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Source: *The Business Times*, p21
Date: 17 September 2020

Does Covid-19 mark the death of financial globalisation?

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> It is unfortunate that countries are abandoning their commitment towards free trade, when there is a near-unanimous consensus that trade globalisation is net positive for a country.

AS COVID-19 continues to ravage economies across the world, it has now become a common refrain that economic globalisation is passé. Indeed, even before the onset of the pandemic, there were significant concerns that the world was moving towards an era of trade de-globalisation, fuelled by the US-China trade war.

The spread of the pandemic has only amplified such concerns, setting in motion a wave of supply chain-related trade disruptions. Protectionist policies have also risen globally, as some larger countries in Asia and elsewhere have turned inwards as a means of becoming more self-reliant.

It is unfortunate that countries are abandoning their commitment towards free trade, when there is a near unanimous consensus that trade globalisation is net positive for a country – that is, gains to the winners (exporting firms and consumers) far exceed the losses incurred by firms and workers in import-competing sectors.

Somewhat paradoxically, while trade barriers are rising, capital flow restrictions are being eased, despite several studies pointing out that the benefits from financial globalisation are ambiguous at best.

To be sure, in theory, financial globalisation can bring about potential benefits, such as greater risk-diversification opportunities, lowering cost of capital (which in turn promotes investment and growth) and enhanced financial-sector development.

However, in practice, such benefits are not clear-cut and are subject to a number of caveats. Uncertain benefits aside, embracing financial globalisation can also potentially be accompanied by some major risks.

For example, if a country does not have strong fundamentals, sound prudential regulations and good governance in general, full-fledged financial globalisation could increase the likelihood of outright financial crises, as many emerging economies have experienced.

Thus, while countries with sound fundamentals, regulatory and governance structures like Singapore have flourished by embracing financial globalisation, others have fallen into a financial globalisation trap of instability and anaemic growth.

A useful metric to measure financial globalisation is to consider a country's stock of external assets and liabilities (as a share of gross domestic product). Data for Asean+3 reveals that international financial integration has risen notably over the last two decades in the region, emphasising the sustained and enthusiastic embracement of financial globalisation by the regional economies. International financial integration in the region hit an all-time high in 2019, just before the onset of the Covid-19 pandemic.

While the region on the whole has experienced an increase in de facto international financial integration, Singapore is a clear outlier, where the levels of integration were almost 18 times GDP on average between 2007 and 2019 (compared to the regional average of just over three times), owing to its high degree of openness as a global financial centre.

Despite the initial sudden stop in capital flows in the early stages of the pandemic, there has been a subsequent recovery and resurgence in capital flows across many emerging markets in Asia and elsewhere. With burgeoning fiscal deficits in response to the Covid-19induced recession, the external financing needs in many countries will only increase over time, in turn driving them to open up even more to certain types of capital flows.

RISING FISCAL NEEDS

Indeed, some Asian economies have already raised additional funding by selling US dollar-denominated pandemic-type bonds. Indonesia was one of the early movers, having raised US$4.3 billion in April 2020. The Philippines issued US$2.35 billion worth of pandemic bonds in two tranches in May 2020.

As the fiscal needs of regional governments rise, one can expect more of such sovereign issuances – implying more, rather than less, financial globalisation.

In terms of actual regulatory policies, China has removed restrictions on the investment quota of foreign institutional investors; India has similarly raised its limits for investments in corporate bonds by foreign portfolio investors.

Several countries in the region have also been encouraging foreign direct investment to boost domestic investment, growth and employment, though some, like India, have simultaneously taken steps to restrict cross-border mergers and acquisitions (M&As) in sensitive areas.

In addition to cross-border capital flows, one of the other important dimensions of financial globalisation pertains to the internationalisation of the financial sector, defined here in a narrow sense to involve foreign bank presence. Until the global financial crisis, European and American banks were dominant in Asia.

However, the region witnessed a significant retreat by European banks following the eurozone crisis, which was partly compensated by the rise of Asian banks from Japan, China, Korea and Singapore.

The role of Singapore as a financial hub to the rest of emerging Asia has evolved over the years. Singapore-based financial institutions have become critical nodes in helping mobilise financial resources from advanced economies and recycling them to emerging economies in Asia.

The republic's role in the rise of intra-Asian banking, which McKinsey in 2019 called the "world's largest regional-banking market", has been an important driver in promoting regional integration and development, and will likely remain so, as corporates look to re-organise their global and Asian operations.

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