NUS National University of Singapore
**Source:** *The Straits Times*, pA35
**Date:** 11 July 2020

# *Can the global financial safety net rescue Asia?*

## There are many layers, but the performance so far is patchy

**Ramkishen S. Rajan and Bhavya Gupta**

For The Straits Times

The global spread of Covid-19 and subsequent Great Lockdown to mitigate the health impact has brought unprecedented disruptions to economies across the world. Emerging economies in Asia and elsewhere experienced abrupt and sharp reversals in portfolio flows in the first few months of 2020 following a spike in global risk aversion and a generalised flight to safety. These outflow pressures in turn triggered concerns about acute exchange rate and financial instability.

While aggressive intervention by global central banks led by the United States Federal Reserve has certainly reduced strains in the global dollar funding market and helped flatten the curve of financial panic, the damage to the real economy has been massive and in some cases, there is likely to be long-term scarring.

The IMF World Economic Outlook 2020 (June update) projects emerging and developing Asia to contract by 0.8 per cent in 2020 (compared with a 5.5 per cent expansion last year). The forecasts for 2021 remain highly uncertain, with some countries like India still struggling with the first wave of coronavirus infections while others like South Korea are battling the second wave. Meanwhile, doubts remain about when an effective vaccine will be available. Rising regional and global geopolitical tensions add another wildcard to future economic prospects in Asia.

### A MULTI-LAYERED NET

After successive economic and financial crises, including the Asian financial crisis of 1997-98 and the global financial crisis of 2008-09, a de facto global financial safety net (GFSN) seemed to have organically emerged to deal with their adverse impacts on countries.

The GFSN comprises multiple layers, starting with domestic responses (fiscal, monetary, macro-prudential policies and use of own reserves), bilateral swap lines, regional financing arrangements, and international assistance from multilateral and regional organisations such as the International Monetary Fund (IMF), World Bank, Asian Development Bank (ADB) and the two newest kids on the block – the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB).

How has the GFSN fared in the Covid-19 pandemic for Asia?

At the domestic level, Asian countries have utilised their foreign exchange reserves to buffer themselves against sudden stops in capital flows, as well as deployed aggressively expansionary macroeconomic policies to combat the pandemic-induced downturn.

Almost all central banks in the region have cut interest rates sharply and boosted liquidity in general, with additional schemes targeted specifically at small and medium-sized enterprises (SMEs) that have been hit hardest by social distancing and circuit breaker measures.

The ADB's Covid-19 policy tracker estimates an expenditure of US$3.3 trillion (S$4.6 trillion) in aid packages by developing member governments as of June 29, with about half aimed at direct income support.

Many countries do not have the kind of hard-earned fiscal space that Singapore has judiciously built up over the years to aid in economic healing and recovery. If additional fiscal stimulus is needed over time, one can expect further vocal calls for central banks in the region and elsewhere to offer direct monetary financing to the government as have happened in some countries.

However, as with the use of selective industrial policies, while the analytical case for such a policy may be strong, they may be ill-suited for countries where political capture is a genuine concern and central bank independence has been under threat even prior to the pandemic.

### UNEVEN RESPONSES

On a bilateral level, despite the existence of bilateral swap arrangements between many Asian countries, they have generally not been activated during the pandemic (with some exceptions in South Asia such as India's assistance to Maldives).

Instead, bilateral US dollar swaps facilitated by the Federal Reserve have once again taken on a prominent role, as happened during the global financial crisis. In March, the Fed extended liquidity arrangements worth US$60 billion each to selected countries, including South Korea and Singapore in Asia. The limited set of countries chosen by the Fed for its bilateral swap lines suggests it is unwilling to act as an international lender of last resort despite the vulnerability of emerging economies to sudden shifts in US dollar funding.

While the Fed has rolled out repurchase facilities for a larger number of foreign central banks through which they can temporarily sell their holdings of US Treasury securities to the Fed in exchange for US dollars, this was likely done primarily to soothe possible strains in the Treasury market than the Fed looking to expand its role as an international lender of last resort.

In Asia, a subset of countries in the region, namely Asean Plus Three (China, Japan and South Korea), have over the years nurtured closer regional financial cooperation, surveillance and liquidity support via a network of multilateral swap arrangements (the Chiang Mai Initiative Multilateralisation or CMIM).

**The GFSN (global financial safety net) comprises multiple layers, starting with domestic responses (fiscal, monetary, macro-prudential policies and use of own reserves), bilateral swap lines, regional financing arrangements, and international assistance from multilateral and regional organisations such as the International Monetary Fund, World Bank, Asian Development Bank and the two newest kids on the block – the Asian Infrastructure Investment Bank and the New Development Bank.**

The CMIM, which came into effect in March 2010, currently has a fund strength of US$240 billion to provide financial assistance to member countries. However, the arrangement was not activated even in the height of the Covid-19 financial market turmoil when it seemed to be needed by some countries in the region. While the CMIM has been amended recently, it remains untested, with observers questioning its operational readiness. Overall, regional response to the crisis in Asia has generally been found wanting on the financial dimension.

At the global level, the IMF has mobilised a quarter of its entire US$1 trillion corpus of lending capacity to assist member countries, disbursing loans fairly quickly via its emergency facilities – the Rapid Financing Instrument and the concessional Rapid Credit Facility. In Asia, Bangladesh, Myanmar, Nepal and Pakistan are among a handful that have been granted IMF emergency financing.

The other Bretton Woods institution, the World Bank, has committed to providing US$160 billion in financial assistance. To date it has disbursed over US$2 billion in fast-track assistance to selected countries in South Asia and East Asia, and has activated emergency components of existing projects to strengthen the public health systems of these countries.

The ADB has announced the creation of a US$20 billion Covid-19 Pandemic Resource Option. The CPRO comprises a package of grants and concessional loans to poorer member countries, expenditure on counter-cyclical programmes and microfinance loans for the worst-hit SMEs. It has thus far disbursed US$7 billion to developing member states. The AIIB has created a Covid-19 Crisis Recovery Facility for disbursement to member states and the NDB has established an Emergency Assistance Facility to disburse rapid financial assistance to Brics (Brazil, Russia, India, China and South Africa) countries.

### PAYING THE PRICE

Overall, while there have been multiple responses to combat the economic effects of Covid-19 at various levels, their effectiveness is compromised due to the lack of coherent design of the GFSN and limited coordination among countries and institutions.

A Group of 20 report on global financial governance published in 2018, entitled Securing The Benefits Of Interconnected Financial Markets: Reforms For Global Financial Resilience, which was chaired by Senior Minister Tharman Shanmugaratnam, was prescient in emphasising the risks posed by a pandemic/public health emergency to individual countries and the global economy.

The report further noted that "the current decentralised structure as a whole lacks the necessary coordination to effectively use its aggregate financial capacity". The patchy and uncoordinated response to the Covid-19 pandemic has clearly validated this conclusion and the world is paying a very heavy price.

stopinion@sph.com.sg

• Ramkishen S. Rajan and Bhavya Gupta are respectively Yong Pung How Professor and PhD student at the Lee Kuan Yew School of Public Policy, National University of Singapore. The views expressed are personal.

Source: The Straits Times © Singapore Press Holdings Ltd. Permission required for reproduction.