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Averting a Great Divergence

Exiting the pandemic with minimal scarring will require policy action on several fronts

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THE COVID-19 PANDEMIC and the widespread lockdowns imposed in 2020 led to the worst peacetime global contraction since the Great Depression. The first half of 2020 saw record collapses in output and only a partial rebound in the second half as economies gradually reopened, supported by decisive fiscal and monetary policy measures. While the remarkable success in developing vaccines provides hope of conquering the pandemic, fresh waves of the disease and a mutating virus portend uncertain times and risky prospects for 2021.

In the January 2021 update of the *World Economic Outlook*, the IMF revised global growth upward for 2021—reflecting the start of COVID-19 vaccinations, continued policy support in systemically large economies, and adaptation to social distancing measures by firms and households. But the projection is fraught with uncertainty and highlights the stark divergence in prospects across countries. On the one hand, China returned to its pre-pandemic projected level in the fourth quarter of 2020, and the United States is projected to surpass its pre-COVID levels this year. On the other hand, more than 150 economies are expected to have per capita incomes below their 2019 levels in 2021. And more than half of the emerging market and developing economies whose per capita incomes had been converging toward those of advanced economies over the past decade are expected to diverge over the next few years. Nearly 90 million people are expected to fall into extreme poverty during 2020 and 2021, reversing the trend of the past two decades.

These divergences partly reflect differences in the sectoral composition of countries. But they also reflect the severity of the health shock and how effectively governments dealt with the crisis. Averting the divergences in growth prospects and exiting the pandemic with minimal scarring will require policy actions on several fronts.

On the medical front, advanced economies and some emerging market and developing economies have secured substantial doses of vaccine and initiated large vaccination drives that hold out hope for faster easing of containment measures and stronger recoveries. However, many developing and low-income countries have had less success accessing vaccines. As a result, they are dependent on the multilateral COVAX facility, which guarantees vaccine coverage for just 20 percent of the population. But the pandemic is not over until it is over everywhere. To vaccinate enough of the world's population to contain the pandemic will require global action on scaling up of vaccine production, additional funding for COVAX, and financing the logistics of getting people vaccinated.

The crisis has had not only health consequences, it has wreaked havoc on many livelihoods. While advanced economies have the fiscal space to extend widespread measures to support economically devastated households, other countries, especially those with scarce fiscal space, will face difficult trade-offs. To avert an even greater divergence in economic prospects, all countries must continue to support livelihoods and keep viable firms afloat until they are certifiably past the crisis.

Many countries can ramp up spending by borrowing and still maintain debt at sustainable levels because of historically low borrowing costs that are expected to stay low for the foreseeable future. But in countries with limited fiscal space, spending should be prioritized for health and transfers to the poor. International organizations and bilateral donors must ensure that these countries have adequate access to concessional financing and grants to support critical spending. Expanding the IMF's Special Drawing Rights (SDRs), an instrument that was designed precisely for a global crisis like the one we are living through, should also be considered.

For the hardest-hit countries—especially those that entered the crisis with high levels of debt distress—globally coordinated measures to provide debt relief, and in some cases outright debt restructuring under the new Common Framework agreed to by the G20 countries, may be inevitable.

The pandemic has not just inflicted short-term economic damage, it has left potentially long-lasting scars that can further exacerbate divergence. A chief concern is school closures, which threaten the livelihoods of a generation of children. These disruptions have been particularly costly in emerging market and developing economies, where remote learning is practically infeasible. Left unaddressed, this diminution of skills and educational attainment can have lifelong implications—exacerbating inequality and precipitating social unrest. Governments must swiftly take action to ensure that all school-age children can benefit from distance learning. They must provide vouchers to enable families to buy computers and other IT equipment, ensure the return to school of the large number of students from poorer households who dropped out, and create programs to allow students to make up for lost learning.

Not only are there divergences across countries, there are worrisome divides within countries too. Millions who lost jobs to lockdowns joined the ranks of the long-term unemployed, and many have given up looking for work. Low-skilled workers, women, and youth—who are vastly overrepresented in jobs where social distancing is difficult or impossible—experienced the largest increases in unemployment in many countries, exacerbating pre-pandemic inequalities.

Many of those same workers are confronting another transformation of the labor market accelerated by the pandemic: the automation of work. Workplaces have hastened to adopt technologies to mitigate health risks to workers and strengthen preparedness against future shocks. Self-checkout machines replace grocery store cashiers. Chatbots fill in for call center operators. Such technological changes can help the overall economy by raising productivity, increasing output, and improving living standards—though the evidence is somewhat mixed. What is well established is that low-skilled workers are the most easily replaced by machines.

Moreover, as the pandemic transforms the business landscape, the major impact is on small- and medium-sized enterprises (SMEs), which employ up to two-thirds of the labor force in some countries, and which are even more vastly overrepresented in contact-intensive sectors hit hardest by the pandemic—such as leisure, hospitality, accommodation, and the arts.

Because of persistently weak demand in these sectors, a prolonged health crisis will spell the end of many SMEs. A premature withdrawal of policy support would hasten this process. With a decline in SMEs, a significant number of jobs could be lost, some permanently. Here again, the fortunes of those employed by SMEs in sectors heavily impacted by social distancing measures will diverge adversely from those in other sectors.

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Credit guarantees, equity-like financing, and similar lifelines should be offered to otherwise viable firms that are struggling. Support to displaced workers—more generous unemployment insurance, retraining assistance, and facilitating their shift to thriving sectors—will be critical to fixing labor markets. Relaxing eligibility rules for welfare benefits will help workers who have borne the brunt of the pandemic. These actions will not just alleviate the economic hardship on displaced workers, they will limit the potential for long-lasting earning and productivity scars and the higher mortality associated with job loss.

The world has taken a major step toward ending the worst crisis in a century with multiple vaccines developed in record time to fight COVID-19. It will take an even greater combined push of the scientific and medical community, governments, and multilateral institutions to avert a great divergence in prospects across countries. FD

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