



# MIER POLICY BRIEF

## Covid-19 and The Disruption Of Globalisation

BY ©SHANKARAN NAMBIAR

It appears that the Covid-19 pandemic puts into question our basic assumptions about globalisation. By extension, it means that Malaysia, as a small, open economy, has to question its position in a globalised world that is open to abrupt disruptions, and the challenges that it faces.

Although there are other aspects to globalisation within the social domain, impinging upon the media, culture and connectivity, globalisation primarily rests upon economic integration as its foundation. Economic integration is possible when economies are inter-connected, inter-dependent and markets are linked. This implies the free (or almost free) flow of resources. Simply, it depends on the free movement of goods and services, capital and natural persons.

Neoclassical economics conceptualises globalisation as functioning through interconnected markets and geographies only if markets are liberalised and restrictions to movement are removed. This explains the emphasis that is placed on the liberalisation of economies and a regulatory framework that favours the free movement of factors of production.

International organisations such as the WTO and the IMF are premised on the need for a global economy that will further promote trade and investment because these two factors, as the evidence indicates, have done much to promote growth and development in developing economies.

However, the free movement of resources is not without its shortcomings. The volatility of capital flows and the contagion effects that ensue are examples that come to mind. We are familiar with issues that can arise due to unrestricted financial flows and the transmission of financial and economic crises through linked monetary and financial markets.

A key characteristic of globalisation is the interconnectedness of financial markets. The 1997 and 2008 crises are ample examples of how a financial breakdown in one country can affect economies around the world. The 1997 Asian financial and economic crisis which affected Malaysia severely was the result of financial contagion; and the 2008 crisis sprung from the housing bubble and subprime crisis in the US.

Dr. Shankaran Nambiar, Head of Research at MIER explains that, "The Covid-19 outbreak has fractured the tenets of globalisation; in the months after the phenomenon has settled, government expenditure will have to go into putting the pieces together and revitalising domestic industries. The government will have to work with the private sector to ensure that trade and investment is reinvigorated. Since ASEAN as a whole would suffer from the impact of Covid-19, a regional strategy would be well-advised, especially in encouraging economic integration as part of the reset when nations recover.

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The trade war between the US and China was a recent incident that illustrated how trade tensions between two countries, especially if they are economic giants, can have impacts that spill across the globe. The tariff imposition initiated by the US and subsequent retaliation between the US and China had consequences for the global economy. The outcome hurt most economies, particularly those that are open and export oriented, such as Malaysia. The extent of damage was considerable, disrupting global supply chains and international trade, consequently lowering global demand and, therefore, global and national GDPs.

The recent trade tensions between the US and China did not result in a crisis in Malaysia. But it did result in lower growth rates. There was a slowdown in Malaysia's growth numbers because Malaysia's trade is closely tied with China; what affects China will affect Malaysia. The general softening of China's economy in 2019, with a six per cent growth rate, something not experienced in the last decade, did affect the Malaysian economy in so far as global demand for Malaysian output decreased.

If the tension had worsened, that might have helped Malaysia since companies in China would have decided to relocate to Malaysia. Given initial adjustments trade diversion would have occurred and Malaysia would have benefitted from it. Thus, a prolonged trade war could have acted in Malaysia's favour.

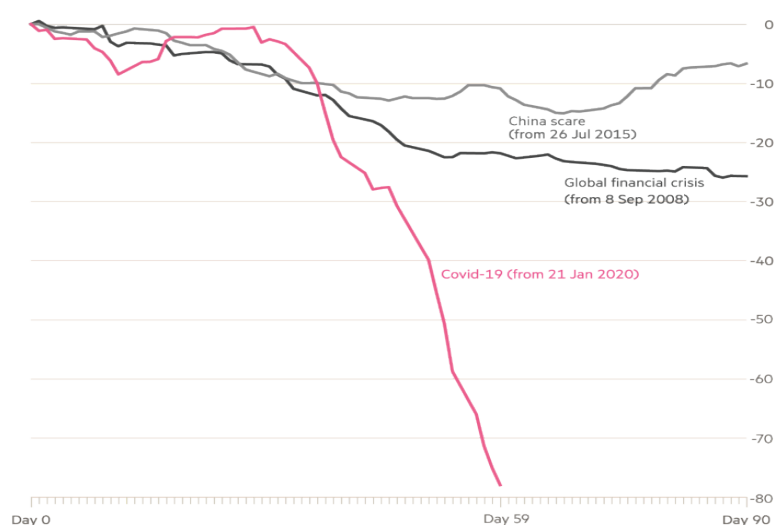
The trade war did not result in an economic crisis, but it could have resulted in a contraction for any vulnerable economy. Most studies placed Malaysia and Vietnam in a favourable position, indicating that both would stand to gain from trade diversion and the relocation of investment to Malaysia. The point, however, is that fissures in the real economy can affect the rest of the economy, leading to downturns, and possibly recessions. That is why the Covid-19 outbreak has deep out-turns for the economy.

This time the crisis is different. It is different because its origins are biological; but it affects cross-border trade and investment. There are outflows from emerging economies and the outflows in this period of the Covid-19 are going to be worse than it was during the 2008 global financial crisis and the 2015 episode when China's stock market crashed (Fig. 1). Malaysia will not be an exception; it is likely to see outflows, too.

The Covid-19 episode restricts movement within national boundaries, affecting domestic demand, which in turn will negatively impact global trade and investment. This time, unlike the 1997 and 2008 crises, it is the real sector that is affected in the first instance, and if prolonged, could result in the financial sector being put under stress. An economic crisis cannot be ruled out as a consequence of the outbreak if it is not quickly contained.

**Figure 1: Capitulation In Emerging Markets**

Cumulative non-residential flows to/from EM debt and equities from start date (\$bn)



Source: IIF  
© FT

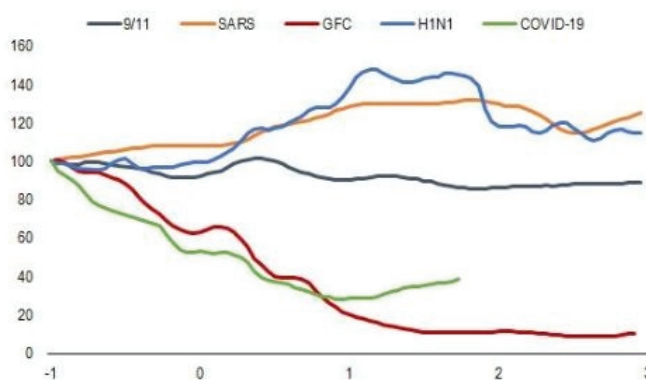
Source: Institute of International Finance. Financial Times  
(<https://www.ft.com/content/69fc6e2a-69d3-11ea-a3c9-1fe6fedcca75>)

Due to the pandemic countries are imposing self-isolation, something that is anathema to globalisation. Travel across countries has been restricted and many countries have closed their borders to travellers from other countries, particularly if they are from high risk countries like China, Iran, Italy and Spain. Australia has banned the inflow of all foreign citizens, a measure not taken in its history. The US has travel restrictions from China, the Schengen area, Iran, the UK and Ireland. Malaysia has its own list of restricted countries.

The similarity between the trade war and the current outbreak rests in the fact that both are affecting the real economy. There is going to be a contraction to the real economy in Malaysia and this is going to start with the export-oriented manufacturing sector. In the early wave of the Covid-19 outbreak in China, the electronics sector in Malaysia was beginning to feel the pinch, with manufacturers of test equipment and chips finding it difficult to produce due to delays in shipment of inputs from China. Goods are transferred through ships and available indices indicate that shipment has been slow to a significant degree (Fig. 2). Other sub-sectors that have been affected have included valves and fittings, fasteners and smartphone parts.

**Figure 2: Shipping Index**

(Baltic Dry Index, one month prior to start date = 100)



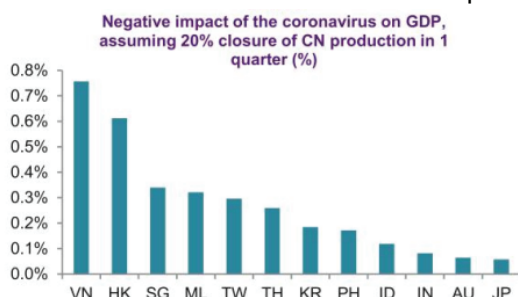
Sources: Haver Analytics; and IMF staff calculations.

Note: The x-axis shows the months elapsed since the indicated event, with t=0 the initial impact month. Underlying data are at daily frequency. Specific start dates by event are: COVID-19 = Coronavirus Disease 2019 (January 11, 2020), H1N1 = Influenza A virus subtype H1N1 (April 15, 2009), GFC = Global Financial Crisis (September 15, 2008), SARS = Severe acute respiratory syndrome (November 16, 2002), and 9/11 = (September 11, 2001).

Source: IMF. <https://blogs.imf.org/2020/03/09/limiting-the-economic-fallout-of-the-coronavirus-with-large-targeted-policies/>

The free flow of goods is under attack with the Covid-19 outbreak. This will slash the output from the manufacturing sector and hit Malaysian exports. To a large extent Malaysia's export profile comes from the manufacturing sector and this will translate into a reduction in the manufacturing sector's contribution to GDP. It should be noted that exports amount to about 68 per cent of GDP. But the disruption of global supply chains due to the pandemic will not help local producers. It has been reported that manufacture have been affected by supply disruptions of raw materials and intermediate goods from China and this alone could translate into a contraction in GDP that is close to 0.3 per cent (Fig.3).

**Figure 3: Macro-Economic Value Chain Impact of Covid-19**



Source: CEIC, UNCTAD, Natixis

Notes: VN denotes Vietnam, HK denotes Hong Kong, SG denotes Singapore, ML denotes Malaysia, TW denotes Taiwan, TH denotes Thailand, KR denotes Korea, PH denotes Philippine, ID denotes Indonesia, AU denotes Australia, JP denotes Japan.

Source: CEIC, UNCTAD, Natixis, Herrero, A.G. (2020). The impact of "Novel Coronavirus Pneumonia" on Global Value Chain. Working Papers No. WP/2020-04/70. Asian Financial Cooperation Association.

Without doubt the free flow of labour will also be impaired. It is not clear how the flow of undocumented migrant labour will be impacted, but skilled labour will surely be affected. Company officials will not be able to visit the destinations of overseas clients and suppliers. Restrictions on the movement of natural persons will also affect the flow of tourists to Malaysia. Not only will the tourism industry be affected but also related industries such as the hospitality and travel sectors. With the tourism industry accounting for about RM84 billion or six percent of GDP and value added of tourism industry to GDP amounting to around 15 per cent the effect cannot be casually swept aside.

The odd thing about the Covid-19 pandemic is that it seems to support what the world has been fighting against – a tendency to break away from globalisation and to stress national health priorities above all else, as it is, of course, absolutely necessary to do at this moment. Brexit, the US-China trade war, the US pulling out of the TPP and Trump's threat to withdraw from the WTO all spell the threat that globalisation is under. The Covid-19 pandemic is yet another event that threatens globalisation. The virus outbreak has led to a disruption in supply chains, the closure of airports, restriction in travel, a choking of the tourism and hospitality industry, all of which result in self-isolation, the very reverse of what globalisation implies.

The outbreak on one hand disengages countries from several aspects of globalisation, but by doing so highlights the importance of globalisation. The transmission of the disease from external borders will have an effect on domestic demand (shutdown of malls, movie theatres, restaurants, schools, universities, etc), employment and consumer demand. The Malaysian economy in the last few years has been largely buoyed by domestic demand; this year domestic demand will take a big dent.

The disruptions to global activity will not only affect domestic demand but will also affect Malaysia's fiscal position. Malaysia has had an unresolved RM1 trillion debt problem; it has also been trying to achieve a balanced budget over the last several years. Malaysia's fiscal deficit of 3.4 per cent in 2019 has no chance of narrowing in 2020. The government's RM20 billion stimulus and the additional measures to counteract the outcome of the Covid-19 spillout will possibly be inadequate should the current partial lockdown be extended beyond 31 March. Depending on how the pandemic turns out, further expansionary measures may be necessary.

Once the curve is flattened and a state of relative normalcy is attained, a great deal will have to be done to get the global economy back on track. Individual countries will have to stimulate their export-oriented industries. Malaysia will have to lend additional support to its manufacturing sector, particularly to the E&E sector. The SME sector will also have to be brought back to its feet, as will the tourism and hospitality and retail sectors. It is reported that the aviation industry seeks assistance from the Ministry of Finance to withstand pressures due to lower passenger demand. Consumer and business confidence will also have to be revived since we have been suffering from rather lukewarm expectations even in the months before the onset of Covid-19.

In the spirit of ASEAN, it would be helpful if ASEAN leaders could coordinate their efforts in combatting the pandemic. This is an opportunity for Malaysia to assume a leadership position. Some of the steps that can be explored would include learning from each other's experiences and sharing technical expertise. Where possible and necessary member states can consider the possibility of sending masks and equipment to countries that need the resources. Joint operations can be launched to help trace those who have tested positive and travelled to other destinations within the region.

ASEAN will have a bigger role to play in the aftermath of the outbreak after the pandemic is over. Member states that have been deglobalized, will seek to recover and to reinvigorate their economies; that is when normalcy will have to be restored to the shipment of inputs and final products and the movement of labour. If Covid-19 is about borders being closed and deglobalisation, then the period after the crisis will be a period for economic integration. ASEAN can play an important role in facilitating economic integration post the outbreak.

The Covid-19 outbreak has fractured the tenets of globalisation; in the months after the phenomenon has settled, government expenditure will have to go into putting the pieces together and revitalising domestic industries. The government will have to work with the private sector to ensure that trade and investment is reinvigorated. Since ASEAN as a whole would suffer from the impact of Covid-19, a regional strategy would be well-advised, especially in encouraging economic integration as part of the reset when nations recover.