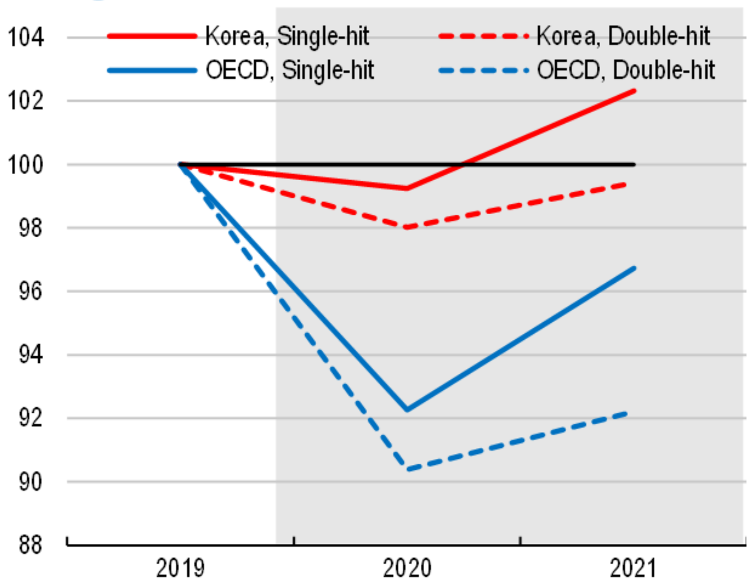
The Korean economy: resilient but facing challenges

By Christophe André, OECD Economics Department

The prompt and effective reaction of the Korean authorities to contain the spread of COVID-19 limited the impact of the pandemic on the economy. Strong fiscal and monetary policy measures were quickly implemented to support households and businesses. As a result, the Korean economy is set to contract much less than other OECD economies in 2020, both in a scenario with no resurgence of the pandemic (single-hit scenario) and in a scenario assuming a second global wave of infections (double-hit scenario) (Figure 1).

Figure 1. GDP falls less than in the OECD

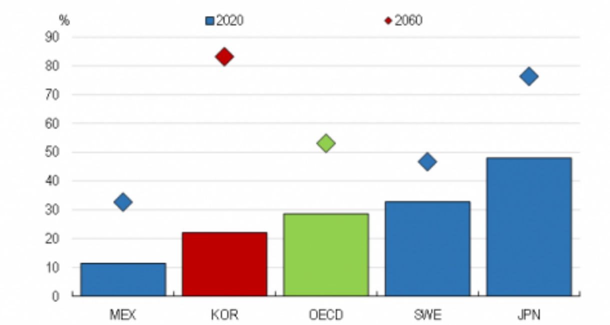


Nevertheless, the pandemic generates strong headwinds. Some sectors, like transport, tourism and entertainment still suffer from substantially reduced activity. Exports, traditionally a key growth engine of the Korean economy, are hit by the weakness in the global economy. Additional obstacles to the operation of global value chains, in which Korea is strongly integrated, would deal a further blow to the economy. High uncertainty is holding back investment and employment has fallen, especially for non-regular workers.

Hence, continued support for households and businesses will remain crucial until the recovery is fully under way. It will need to be carefully tailored to preserve long-term fiscal sustainability and avoid hampering the reallocation of resources towards the sectors with the strongest growth prospects. Any additional income support should be targeted towards low-income households and skills training should be provided, even beyond the crisis, to vulnerable people who lost their job. Investment in areas featuring in the recent Korean New Deal, such as 5G, telecommunication and artificial intelligence, will help boost the knowledge-based economy. Green investments are essential to tackle current problems, not least air pollution, and to ensure long-term environmental sustainability.

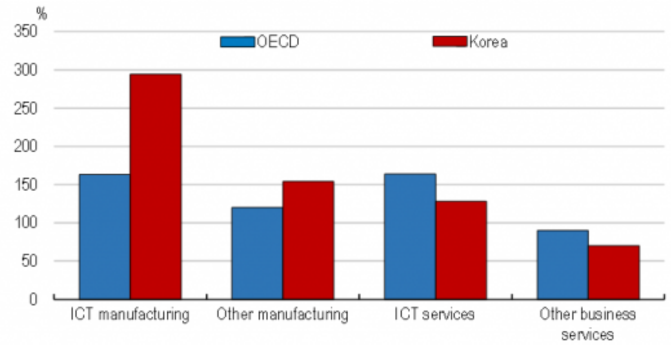
The pandemic compounds pre-existing challenges, many of which are shared to various degrees by most OECD countries, notably rapid population ageing and relatively low productivity in parts of the economy. Korea has the fastest ageing population in the OECD, with the number of persons aged 65 or over projected to exceed 80% of the working-age population by 2060, the highest ratio in the OECD (Figure 2a). The shrinking working-age population will weigh on GDP growth over the coming decades. However, better mobilising labour resources, especially from women, older workers and youth, can partly counteract this trend, as well as help build a more inclusive economy and society. Moreover, each worker has the potential to create more value. While productivity is high in manufacturing, especially for information and communication technology equipment, it is lagging in services, including digital services (Figure 2b). The productivity gap between big firms and SMEs is wider than in most other OECD countries. Overall, Korea’s GDP per worker is about 20% below the OECD average, pointing to huge potential for catch-up.

Figure 2a. The old age dependency ratio will soar



Note: Ratio of population aged 65 and over to population aged 15-64. Unweighted average for the OECD.
Source: United Nations and OECD calculations.

Figure 2b. Service sector productivity is lagging



Note: Sectors' productivity relative to total productivity.
Source: OECD STAN Database.

As the population ages, scarcer labour resources will need to be used more effectively. Women’s employment rate is about 18 percentage points below that of men, despite very high average academic qualifications among women, especially in younger generations. Relatively low wages and weak career prospects discourage many women from working. The gender wage gap is the widest in the OECD, at about 34% in 2018, compared to an OECD average of about 13%. A number of recent government measures, in particular to enhance childcare quality, improve work-life balance and facilitate return to work after career breaks, could help reduce the gender gap. More broadly, a culture of gender equality needs to be promoted in the workplace and at home.

Koreans effectively retire at an advanced age, but often end their working lives in poor-quality non-regular jobs, after being forced to retire from their career job in their fifties. Maintaining high activity rates, while enhancing the quality of jobs for older workers, will be essential to sustain the economy's growth potential. At the same time welfare measures are needed to increase support for the elderly who are most in need. Indeed, old-age poverty remains the highest in the OECD, with more than 40% of people aged 65 or over living in relative poverty.

Less than half of youth aged 15-29 were employed before the COVID-19 crisis, the fifth lowest share in the OECD. This reflects long studies, as more than two-thirds of youth obtain tertiary degrees, but also slow transition from education to employment. The crisis exacerbates the difficulties faced by youth entering the job market. To address skills mismatches, the government has stepped up career counselling, developed apprenticeships and vocational education (notably Meister schools) and introduced incentives for tertiary education institutions to propose more market-relevant degrees. Nevertheless, career guidance and counselling will need to be stepped up, in particular through increased resources for the public employment service and stronger involvement of employers.

Digital technologies, in which Korea is a top player, offer vast opportunities to raise firms' productivity and people's well-being. Policies should aim at promoting the diffusion of technology across the economy and addressing digital skills gaps. Regulatory reforms, based on the recent experiences with sandboxes, which allow waiving some regulatory obligations to encourage innovation in products or business models, could boost growth and offer people better access to valuable services, as illustrated by telemedicine during the COVID-19 crisis.

Altogether, Korea is proving exceptionally resilient during the annus horribilis the world economy is undergoing, even though the global recession is hurting exports. Korea also has strong cards to address the longer-term challenges it is facing.

References:

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