread to other parts of China. What was the topic? What infrastructure projects the town should build and they had the budget to do ten out of thirty potential projects. Mr. Jiang said that in other towns the town leader would decide and people would just assume that he was getting paid off in some way. Mr. Jiang was an honorable man and wanted the people to decide. What kind of system could allow them to thoughtfully decide? They did it pretty perfectly. We wrote an article called Deliberate Democracy in an Unlikely Place but how it worked perfectly. The sample was almost perfect. In the British case, we did 300 initial interviews and compared it to the 500 of those that didn't come. There were almost no significant differences. We had the data to say this is a credible microcosm of the United Kingdom.

In this China case, they selected 300 and 275 showed up. Then there were a few husbands who had substituted themselves for their wives and sent those men home. We had 250 or 260 and had almost a perfect sample of the community there. We did the deliberation and before it started the local leader Mr. Jiang said I think I know which are the best projects but I told him that he needs to agree to follow the people's projects. Mr. Jiang wanted to do major, fancy projects such as big highways. What the people wanted after deliberation was sewage treatment plants, in other words clean water, comprehensive environmental plans, a people's park for recreation, things that would affect their lives and all of these items were at the bottom of his life. He submitted this list to the People's Republic of Congress and they built them all exactly as the people specified. He became very famous in China on the internet and he was promoted and given a year at Stanford to study English. He also said in an interview "I gave up power and found out I have more". He didn't impose his opinion but followed the people which increased his legitimacy. The thoughtful and informed views of the people and policy can be affected immediately with this. We have done this in Macau, Chengdu, districts of Shanghai, and other various places and we think its spreading.

Mr. Jiang said at a conference. He was asked "Why were you so surprised by the results?" He said "Well obviously I never talked to the people and never knew what they wanted!". Even in my country the policy makers are not really in touch of the people but not a representative sample of the people.

This is the Parliament building of the European Parliament. Those are people who were randomly sampled from the European Union. We did this twice. One of the interesting things about sampling is that you don't need a larger sample for a larger population. The precision of the sample depends on the size of the sample and not the population. You can use the same size sample to represent Taiwan or Macau as a whole. It's very reasonable to do this thing if you do the statistical inferences seriously.

You have to worry about sub populations. If you want to break out and think about what do the people of Netherlands think you might have to have a very big sample in order to have enough dutch people to represent. The trick was to think of Europe as one population. TNS the survey research firm in Europe takes a sample of 1,000 people for every country. At the time, there were 27,000 in their survey for Europe as a whole because they think of Europe as 27 countries. If you think of Europe as one population you only need one sample. We did it and it worked well. The problem is that the people of Europe speak different languages so we had simultaneous interpretation for 22 languages.

That is a picture that I snapped in the museum of the forum in Athens. I thought I invented deliberate polling and I did in modern form. But there is nothing that original about this research program. It goes back to the dawn of democracy in Athens 2,500 years ago. In Athens they use this machine which is called the kleroterion. This is the only remaining one and it was used to select a random sample of 500 citizens and that was the council of 500 who met continuously over the year and set the agenda for the assembly. The idea of the deliberate poll is the random sample of people deliberates. People in the assembly could vote. After the Peloponnesian war, they reestablished the democracy in Athens that they would

add an additional version of this device. The council of 500 was at the front end deciding on what would go to the assembly. They added something at the back end which is a legislative commission. It wouldn't become a law unless it was approved by legislative commission who were selected randomly (500 total people) while the case for the law and against the law was presented. Sort of like a court case so they heard all the arguments for a day and they voted. Only if the majority votes in favor did the proposal become a law. They trusted the random sample that deliberated.

This was lost in the dust of history. Only recently have they reconstructed the legislative commissions after. I took the idea to Greece because in modern Greece. George Poppins Dreyo used the deliberate poll for candidate selection. We did a very successful project in Athens to select the candidates for his party. The Financial Times wrote it up as Athenian Democracy Returns. We also used it with American presidential candidates.

This is a case in Bulgaria in 2007. There is a minority group called the Roma or Gypsies who are seriously discriminated against. They are 6-7 percent of the population. They speak their own language, live in ghettos and a large percentage of those in prisons are Roma. We did a national deliberate poll on the Roma. We had active participation from the government and NGOs. We considered education, housing, and the criminal system. In all three, there were two possible directions for policy. Whether the Roma should be fully integrated into Bulgarian society or kept separate. In both groups they wanted to be fully integrated into society.

In this case, in schooling the percentage who supported closing the Roma-only schools rose from 32-66%. People realized that the Roma-only schools didn't have any teachers. The older students were expected to teach the younger students. They didn't learn the mainstream language and couldn't get jobs either. Everyone else discovered that it was a lousy educational system as well.

We had a conference in Poland about all of the polls. The Bulgarians announced the Roma-only school were all closed. They made the point that they weren't the only

factor, but they obviously did impact that situation. They helped de-segregate schools.

Let me tell you about the Japanese projects because they are fairly consequential. There were two national projects, Professor Sonya set up a center for DP. One of the really interesting projects we did was on the pension system. The government at the time was strongly considering what in the US we would call privatizing the pension system, what they called the funded system because everyone would have their own account and be funded by a funded system. When they did surveys about this system they did very well. In our own survey, the funded system was one of the options for change. At one point, the funded system had 69% support. You need to understand that conventional poll results are like shifting and difficult to get. Deliberate polls provide a firmer basis for policy.

The Japanese Advisory Committee decided on the Funded System (private accounts) and the other was the idea of increasing taxes so that the current government runs pay as you go system could be funded. Obviously the Japanese are very old. They face a big problem because of aging population. The Japanese also, the public objected to telephone polls, the Japanese have a greater concern for privacy in every way than any other society. To my astonishment, NHK made a documentary film summary which was part of the briefing document that there is a shortfall to the current pension system because they don't have a good method for keeping track of social security numbers. Many expect benefits but don't pay what they are supposed to pay.

If they do nothing for reform they face bankruptcy, collective bankruptcy. If they do the funded system there are problems. If they raise taxes they need to find a way to get everyone to pay the tax without invading privacy. The consumption tax was low and so the public supported a rise in the consumption tax and the support for the funded system fell from 69% to 35% which was a big warning to not go ahead with the privatization of social security. It was approved by the cabinet and approved. The root to pension reform is what the Japanese government adopted.

We did another Japanese project on what to do with their power after Fukushima. This was a national project. The government endorsed three proposals: 0% nuclear power by 2030, 15% which is the newer but not the older reactors, 20-25% which would be building up to the level before the disaster. The government came to us and first they did polls but they didn't know how much the people who did the polls thought about it deeply. Then they had open town meetings around the country and it became a media laughing stock because antinuclear activists showing up and yelling at electricity company employees who pretended to be the public and the two groups yelled at each other where everyone was trying to speak for each other in the public. Then the government decided to consult online but they got 90,000 comments but they thought they were from the same groups insulting each other online. It was difficult to interpret these 90,000 comments. They turned to us and did this deliberate poll which confirmed that the government over the long run. The government designed something they could live with but they involved different amounts of natural gas, renewable energy, and conservation, etc. and the phasing out of nuclear power was the result which was confirmed by the cabinet. Now the Abe government is now trying to phase it back in nuclear power. This was the issue where we were briefly conformed by government but it didn't stick.

This is the case with Northern Ireland who are still killing each other. This was about whether they could go to school together and these results are being implemented. Look at the increase in the mutual respect. The sense that Protestants or Catholics are open to reason.

Energy policy choices in Texas where the people were okay to pay more for wind power. Went from last with wind power to the first in 2007. Wind power ended up being a good investment.

We dealt with a government crisis in Rome. This is Uganda. We did random sample in the household and we had 232 households and only 11 refusals. This was an area of Uganda with major floods, but we also did emergency and family planning. We take all the small groups and the transcripts in English. In the family planning

discussion he said he had only two wives and he has 18 children, 14 boys and 4 girls. It is a burden to provide land for the 14 boys. I now think that family planning would be a good idea. They needed to accept family planning because this area is over densely populated and very poor. The girls were not getting education because they were afraid to get raped because the schools were far away. One of the measures included providing a school in the village and provide technical education. Enforced the law against child marriage. The women in Uganda would have a better opportunity. These people knew what would affect their community and I am going back to get these measures implemented.

This is a practical method of getting the informed and practical measures into the community. Party competition democracy determines who will govern and win elections. But it does not necessarily permit or facilitate people thinking about the issues in an informed way. The willingness of the people to care about what the government does. Deliberate polling is the best so far when done well and this is a strategy that goes back to the Athenians and it deserves to be used to reinvigorate the democratic process.

MODERATOR: Professor Chi-lik Yu

I am convinced that this is a policy that we should use in Taiwan for adopting policies in our democracy. We are going to the panels. We only have 15 minutes per panel. The first panel is given by Dr. Ming Sing who is an associate professor at HK University of Science and Technology.

DISCUSSION PANEL 1: Dr. Ming Sing

Thank you for having me. In Taiwan we just had an exciting election last week and it talked about criticisms in democracy of Taiwan. Professor Fishkin talked about a great way for it to work. Can that work in China or HK? In HK we are still witnessing one of the biggest movements. We have just entered the 70th day. In my speech I am trying to share my understanding of why the Umbrella Movement came about but first lets watch this quick video.

The scenes seem to be familiar with Taiwan. This afternoon I'm going to Qinghua University joining a conference on the Sunflower Movement. In HK they want to have the real democracy. The role played by the deliberated poling. One is not sure about this movement. For one, there is no evidence that the movement has been funded for money or power. It's not the movement about students, most of them are middle class. In the survey I did about 6 weeks ago, about 80% of them were not students. Mostly they were the younger generation, 20s to early 30s. They were very civilized and 80% in my sample received compulsory education, 70% in my sample are bachelor degree. We saw 200,000 people in the city taking to the streets, supporting the movement and technically speaking they have all breaking the law.

Here are five possible explanations as to why this movement as occurred, one is about social justices, second is the freedom of rights, three is accountability, fourth is HongKong and Mainland's relationship, fifth is the frustration of delay democracy. This represents the cumulative discontent with dramatic erosion of HK's certain aspects. Hong Kong was a rich society but twenty years ago we had a much lower GDP (from 70,000 to 38,000). When you compare income gap before, Hong Kong was the worst compared to the richest countries in the world! People in Taiwan complain that inequality is rising, but if you look at this table HK is much worse than Taiwan and the U.S. In 2011, we got a Ginny rise to .537. In 2014, the richest 10% controls 70.5% of the wealth which has risen and worse than the U.S. You can ask how many billionaires in HK. There are at least 45 and if you add up their total assets. The richest percent of billionaires combined with economic output as measured by GDP. Basically the wealth has shifted to a few minorities and its much worse than Taiwan. How is the highest prices and worse than San Francisco. Beijing could also control more or less legislator which is inclined to protect the wealthiest. There is a motion to help poor women and it was rejected. The legislation of minimum wage was rejected.

Hong Kong suffers from lesser terms of upper social mobility. X-axis is income inequality. The more to the right, the more severe. The y-axis is the chance of inter-generation mobility. The U.S. and the U.K have a much more severe income

inequality. They also have a smaller chance of inter-generation mobility. Hong Kong is more severe than the UK and US, and an even worse chance of inter-generation mobility than the US or UK.

This is the crony-capitalism index which showed the amount of wealthy people can control a lot. 5 companies account for 70% of private residential markets. The guy on the top left hand corner is the wealthiest person in the Asian region. They control financial markets and basically everything. Watsons belonged to Li Xiaohong's empire and Wellcome also belonged to another conglomerate which was situated in HK. It controlled nearly everything related to our lives. We called it "Collusion".

That's not the whole story. Beijing and Hong Kong's chief executive who was a puppet serving Beijing. The complaint is mostly based on the rights of the people! The higher the figure on the y-axis, the lower the level of repressed freedom. Hong Kong and Taiwan have an erosion of expressed freedom. There were many examples and I don't have time but an alarming example. HSBC and Standard Charter which are both international banks in Taiwan. These banks even surrendered to Beijing pressure by withdrawing advertisement from Apple Daily, a democracy newspaper that is highly critical of anti-democratization and Beijing. They surrendered to huge pressure because the Apple Daily was the only newspaper that publicly supported the Occupy Central Movement. This made a scandal because the second highest ranking official Minister Chen complained about these two banks in the Financial Times and yet these two banks did not change their policy. This posed a threat not only to press freedom but to our future economic development. Press freedom failed creates and it attacks academic freedom which were attacked by Beijing news.

This is Robert Chung and he is the one who suggested the Occupy Central Movement. He invited Professor Fiskin to come to Taiwan but he was too busy. Many times he transpired the idea of deliberate voting in Hong Kong by gathering the people who in principal supported Occupy Central and asked them who deliberated polling? Which political model of democracy they really preferred? In a

way, it has to do with the deliberate polling in the semi-democratic Hong Kong to mobilize the people to join in a democracy movement. That was the way that deliberate polling was using Hong Kong. These academics were hit by unreasonable attacks from Beijing newspapers. Those on the left-hand side who are liberal-minded scholars had their private information publicized over social media. They were harassed. The judges were told to be patriotic which was a severe blow.

In the White Paper it also issued by National People's Congress of China (2014) they violated the law saying that Beijing has the right to meddle with Hong Kong's domestic policies. There was also an erosion of accountability, worsening of corruption, and this respective procedure justice when having a debate on highly controversial motions.

Intensifying Hong Kong and China scandals. Hong Kong and China's relationship has gotten worse. Hong Kong was much worse than Taiwan. You see a much greater proportion of travelers from Mainland. If you consider the number of travelers and the size of Hong Kong, the cases are five times more severe than that of Taiwan. That is not doing good for our economic situation. Many people in Hong Kong saw the many tactics for Beijing to control Hong Kong. Beijing tried to control Hong Kong by making it more economically dependent on China. Excessive use of tear gas was used but does not tell the underlying causes.

The survey I did six weeks ago, near Admiralty near the business district. I asked them what the two most important causes were that they had supported. 41% said it was democracy. Freedom and human rights were about 4%. The main reason is that they want to have democracy.

The end game, there are a lot of uncertainties, Beijing was calling the shots. In the short-term, waiting it out seems to work. There has been a rise in public pressure for people to leave the occupied sites. Without a bloody crackdown and plus an illegitimate chief executive, how would we preclude the return of protesters and provoking greater support for the movement?

Beijing confirmed the Juan Linz's prediction. He predicted more than 20 years ago that Hong Kong won't be able to appreciate democracy if they belong to China because they are not democratic. This larger country will not allow, Beijing, will not allow this democracy. At the same time it also shows how people have downplayed the importance of Hong Kong for China!

What is the end game? When will a sustained economic recession and legitimacy crisis emerge in China?

Will political reformer gain power in China and allow political experimenting in Hong Kong?

Thirdly, how did this case of social wisdom of a few insightful competitive issues. Highlights that among democracies, it is the semi-democracy that is most promising of political instability and this is Hong Kong. We are not at the second and third phase. I don't expect this to end softly. Hong Kong will get into big trouble and there will be turbulence.

The political showdown, the young people were frustrated with Beijing. They don't want to have no opportunities socially, economically, or politically. They are denied the ability to share in government. The young generation has agreed to do more radical means to change their reality. There is one whole generation that is now against Beijing and is politically explosive.

The real battle hasn't begun. If it ended next week, what would happen? What about social mobilization of civil organizations? Grassroots groups? Professors, doctors, lawyers, took to the streets and protesting against the abuse of power.

MODERATOR:

Thank you sharing. Let's take a ten-minute coffee break. Let's get started with our panel. Dr. Wong and he's from the University of Hong Kong. I wish to thank the organizers of this seminar and thank the rescheduling the coffee time!

I will talk about the Umbrella Movement and from a different angle. We will talk about the evolution of democratic movement. Secondly I will focus on recent development. The long term lack of democracy creates risk of stability. We were promised eventual universal suffrage but there were no details or roadmaps. The repeated delays leads to prolonged democratic movement and more risk to government. The movement was triggered by Beijing's decision because they wanted a nomination method for Chief Executive election.

This movement has been happening and been prolonged for over 20 years. We have a rigid democratic structure. The older leaders have already been established and the younger generation will provide the older generations with assistance on a new way of thinking about this.

The three macro events is the June 4th Massacre which created an important organization in Hong Kong which supported the democratic movement in China. The second one is in 2003, another major organization Civil Human Rights Front. Finally in 2014 the Occupy Movement but not sure if we should move it to Occupy Central? There is confusion as to what group is leading?

ASPDMC was formed in 1989 and they organize annual commemoration events. It incorporated and was in good terms with all civil society organizations, overlapping with leadership and membership. At that time, the Hong Kong people are willing to cooperate together to save that democracy.

The Civil Human Rights Front was in response to the national security legislation in 2003. It was successful in rejecting that because it was postponed eventually and we don't have a timeline about when this will be implemented. It was quite successful but was a much more loose structure compared to the ASPDMC. It was not about to function as a central structure, expected during the July 1st march. The July 1st, 2003 was the initiation of 5,000 people who protested against the above problems and bad government. After that success, they continued this annually.

The issues in the protest have been diversified to constitutional concerns. These protests are diversifying the initial concerns of the democratic movements. After seeing the key events, we can see that democracy movement is still very much alive and there are annual events. We have the annual democratic movement on July 1st. Repeated performance year after year frustrates the young people because these haven't been effective yet. They argue that once the politicians are into power, they will just be complacent. They are not creating any type of innovation in terms of democratic movement. Initially there was enthusiasm on the new parties and politicians. For example they restrict arena of the legislator, like froze a banana. Yet this gets pretty old quickly and shows no obvious progression in terms of democratic movement so this enthusiasm faded quickly.

Occupy Central was proposed by two scholars and a pastor. The scholars were not verbal but they risked their career in order to tell everyone about Occupy Central. Finally it involved three deliberation days and 1 popular voting on platform.

They have 3 Deliberation Day. During the Day 1 they have supporter section and public section. During Day 1 they choose supporter section and supporters and in the public section they randomly invited ordinary citizens to the Day 1 Deliberation Day. They talked about problems with Occupy Movement. Talked about problems and opposing opinions.

On Day 2 they invited those citizens who were genuinely support the movement. Talked about what elements should be part of their ideal government system.

On Day 3 they invited discussion groups of 15 suffrage proposals which were moderated by 1 moderator and 1 constitutional expert. By the end of Day 3 they voted for three proposals out of the fifteen. Finally they have a civil referendum where can vote on one of the three proposals. That is the deliberation model and the occupy movement.

The basis of the movement is that the participants of deliberation were biased because they shared the same views on many issues. Each participant had

discussion time and they ended with proposals which are all pretty acceptable but not acceptable for government or Beijing. For Occupy Central Movement was expected to have a low persuasion rate and they thought they were going to be arrested immediately.

The actual Occupy Movement was highly decentralized and spontaneous with no central leadership or visual organization. They loosely revolved around student leadership which is not recognized. It's not Occupy Central Movement because these organizers turned themselves into the police and told protestors to do the same. Initially central was not occupied during this movement.

There is a new generation who grew up with the traditional tactics of democracy. Some, and the younger generation, think that it's too conciliatory and with more of a loose organization.

SPEAKER: Yun-Peng Chu

After the two presentations from our Hong Kong colleagues, I would like to bring the issue back to the theme of the conference. You have just witnessed some of the core element of stability risks. It happens around the world. If there is anything that threatens to change the existing structure then it's considered. Nobody knows how long it will take for the disputes to be settled. No one knows what will happen next.

These are really important issues and for me as scholar it's important for me to think about a decision making model that would be representative of the people and present the collective thoughts of the society. It will not solve all the issues, but it will be a beginning.

I will discuss the results of two experiments which I participated using the method of deliberative polling. These were funded with limited sources and time. The first one is on the entrance system of the 12-year compulsory education and this new system created a lot of controversy, especially selection process. Parents of grade 7 and 8 students who will be affected by this. The method was headed by Wang Lee-shen of National Taiwan University, myself, and other associates. This is the timeline

of the project.. Basically we have meetings of the research team and two consulting committees and we invite people with different opinions on the topic to the committee. The purpose of the committee is to make sure the pre-forum questionnaire and the list of experts attending the forum are acceptable to different groups with different opinions.

The polling was very successful because we convinced the local authorities who issues a local document and asked these schools to do the polling for us with a written questionnaire.

The same committee members are with members with different viewpoints. These are the population we are talking about, 203 schools are involved and these are the total number of students. Out of these we pulled them randomly and these are the proportions of the sample description and they are representatives of the population and we had a large sample of 1113 parents. Out of these parents, 370 indicated their willingness to complete the forum.

We approached them by telephone and we send for them by on their background and invited them to the forum. 112 parents attended and they were given NTD 1500 for a full day of attendance. This is the agenda for the forum. There are the introduction and who sponsors the forum. Some parents told us afterwards that they were highly skeptical to the purpose of the meeting which was slightly resolved after the introduction. They saw that its funded by the government.

The main findings. The first column is the full sample answers among the 12 people who attended the forum. This is the post forum. As you can tell there is significant differences. Do you agree that with the first round of school should be randomly chosen? The charts show the level the agree with the statements. Most parents agree it should be a competitive system so that the elite public high school will not disappear from Taiwan. This is one of more question about the existence of the traditional elite senior high schools. These are different views of the roles of traditional elite senior high schools in the society.

The product has its expected results. After the forum was held, the organizers had a press conference and newspaper carried the news about the results and nowadays the massive analysis by the local government of these three cities are in line with the recommendation of the product.

Please consult my PowerPoint because of time. There was another attempt, energy policy which was also carried out last year. It consists of a much larger original sample but the format of the forum is very civil.

Ballet sample 3,013. The entire Taiwan was polled and out of these regional dispersion of the big sample. Out of these 3,000, a little over 100 indicated their willingness to participate and 90 people participated. It was a teleconference.

The black letters show statistically significant changes. These are the results. The most interesting parts of the exercise is that any original questionnaire has three questions. Testing the background knowledge of the nuclear issue. Can the nuclear power plant explode? Does the radioactive waste still stay on Lanyu Island? You see the difference and the effect of forum on group discussion, those that got them all correct was less than 5%.

In conclusion, every society faces the same problem such as not getting the opinion from the public. This polling technique is something that we can consider. There will be many poor people in the sample. Maybe not too late to have it in Hong Kong.

(V) DISCUSSION PANEL 4: Dr. Chun-Ming Chen

To me, the theory of deliberative democracy. Our indirect democracy has been questioned by legislators. That is the reason. Most people when talking about supporting a democracy in Taiwan. Being able to give the issue some weight either initiated by the government or the people themselves.

The theory of deliberate democracy. The focus is often on, in the North most of the discussion or practicing of democracy, are seen in the North. More attention is being paid to other parts of the world. I think it's good for the deliberation to be checked

and I am happy to hear that the deliberation efforts have been very fruitful, especially outside of the region of Southern Europe.

The two cases that were done by him and his colleagues, The government plays a central role in promoting deliberation. In 2011, we have 77 deliberative conferences and among them 33 are sponsored by the government including local and central government and are good at supporting deliberate democracy.

Also they hope that the national conference themselves, especially in the health insurance issues, tax reforms, and even some issues concerning labor relations. We have various kind of issues that are being conducted in terms of deliberate democracy. We see social academic groups that also help the conference. What is very special is that we have seen deliberation in the streets.

The other question is the NGO's lack of trust in sponsoring authorities. The government tries to manipulate the agenda and that's why I think they will want feedback. In 2014, there was collaboration between social movement and social democracy.

The challenges to the deliberative democracy. Is it fair to say that the public deliberation does not necessarily change existing power relations? Authoritarian power can be more effective than its counterparts with liberal democracy in implementing deliberate conferences by forcing participation, reducing sampling error.

SPEAKER: Professor Fishkin

So many interesting issues have been raised including the Hong Kong issues which are dramatic and I hope and pray that bloodshed will be avoided and I often have said that deliberative polling and the kind that I practice with a good sample and a somewhat broader range of options could maybe chart a path forward on the issue of candidate nomination which is the problem. Candidate nomination or candidate selection is a vexed issue all over the world. In Europe, the party leaders would just select the leaders. There are some creative possibilities to creatively create a way

with the correctly planned deliberative poll, that there could be peace and a conclusion as long as things don't get out of hand. I have been to Hong Kong and I have colleagues there and I hope in the future it would be great be able to assist and support their democracy. I was shocked and astonished that the person who invited me to this conference also practice deliberate polling and I feel gratified that you are also engaging in this work and there are things that could be done that such as using the key problems as opinion variables. Why is it that people change their opinion so we do regressions? We could also take the small groups and code the responses. This is why the project has been called a poll with a human face because you can see the reasoning of people. What you did was extremely interesting. The basic spirit of what you are doing is what we do and maybe we can help advice and assist in the conduct of deliberate polling but the basic idea is the same. I didn't invent it, I only improved it and the issues that were raised about... A lot depends on the specific design. A lot of things that go under deliberate democracy but they are too small like the citizen's journey or a focus group. If you are in a jury you can get social pressure for a conference. My last slides explain how we avoid the distortions of group polarization or those imposing their opinion onto others but we don't really have that issue. At the end of the day, we want this force of the better argument to triumph as viewed by the people. Instead of drawing inferences from coffee houses, we can have a practical method where the will of the people are. I am a big fan of reading about the Athenians. My other hobby is to read about the debate of the American founding. The Americans invented a Republic that was unprecedented. Maddison had to make up the political science that could tell you could be ruled by the people in any way. Well we have modern social science so we can experiment with institutions, using real data and try to improve them. That's what we offer with deliberate democracy by allowing people's opinions to have impact the political institution and so happy to have attended.