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Analysis

China and Asian Regionalism Ten Years After the Crisis

Yu Yongding *

The Chinese leadership drew a number of key lessons from the Asian financial crisis. These included a new understanding of the value of a healthy, well-regulated financial system, the interplay between exchange rate flexibility and stability, the importance of liberalizing capital controls in a steady and orderly fashion and the need for regional financial cooperation. There is no doubt that the lack of regional financial cooperation was a major factor in the failure to contain the crisis in its early stages and why the contagion effect was so serious.

Yet, though the benefits from closer regional integration and cooperation are well understood, there is no clear and agreed strategy on how best to promote it, either in China or elsewhere throughout the East Asian region.

There has been some significant progress on monetary cooperation. In the wake of the crisis, in May 2000, the finance ministers of ASEAN+3 announced the Chiang Mai initiative (CMI). The CMI commits member countries to strengthening policy dialogue and cooperation in areas related to the monitoring of capital flows, the reform of domestic financial arrangements, and the development of a more robust regional financial architecture. At the centre of the CMI is an

expanded ASEAN Bilateral Swap Arrangement Network, which allows member countries to borrow liquidity collateralized by domestic currencies and subject to government guarantees.

This development was followed by the Asian Bond Market Initiative (ABMI) in 2003, which is directed at overcoming the region's over-reliance on the banking sector as a source of investment finance by fostering a pan-Asian market in long-term debt securities. A related initiative by the Executives' Meeting of East Asia-Pacific (EMEAP) Central Banks has seen the creation of an Asian Bond Fund (ABF). The ABF is designed to capitalise on the growth of Asian bond markets by allocating a portion of the reserves of regional central banks to purchasing regional government and quasi-government securities.

These are important initiatives for East Asia of the like there has never been before. However, much still remains to be done in order to create the institutional environment necessary to prevent, or at least limit, the impact of any future financial shock on the region.

With the benefit of hindsight, the most necessary of these reforms can be categorised into four broad areas.

The first is the creation of a forum for the exchange of economic information. This is needed to collect and disseminate economic and financial information on ASEAN+3 countries. It would not only improve understanding of developments in the region's disparate

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economies but would also allow national governments to independently increase coordination in their policy making.

The second is the development of a mechanism for pooling regional funds which can effectively be used to supplement IMF rescue packages which tend to come too late, are too small and are saddled with conditionalities that are too harsh. This would require a surveillance arrangement to ensure that borrowing countries do not draw excessively or make reckless use of the regional funds pool.

The third is the continued development and deepening of the ABMI. An important factor in the 1990s crisis was the region's over reliance on the banking sector as a source of investment funds coupled with currency and maturity mismatches on borrowings. The continued development of the ABMI will help overcome this 'double mismatch' by allowing regional issuers to raise funds not only with longer maturities but also in local currencies.

The final area is the development of a coordination arrangement for exchange rate movements in the region. This would help create a more stable exchange rate environment in the region so that when regional currencies are under pressure to devalue, competitive devaluation can be avoided, and when regional currencies are under pressure to appreciate, burdens of appreciation can be more evenly shared.

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Clearly, China must play a key role in determining whether or not any of these initiatives will be successful. The immediate issue for China, however, is not how to progress regional financial integration or how to implement a new national exchange rate system, but how fast the RMB should be adjusted in the context of the existing exchange rate regime.

The benefits of revaluation are obvious. Reducing the booming trade surpluses; providing enterprises with an impetus for upgrading their industrial positions; and most importantly, reducing the growing trade frictions with key trade partners such as the United States. It will also be a critical instrument for alleviating inflationary pressure in a booming and rapidly growing economy. But the impacts of a rapid revaluation on China's exports and employment still worry the Chinese monetary authorities. These pre-occupations mean it is unlikely that China will have enough policy energy or manpower to take a lead role in progressing any of the initiatives that have been proposed on regional financial cooperation.

With its huge foreign exchange reserves, China could now be more forthcoming in making a contribution to advancing these proposals. Over the short-term the region can, and should, look to China for financial and 'in-principle' support for progressing the regional financial integration agenda. But it is unlikely, given the challenge of dealing with its more immediate currency concerns and the long-term need for the maintenance of independent monetary policy, that China will be able, or willing, to take a leadership role in the coordination of regional exchange rate arrangements.

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