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THE GLOBAL ECONOMIC CRISIS, REGIONAL POLICY COORDINATION AND REBALANCING GROWTH IN ASIA

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The Global Economic Crisis, Regional Policy Coordination and Rebalancing Growth in Asia

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## I. Impact of the crisis: Deeper and Scary

-Large Variations in Forecasting: Is the End near?

<table>
<thead>
<tr>
<th>Country</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>6.5*</td>
<td>6.0**</td>
</tr>
<tr>
<td>Japan</td>
<td>-6.2</td>
<td>-6.4</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>-4.5</td>
<td>-5.9</td>
</tr>
<tr>
<td>Korea</td>
<td>-4.0</td>
<td>-10.1</td>
</tr>
<tr>
<td>Singapore</td>
<td>-10.0</td>
<td>-7.5</td>
</tr>
<tr>
<td>Taiwan</td>
<td>-7.5</td>
<td>-9.3</td>
</tr>
<tr>
<td>Indonesia</td>
<td>2.5</td>
<td>1.9</td>
</tr>
<tr>
<td>Malaysia</td>
<td>-3.5</td>
<td>-3.0</td>
</tr>
<tr>
<td>Philippines</td>
<td>-</td>
<td>-1.9</td>
</tr>
<tr>
<td>Thailand</td>
<td>-3.0</td>
<td>-4.4</td>
</tr>
</tbody>
</table>

Source: *International Monetary Fund, World Economic Outlook, April 2009
**Economist .Com/Country Briefing, April 19 2009*
Crisis contagion has thrown Asia into a deeper recession through:

<Trade Channel: Dominant>
• Exports are plunging at double digit rates
• So are Imports, producing recession surpluses

<Financial Market Channel: Secondary>
  • Financial meltdown in the US => contraction of global financial intermediation => dollar liquidity shortages => deeper recession in Asia
  • Asset prices have nosedived and many currencies have weakened vis-à-vis the dollar
  • Soundness of the banking system deteriorated
Uncoupling or Recoupling of Asia: Too early to judge?

- China has not been able to substitute US and Europe as a regional engine of growth
- Japanese market for Asian exports has contracted
- Financial linkages constitute a key channel of crisis transmission for emerging market economies (IMF April WEO)
- Falling exports suggest that the volume of Asia’s intra-regional trade is shrinking rapidly
Figure 1. Export growth of Japan, China, Korea, Taiwan and ASEAN6 (Jan 2005 – March 2009)

Source: Prema-Chandra Athukorala (2009)
Figure 2. Import growth of Japan, China, Korea, Taiwan and ASEAN6 (Jan 2005 – March 2009)

Source: Prema-Chandra Athukorala (2009)
China: A “W” shape recovery and contraction?

- The Chinese authorities are prepared to execute a series of stimulus packages to achieve target rate of growth
- They are confident about sustaining 8 percent growth in 2009
- Many fear that a slowdown in growth in 2010

Japan

- Hoping that a huge stimulus package amounting to 10 percent of GDP will prevent a free fall
- Experts are divided on the possible effects of the expansionary policy
- Why have Asian NIEs been hit harder? Is their performance predicated on:

  - Export dependence (Yes and No, see Netherland)
  - Export-led growth strategy (Yes)
  - Export product concentration (Yes, see Korea)
  - Degree of deregulation and openness of financial markets (Definite Yes)
  - Labor market rigidities (Yes)
  - Flexibility of the exchange rate (Yes, see Korea)
  - Inflation targeting (?)
II. Short-Run Crisis Management

- Fiscal and monetary stimulus: too little or too much?
  - Where to sell all those goods and services unable to ship abroad in the short-run?
  - China and Japan have organized large stimulus packages: Other Asian countries to follow
- IMF: Effects of fiscal stimulus are small (WEO October 2008), but now large (WEO April 2009)
- Asia may need additional stimulus: Do they worry fiscal sustainability?
- Can Asia prevent the rise of trade protectionism?
- Preoccupation with fiscal stimulus may incur long-run losses: A serious problem?

- Domestic demand stimulation conceals structural weaknesses revealed by the crisis that call for reform
- The delayed reform will undermine long-run growth potential
- Domestic stimulus should be accompanied by institutional reform, but is it realistic?
- Lack of policy coordination to prevent leakages: Another Problem?

- Urgent need for curtailing the region’s expected current account surplus—requires coordination for stimulus and prevention of trade protectionism

- But no effective mechanism for policy coordination: ASEAN+3 has not met the region’s expectations

- The collective action problem may frustrate regional efforts
III. Regional Movements for the Prevention of Future Crisis

- A regional financial and monetary cooperation is built around a liquidity support system, a cooperative arrangement for exchange rate policy, and a surveillance system

  • ASEAN+3 has succeeded only in constructing a mutual liquidity support system known as the Chiang Mai Initiative Multilateralization (CMIM) for ASEAN5 and plus 3
- The CMIM is a multilateral arrangement governed by a single contractual agreement

- A total size of $120 billion in pooled reserves contributed by ASEAN 5 and plus 3

- Supported by a soft surveillance system known as the Economic Review and Policy Dialogue (ERPD)

- Any member drawing more than 20 percent of its borrowing limit is subject to the IMF conditionality
- Other key aspects of the CMIM including borrowing accessibility, activation mechanism, decision making rules, and lending covenants will be worked out

- **ASEAN +3** is committed to constructing a credible surveillance system to monitor the economic and financial situations of its member countries

- ERPD will be strengthened to serve as the ASEAN+3 surveillance system
- Once a credible regional surveillance system is constructed, the CMIM will become a *de facto* regional monetary fund

- Monetary unification is at best a long-term objective

- The creation of a regional monetary fund will be an intermediate step toward monetary integration

- It will help enhance exchange rate policy cooperation
What is meant by Rebalancing?

- It means changing composition of demand and production in favor of non-tradables
- Can Asia go back to the export-led growth after the crisis is over? No
- Rebalancing should focus on rectifying the bias of the incentive scheme in favor of particular sectors such as export-oriented industries
- Rebalancing is needed to remove impediments to resource allocation to the service sector and to consumption and investment in Asia