

Interview with Dr. Keiichiro Kobayashi, a Member of the Government Advisory Committee on Countermeasures Against the Coronavirus Pandemic

# Outlook for the Japanese Economy with the Delta Variant

By Japan SPOTLIGHT

Dr. Keiichiro Kobayashi, a professor of the Department of Economics at Keio University, is a distinguished Japanese economist and a member of the governmental advisory committee on countermeasures against the coronavirus pandemic. He advises the government on how to contain the pandemic and restore the economy simultaneously. *Japan SPOTLIGHT* held the following interview with him.

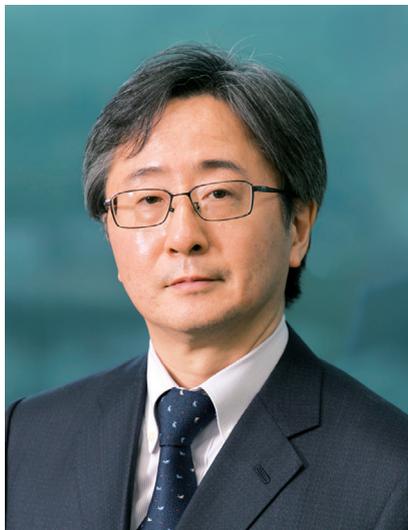
(Interviewed on Sept. 7, 2021)

## Role of Macroeconomic Policy in Restoring Japanese Economy

**JS:** Though it has been said that the pandemic's impact on the macroeconomy would be disastrous, it seems to have been far smaller than that of the Financial Crisis in 2008. According to the IMF outlook in July 2021, the key to a stable recovery of the global economy will be how quickly vaccinations can be implemented around the world. Most economists are saying that macroeconomic policies have so far worked well in minimizing the decline in national economies. Do you share this view?

**Kobayashi:** I think this is a bit obsolete. In recent months, we have new evidence showing that the effects of vaccines are waning and will not continue for more than six months. The vaccines' infection prevention effects do not seem to be so great in the case of the Delta variant. So it may be difficult to restore the economy completely to how it was before the pandemic even after an extensive vaccination program in the country. In this situation, personal consumption will not return to the level before the pandemic, as consumers will have to live for a number of years with infectious disease countermeasures. The economic growth rate in such a situation would be steady but much lower than before.

**JS:** Is this true of the world economy as well as the Japanese one?



Dr. Keiichiro Kobayashi

**Kobayashi:** Yes. This is truly worldwide. We have learned about the incomplete effectiveness of vaccinations from the experience of the United Kingdom and Israel.

**JS:** On consumption, as infections decline could we expect to see a rise in so-called pent-up demand, in particular in tourism? Or would this take a long time to happen?

**Kobayashi:** At the least, I would say that consumption growth will not be strong in November 2021. It could come back in the second half of 2022 or 2023, but with the incomplete effectiveness of vaccines and possible emergence of new and more deadly variants, people would refrain from consumption, and in particular traveling.

## Possible Side-Effects of Current Monetary & Fiscal Policy

**JS:** Would the low interest rate policy and expansionary fiscal policy adopted by the Japanese government cause economic inefficiency to continue? What we call zombie companies could be well maintained by such policies.

**Kobayashi:** Yes. The economy will continue to live with the pandemic for several more years and among businesses such as restaurants or retail shops where face-to-face encounters are inevitable, only those capable of running their business profitably while also implementing strict infectious disease countermeasures can survive. The

bankruptcies of those who cannot survive the pandemic are increasing at this moment, but the Japanese government is now trying to save those in difficulty with interest-free unsecured loans. But 10-20% of those cannot survive even with them. Therefore, it would be better for the Japanese government to stop these loans as soon as possible and let these businesses fail, while keeping its aid for those earning profits in spite of the continued pandemic. Even for those surviving, if the amount they borrow increases too much due to interest-free unsecured loans, the government should reduce their debts to an appropriate level. With this policy, as in the case of non-performing loans in the 1990s in Japan, equity capital in the banking sector would be running short and write-offs would exacerbate this situation. So I think capital injections of public funds from the Japanese government would be eventually needed.

At this moment, corporate debt has increased by more than 50 trillion yen in comparison with the pre-pandemic situation. Assuming that 10-20% of this debt would be subject to write-offs as non-performing loans, the scale of non-performing loans will be around 5-10 trillion yen, at maximum 20 trillion yen. This is much smaller than the scale in the 1990s which exceeded 100 trillion yen. But I think that without such a policy for zombie companies, the accumulation of non-performing loans will prolong the stagnant economy as in the 1990s and the whole economy will fall into a depression.

### **JS: Would continuing to aid these zombie companies be positive in saving jobs in the long term?**

**Kobayashi:** It depends upon how you help the companies. With subsidies or benefits, there would not be any borrowed money left in their budgets, but in the case of Japan there are very few cases of subsidies as government aid and finance is used as a means to help companies in most cases. So there would be loans left even after the pandemic is contained. They would have to streamline their business to repay the loans in the long run, and that would lead to a fall in employment.

## **Inequality Expanding in the Pandemic**

**JS: There is a divergence of economic performance among sectors and individuals under the pandemic. For example, the Information Technology sector is winning, but restaurants and hotels have been seriously damaged. How do you think this divide could be mitigated?**

**Kobayashi:** I think we should create a new social security system. There must be two basic thoughts about this reform. First, we should

consolidate social security not only for the aged or children but also for the working generation, assuming that this inequality is expanding among workers. While those working for large companies or the manufacturing industry are not suffering much from the pandemic, non-permanent workers for restaurants are paying a high cost. This is not an issue limited only to elderly people. We should use this opportunity to create a social security system covering equally both permanent and non-permanent employees, without any discriminatory treatment, as it has only been protecting business firm employees so far.

For example, basic income support could be introduced. Regardless of one's working style, anybody could benefit from this, or in the case of tax exemptions with benefits, anybody could be guaranteed a minimum income by the government through negative income tax. Subsidies would be provided to those with less than the minimum income, while those with income above the minimum level would be taxed. This social security system would need to fill in the gaps between individuals.

To achieve this in Japan, digitalization is an urgent issue to be fixed. The "My number" card, the Japanese social security number, should be linked to all individuals' bank accounts. This might be a rather drastic policy proposal in Japan, but with the tax bureau's access to private information on all individuals such as their monthly salary, it would be possible to set up benefit provisions to those suffering from unexpected losses of income due to a pandemic or a natural disaster in the month following these unexpected incidents.

### **JS: Would it be possible to build such a system in light of the protection of privacy?**

**Kobayashi:** Yes, certainly, we should be able to do this. Privacy can be an issue in Japan. However, in many European countries and the United States each individual is given a social security number and they have to register it in opening a bank account. It is up to Japanese people to choose between protection of privacy and the convenience of receiving benefits due to occasional unexpected loss of salary or jobs.

**JS: How about capacity building to raise an individual's competency? Should the government think about spending more wisely to contribute to an efficient economy?**

**Kobayashi:** Yes, that is true. But it depends upon the person. Perhaps we would need to set up a minimum income level first to reduce the income gap and then help those searching for a new job. It would be wise of the government to add a capacity-building program to this basic income support.

## Making Expanded Fiscal Deficit Sustainable

**JS:** With the fiscal debt expanding under the pandemic, the gap between generations will further increase. Assuming that the pandemic will continue, is this going to be a challenge for a long time?

**Kobayashi:** I think it is rational to increase fiscal expenditure for the interests of the current generations, considering that they are paying more cost due to the pandemic than future generations are likely to. It will take another three or four years to bring the pandemic under control, but I think it is inevitable to do this to save the current generations from disaster. On the question of how to pay the cost of this, I do not think there is any other way but to increase the consumption tax or decrease social welfare provisions for the current generations and transfer the burden of cost to the future generations for a long time. But another way could be to create an international fiscal cooperation system with a global common tax enabling each national government to finance its increasing debt stemming from countermeasures to deal with the pandemic by distributing revenue from this common tax. The consensus achieved recently among the G7 nations setting 15% as the minimum corporate tax rate is one example. I believe we should propose similar initiatives as promptly as possible.

For example, if one country imposes an environmental tax on enterprises active in the country, those enterprises would transfer their factories to another country. In this case, this government would not get the environmental tax revenue, but if all the nations in the world impose environmental tax at a common tax rate, enterprises cannot transfer their factories anywhere to escape the tax. This is how any government could earn tax revenue. This revenue could be equally distributed among nations and with this extra revenue they could pay back the debt accumulated due to the countermeasures against the pandemic.

Such an idea of a global common tax could be applied to transactions of financial assets as well. This global common tax could possibly be implemented by international policy cooperation, which could be considered as a new Bretton Woods system in the 21st century. On the occasion of the birth of today's Bretton Woods system in 1944, international cooperation mechanisms such as the World Bank, the IMF or the Bank for International Settlement (BIS) were created, but they could not achieve international cooperation on fiscal policy, as that is a matter of sovereignty. This time, as national debts are increasing all over the world in coping with the pandemic, we should pursue such international cooperation on tax and fiscal policy, even though it would force a nation to give up national sovereignty to a certain extent.

## New Corporate Governance for a New Age

**JS:** In Japan, it has often been said that we should establish ROE-oriented corporate governance to maximize shareholders' interests. Now, whether due to the pandemic or not, with growing interest in socially common issues such as human rights and a clean environment, corporate management does seem to be changing to a stakeholder-oriented one. How do you assess this change of thinking in corporate governance as an economist?

**Kobayashi:** In Japan, until the 2010s, a shareholder's interest was not much considered, given the low interest rate business environment. In the 2010s, there were initiatives to strengthen corporate governance by considering a shareholder's interest, such as a stewardship code or corporate governance code. The purpose of those initiatives was to raise the efficiency of corporate management by introducing disciplines to maximize a shareholder's interest. But with this situation unchanged even as of now, I assume it will still be necessary to continue efforts to raise efficiency.

With higher efficiency, companies could earn larger profits. This is obvious. The next question must be how this increase in profits is to be shared. In the argument in the 2010s, the allocation of profits for shareholders was to be maximized in raising ROE. But in the current discussions in Europe and the US, it is necessary to increase the share of the stakeholders. In the case of Japan, I think the Japanese companies are not yet quite successful in maximizing their profits. At this stage, if they consider the issue of allocation of earnings too much, their management efficiency would decline again and return to the original level.

Looking back at the history of Japanese business, assuming that efficiency of management is to be achieved by strengthening the discipline of the board members and employees, before the 1990s it had been debt governance by the banks that loaned money to the companies that led the governance of corporate management. But since then, with the decline of the banks' leadership in corporate governance, there have been very few institutes disciplining the management during these three decades. Under such circumstances, there emerged initiatives to discipline the management and employees with strengthened rules on respecting a shareholder's interest. Who would discipline the management and employees other than shareholders? There does not seem to be a best answer to this question in Japan. What I can say at this stage is that less respect for a shareholder's interest will not result in anything but inefficiency of corporate management and decline of growth in Japan. This is my concern.

**JS:** We would need a balanced approach to this issue in respecting both a shareholder's interest and a stakeholder's interest.

**Kobayashi:** We would need to raise efficiency first and then change the allocation of earnings. This is most important.

## Maximizing the Benefits of Digitalization

**JS:** If this pandemic continues for as long as you mentioned, it will be necessary to maximize the benefits of the changes triggered by the pandemic to make them sources of new growth potential. Examples of such changes are digitalization and reforms of working style. With high growth potential, there would be positive effects not only on the economy but also on public finances. What kind of structural economic reforms would be necessary to maximize this positive effect?

**Kobayashi:** Digitalization would certainly raise productivity and growth potential. Whether teleworking promoted by digitalization would raise productivity or not, cannot be answered clearly. With commuting time reduced, productivity could be raised, but with the reduced human communication, it could be lowered. The answer is ambiguous. I hope companies can find a working style leading to a rise of productivity even with teleworking.

**JS:** It is often pointed out that accommodating a business environment that maintains open competition would lead to better outcomes. Do you agree?

**Kobayashi:** Yes. Open competition with the freedom to engage in trial and error in business would lead to better outcomes. For example, there are many regulations in labor markets and with regulatory reform enabling a company to change its working style at its own discretion, we could see what kind of working style could raise productivity and growth potential.

## Democracy vs Authoritarianism

**JS:** As you know, authoritarian governments seem to have been successful in containing the pandemic by complete lockdowns of big cities and have won support for this. But there are still many advantages of democracy. For example, as you said, open and free competition maintained by a democratic

government would raise the growth potential in the post-pandemic era. What do you think about this point? Initiatives like reforms of corporate governance for the interests of stakeholders or Environment, Social & Governance (ESG) investment are certainly necessary to raising common social values, but too much consideration of these values could lead to inefficiency and poor economic performance.

**Kobayashi:** Authoritarianism might be better in leading a nation in one single direction in a short time. But over the longer term of several decades, democracy could survive more easily and be more resilient to any change of environment, since in democratic nations there is a freedom for an individual to engage in trial and error, and a government can do this as well and thus correct erroneous policies. Authoritarian regimes could be vulnerable to a variety of changes of environment, even though they are successful in a certain type of crisis management. Democratic nations are better in terms of flexibility by taking advantage of the diversity of views and thinking that enable them to change their administrations and leaders.

## Japanese Economy in 2022

**JS:** Finally, could you please introduce your outlook for the Japanese economy in 2022?

**Kobayashi:** The pandemic will continue in 2022 and perhaps even in 2023 and 2024 as well, since with much more infectious variants emerging even vaccines will not stop the pandemic spreading completely. In the light of this long-term battle against Covid-19, we will need to think about economic policy and business. In 2022, I hope that enterprises and individuals will be ready for this long-term battle and adjust their activities accordingly. If so, I think growth in Japan in 2022 will be steady and stable even with the unexpected arrival of new variants. We cannot expect high growth and consumption growth will be moderate as consumers will continue to be vigilant against infections. Pent-up demand for tourism will not return fully but only gradually. The overall growth of Japan in 2022 will be low but steady.

JS

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