The Changing Global Economic Landscape with COVID-19

Sungbae An
Ph.D., Senior Research Fellow
Department of International Macroeconomics and Finance
Korea Institute for International Economic Policy

It has been almost half a year since the massive outbreak in Wuhan, China was globally noticed. Lockdowns, however, are still in force in many economies around the world. At first, the question being asked was when we could get back on normal track and make up for the loss of income from a temporary health shock. And now, to everyone's regret and frustration, the situation is devolving beyond uncertainty into ambiguity. Which direction is the global economic landscape shifting toward with COVID-19? The change should be interpreted in the context of a longer-term transition already in progress.

Before the recent downturn phase of globalization cycles started, the international division of labor had contributed to the acceleration of globalization in accordance with the Ricardian trade theory. The diminishing cross-border transaction cost was another driver of globalization, which was made possible by technological advances in the telecommunication and transportation industries and by policy directions to lower trade barriers, for instance through the WTO or FTAs. The expansion of global value chains (GVCs) followed, on the basis of a stable geopolitical environment

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following the end of the Cold War. As cross-border investment increased during the process of expansion, the general public health environment in emerging economies improved as well.

The trend of deglobalization steadily gained strength after the global financial crisis. One popular explanation of this downturn focuses on rising inequalities in advanced economies as a result of globalization. The famous and simple diagram by Lakner and Milanovic, the elephant curve, summarizes how the distribution of global income evolved during two decades of globalization up to 2008. The global richest have benefited from a more than 50 percent increase in their income. Similar gains are obtained by global median workers who coincide with middle classes in emerging economies such as China, India and Brazil. But the globalization leaves no improvement to top 10 to 20 percent workers who happen to be lower earners in advanced economies. Political pressure towards populism rises and is materialized through elections and referendums in the form of the Trump presidency and Brexit. The main economic consequence of the pressure emerges as protectionism. The U.S.-China trade dispute deepens and protective measures are widely adapted. The GVCs are now affected by the rising cost of cross-border transactions.

Longer-term transition depends on other factors, often called the mega trend. It includes advancement in digital technology, climate change and environmental problems, the new normal in monetary policy, and ageing populations. With all these transitions, the global growth has dampened over the last decade. What will be added to the already changing global economic landscape by the humongous shock of COVID-19? A couple of channels will work.

First, economic agents will take health shocks into consideration in their decisions and related costs will be internalized. The foremost impact through this channel is the acceleration in digital transformation. The lockdown has affected the general public's recognition on how to work and to consume. Person-to-person interaction in business will dwindle and digital communication such as video conferencing will prevail. This transformation was predicted even before the COVID-19 pandemic, but was hindered by the large cost involved. On the other hand, the internalized cost elevates cross-border transaction barriers, which will reshape the GVCs. The supply chain will be restructured with the consideration of counter-party country risks and resilience becomes a more important factor. It has also been revealed that the exposure to health risks is uneven across ethnicity, age and income groups, which will escalate the political pressure to reinforce protectionism.

Second, the crisis management leaves long-lasting marks on the economy. Government interventions will become more common and frequent. Additional regulations are expected on medical systems and the labor environment. Privacy issues concocted with digital technology are now under fierce discussion. Rising uncertainty is another concern. Preemptive, decisive and sufficient measures are required to prevent meltdown of the economy in the crisis period. Hence, most governments and central banks have introduced tremendous emergency packages and are considering further vitalization plans. As seen from the global financial crisis, the unconventional monetary policy that was necessary back then proved difficult to normalize after the crisis period, and it left sizeable uncertainty worldwide.

It is still too early to forecast the loss and the recovery from this unprecedented shock. The direction of changes are vaguely foreseeable. Further developments will be determined by the persistence of the shock, the productivity gain from digital transformation, and the ongoing U.S-China hegemony war. Within this ambiguity, we should keep striving to measure and judge the global economic landscape and be prepared to catch the opportunities that materialize. KIEP