

Summary of Policy Measures

Policy tools	Intended outcome	Possible limitations	Evidence on effectiveness	Recommended policy responses
Macroeconomic measures				
Sterilized intervention	Prevent nominal and real appreciation while neutralizing the growth of base money	Rising quasi-fiscal cost; higher interest rates that attract additional inflows; unable to prevent real appreciation over the medium term due to eventual inflation	Some evidence of effectiveness in the short term, but not in the medium to long term	Limit the use of sterilized intervention as a short-run measure; reduce international reserves through a reserve-sharing arrangement (like a multilateral Chiang Mai Initiative)
Greater exchange rate flexibility	Direct monetary policy for macroeconomic management; discourage speculative capital inflows by creating two-way risks	Loss of international price competitiveness	Limited evidence on the response of speculative flows	Allow greater flexibility through regional cooperation (see the discussion of regional collective action)
Fiscal policy tightening	Contain inflationary pressure; discourage capital inflows by reducing interest rate pressure; prevent real appreciation	Lack of flexibility and timeliness; a natural limit to the degree of tightening; reduction of the provision of some basic services and infrastructure investment; possibility of a positive signaling effect to attract additional inflows	Some evidence of effectiveness in preventing real appreciation and keeping better growth performance following capital flow reversals	Exploit the automatic stabilizer function of the budget; that is, the government may implement planned infrastructure investment and basic services delivery without increasing spending out of higher tax revenues or reducing tax rates

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Summary of Policy Measures—*Continued*

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Structural measures				
Financial sector reform	Minimize the negative impact of capital flow reversals by promoting risk management	Not achievable in the short run	n.a.	Strengthen financial-sector supervision and regulation; develop and deepen capital markets
Controls on capital inflows	Limit capital inflows	High administrative capacity required, which is lacking in many emerging market economies	Some evidence of effectiveness in lengthening the maturity of inflows without much impact on the volume; effectiveness tends to weaken over time	For financially open economies, carefully design selective, temporary, market-based controls and avoid a system of extensive administrative controls. For financially closed economies, pursue capital account liberalization in a well-sequenced way together with institutional development
Easing restrictions on capital outflows	Reduce net inflows by encouraging outflows; allow residents to diversify risks	Insufficient pent-up demand for foreign assets; possibility of a positive signaling effect to attract additional inflows	Some evidence of promoting additional capital inflows	Ease outflow controls together with complementary measures such as strengthening financial sector supervision

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Rebalancing growth	Reduce current account surpluses by refocusing sources of growth from external to domestic demand; contain upward pressure on the real exchange rate	Policymakers' reluctance to abandon existing policies	n.a.	For former-crisis economies, stimulate infrastructure investment. For PRC, reduce corporate and household savings and redirect investment toward social sector protection	
Further trade liberalization	Reduce current account surpluses by encouraging imports; contain upward pressure on the real exchange rate	Failure of net imports to rise when the tradables sector becomes more competitive as a result; possibility of a positive signaling effect to attract additional inflows	n.a.	Sustain ongoing efforts to liberalize trade	
Collective action					
Global solutions	Greater transparency	Minimize the volatility of capital flows by strengthening the role of fundamentals	Lack of sufficient attention to fundamentals by market participants	Occurrence of crises despite the rise in transparency	Support ongoing international transparency initiatives
	Counter-cyclical in financial regulation	Minimize herd behavior resulting from imperfect and asymmetric information	Unlikely to receive wide support	n.a.	Consider this measure as part of the agenda for future research

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Regional solutions	Regional exchange rate coordination	Maintain macroeconomic and financial-sector stability without much affecting international price competitiveness	Not viable without a mechanism for conducting intensive policy dialogue and cooperation	n.a.	Utilize existing policy dialogue processes such as ASEAN+3 ERPD and EMEAP to achieve collective currency appreciation
	Regional financial market surveillance/integration	Monitor regional financial markets and capital flows; mitigate the impact of investor herd behavior and financial contagion	Not viable without an effective institution	n.a.	Establish a new, high-level “Asian Financial Stability Dialogue” on regional financial-sector issues
	Regional cooperation on capacity building	Enhance capacity of financial regulators and supervisors to manage increasing financial risks in the markets	Not viable without an effective institution	n.a.	Include this measure among important functions of the “Asian Financial Stability Dialogue”