KIEP Opinions
May 26, 2022

K-shaped Scar of COVID-19 on the Global Economy

Sang-Ha Yoon
Ph.D., Associate Research Fellow, International Macroeconomics Team
Korea Institute for International Economic Policy

The novel coronavirus infections that occurred at the end of 2019 not only claimed numerous lives but also brought about significant changes in the global economy and society. In terms of growth rates alone, the global economy is estimated to have recovered 5.9% in 2021 after recording negative growth of 3.1% in 2020, indicating that the trough of recession runs deeper than that of the global financial crisis. Among country groups, emerging economies experienced 2.1% negative growth in 2020. The International Monetary Fund (IMF) estimated the growth rate of the group rebounded to 6.5% in 2021, but it should be judged that developed countries are doing better in terms of economic performance.

One of the reasons why emerging countries are recovering relatively slowly after the COVID-19 crisis is the imbalance in the supply of vaccines among countries. As IMF President Kristalina Georgieva has mentioned, the vaccine policy in this crisis is indeed economic policy. International cooperation related to vaccine dissemination is essential for the complete recovery of the global economy. Despite concerted efforts, however, the vaccination rate in low-income countries remains far below that of high-income countries. The pharmaceutical companies that jumped into vaccine development after the crisis are located in advanced countries and receive massive support from the government, also possessing excellent research and development capabilities and the resources to conduct large-scale clinical experiments. These companies and networks have given priority to their own countries and neighboring developed countries in accessing vaccines. Efforts have been made to speed up the spread of vaccines to emerging and underdeveloped countries through the COVAX Facility, an international vaccine supply project, but it still remains insufficient in areas such as transportation, distribution and storage. Such a gap in the spread of vaccines has eventually materialized as a differentiation of economic recovery.

Another reason for the K-shaped scar is the difference in the ability of governments to provide financial support. Governments in developed countries enjoy economic stability and reliability, making it relatively easy for them to raise funds in the face of an economic crisis. Examples include the U.S. Infrastructure Investment and Jobs Act, Build Back Better Act, and the European Union's Next Generation EU. Additional spending and foregone revenue used by developed countries to cope with the COVID-19 crisis are confirmed to reach 11.7% of GDP in 2020, and equity, loans and guarantees are estimated to be at 11.4% of GDP. On the other hand, in low-income developing countries, the amount of additional spending and foregone revenue remained at a mere 3.2%, while equity, loans and guarantees stand at 0.9%.

Because of these two disparities among country groups, the COVID-19 crisis has reversed the trend of easing income inequality between countries that has continued for the past 30 years. During the 2008 global financial crisis, emerging countries played a role in supporting the global economy and narrowed the gap with developed countries. However, after the outbreak of the coronavirus, the estimated inequality between countries has deteriorated by 1.2%. According to the World Bank, the world population's income change rate for 2020 and 2021 shows that the bottom 40% of the population was also hit hardest, recording an annual income loss of about 6-7% every year. On the other hand, the top 20% showed only income losses within 5% in 2020 and 3% in 2021. The higher income level group defended their income better during the COVID-19 crisis. Considering that the ultra-low interest rates and the huge liquidity through quantitative easing have caused the spike in asset prices, the asset inequality must be more severe than income inequality.

The increasing income inequality and K-shaped scar can be witnessed in the labor market too. According to the International Labor Organization (ILO), global average working hours failed to recover the level of fourth quarter in 2019 until the third quarter in 2021. For example, working hours in the third quarter of 2021 were 4.7% short of the fourth quarter of 2019, which amounts to 137 million job losses on a full-time basis. In addition, a discriminatory impact on the job market, which varies by country, can be seen. Working hours in high-income countries gradually recovered from losses of more than 5% in the fourth quarter of 2019. On the other hand, low-income countries recorded working-hour losses of at least 4% to 8% compared to the fourth quarter of 2019, and are still not on a full-fledged recovery trend.

Another fact to note in the labor market is that low-productivity and low-wage workers in small-sized workplaces were hit harder than those in high-productivity and large-sized ones. Working hours for small businesses with four or fewer employees fell by 12.1% in 2020, while large businesses with 50 or more employees showed a decline of 8.7%. Small and face-to-face businesses are more directly affected by COVID-19, especially in low-income countries, where government support is small and financial accessibility is falling. On the other hand, large companies are effectively protecting their employees from working hour loss by implementing well-built IT infrastructure in response to the spread of COVID-19.

With the private sector's self-sustaining ability yet to fully recover, it is more urgent than ever for governments to take on additional roles and engage in deeper levels of international cooperation. However, government debt has increased significantly in emerging countries in response to the crisis and the rate of debt growth is faster than usual. Accordingly, the credit ratings of many emerging and underdeveloped countries have been lowered. These countries are expected to experience more difficulties in preparing financial resources to cope with the crisis by issuing government bonds, mainly due to the combination of rising interest rates and shrinking asset markets. This means that while the role of fiscal policy for inclusive recovery has become very important, the global financial market environment has changed negatively for many countries. Therefore, as the COVID-19 crisis is yet to pass, governments need to selectively and effectively support using limited resources. At the same time, the government should come up with an orderly exit plan of smooth restructuring and reallocation of resources to induce marginal companies with dim prospects of growth in the medium and long term to gradually prepare for exiting the market. Second, to properly control inflation that will hit low-income households harder, governments must help prepare measures to improve the efficiency of distribution of goods, find alternative inputs, and restore supply chain networks. Finally, efforts toward cooperation in the area of distributing vaccines should be further expanded, as the world must be freed together from new coronavirus infections, and international financial collaboration among developed countries should be improved in preparation for possible austerity attacks.