

Japanese Economy After COVID-19

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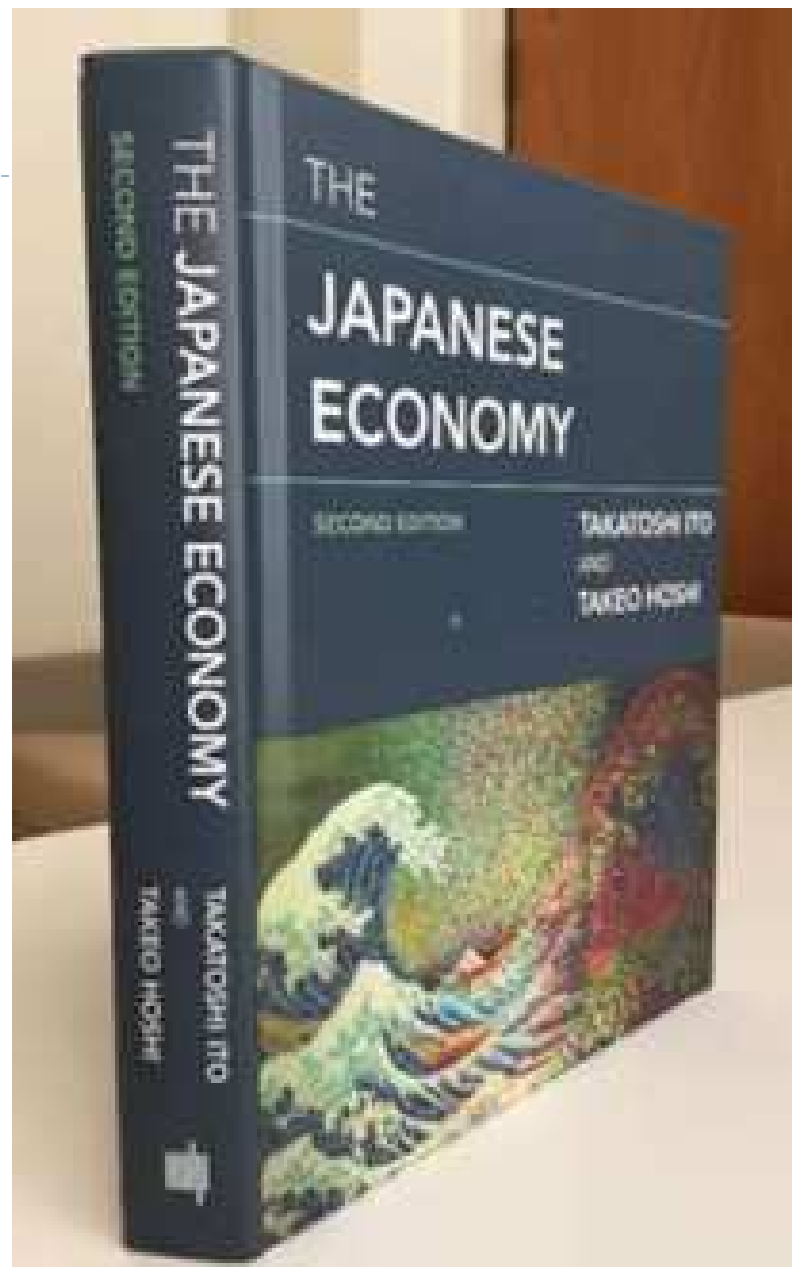
Outline

1. Impacts of the COVID-19 pandemic on Japan
2. COVID-19 is a reallocation shock
3. Japan's failure to adjust to large reallocation shocks in the past
 - ▶ Japan mostly relied on corporations to help their workers cope with economic shocks. When corporations are hit by a large economic shock, the government helps them so that they can stay alive and protect employment.
4. This approach has serious problems
 - ▶ Concentrated the cost of adjustment to disadvantaged groups
 - ▶ Created zombie firms
5. How can Japan avoid the problems?

References

Takatoshi Ito and Takeo Hoshi,
*The Japanese Economy, second
edition*. MIT Press, 2020.

Takeo Hoshi and Phillip Lipsky,
*The Political Economy of the Abe
Government and Abenomics
Reforms*. Cambridge University
Press, 2021.



1. Impacts of the Covid-19 pandemic

- ▶ Cumulative numbers per million population as of September 16, 2020.
- ▶ Source: <https://www.worldometers.info/coronavirus/#countries>

	Cases	Deaths	Tests
Japan	601	11	13,809
USA	20,483	604	282,526
Spain	12,900	642	230,050
UK	5,507	613	298,584
Italy	4,798	590	164,518
France	6,050	475	153,130
Germany	3,159	113	160,260

Economy got hurt

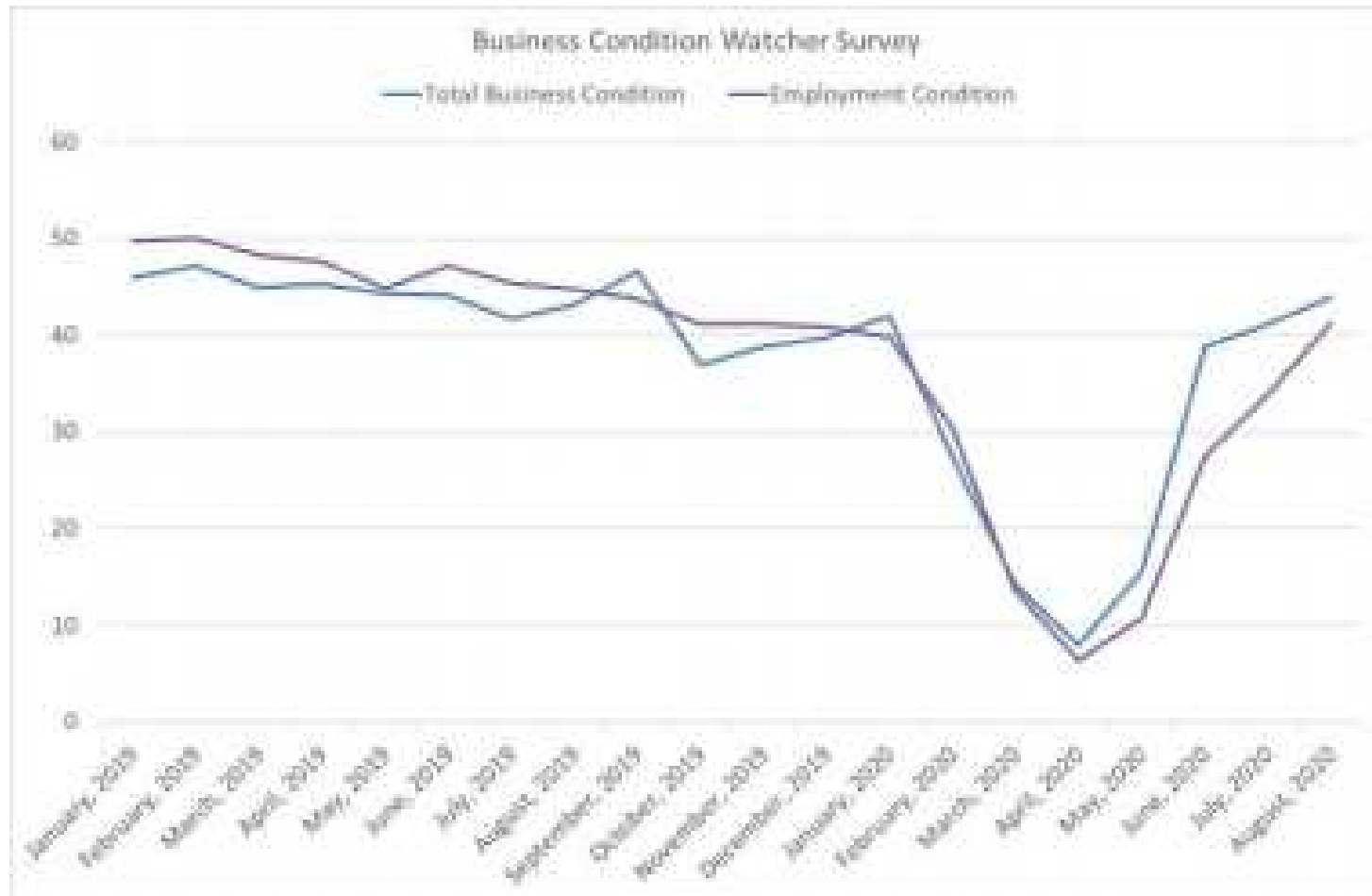
- ▶ Real GDP growth for the second quarter of 2020 (annual rate) in Japan, US, Euro area, and UK
- ▶ Unprecedented recession in the post-war period

Japan	-27.8%
US	-32.9%
Euro Economy	-40.3%
UK	-59.8%

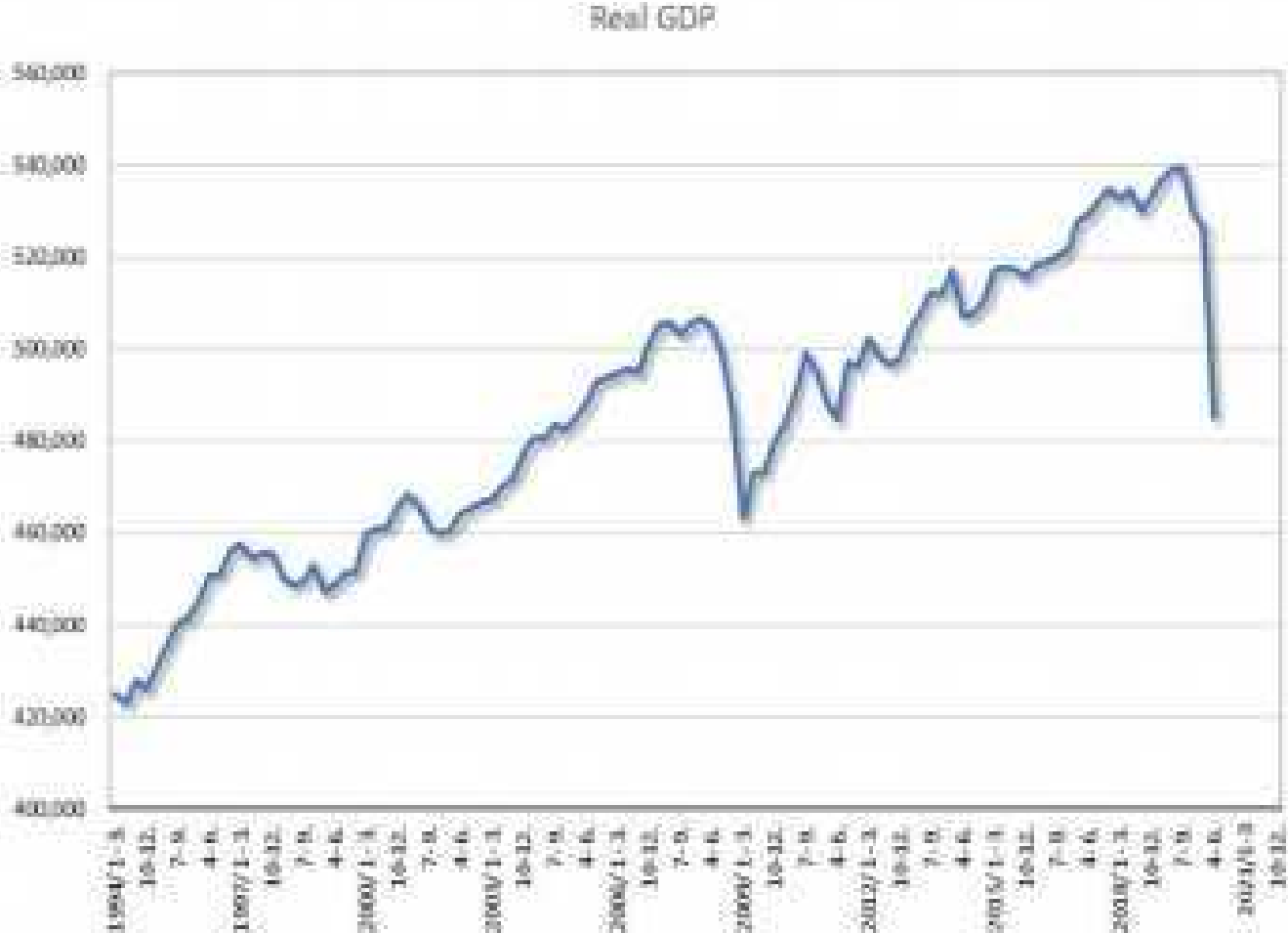
Source: SNA Statistics.

Recovery? Not really

Business Condition Watcher Survey (<https://www5.cao.go.jp/keizai3/watcher.html>)



Real GDP in level



Source: The Cabinet Office

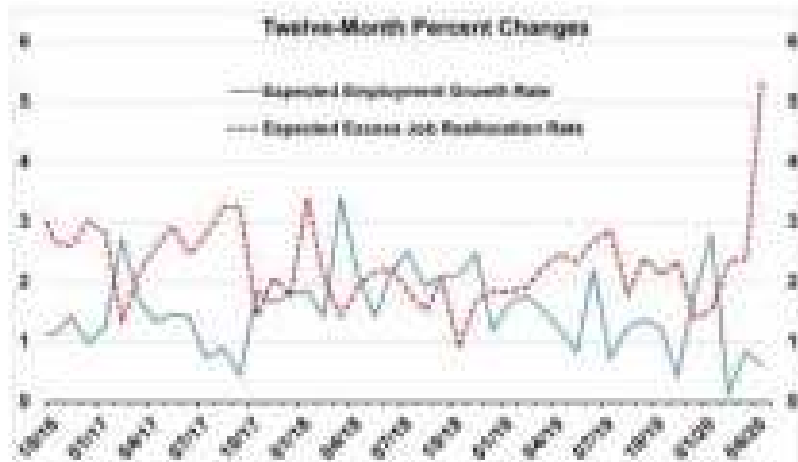
2. Covid-19 is not only a macroeconomic shock

- ▶ It hit some industries/businesses harder and created new opportunities for new businesses
- ▶ We have experienced many changes during the pandemic
 - ▶ Remote working
 - ▶ Online education
 - ▶ More use of e-commerce and delivery services
 - ▶ Digital transformation (end of *hanko*?)
 - ▶ Regulatory changes: remote medicine, fast approval process for drugs, etc.
- ▶ Many of changes will stay → “New Normal” will be new
- ▶ We must expect major restructuring and reallocation of resources

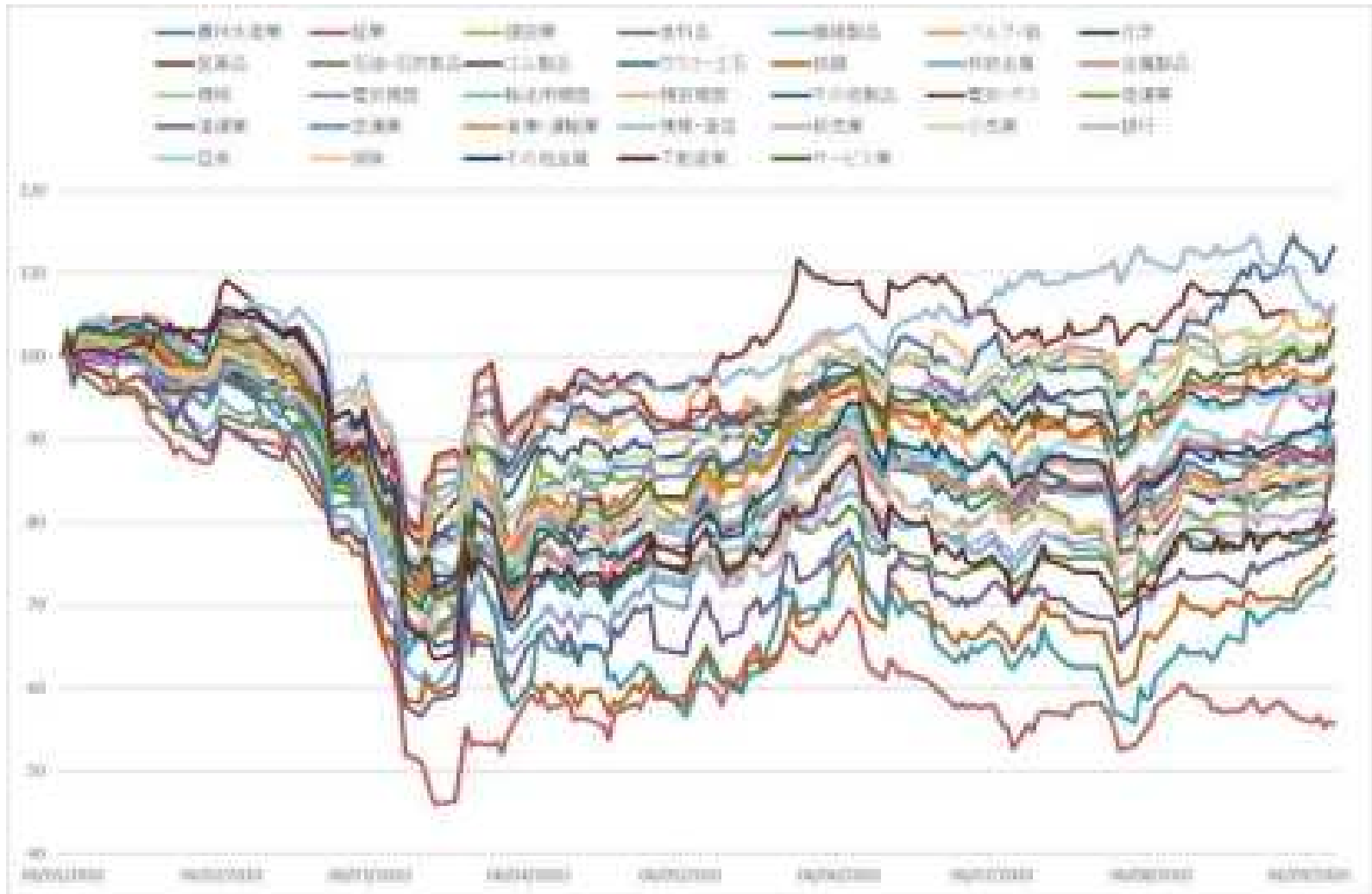
Corona Shock as Reallocation Shock

Jose Maria Barrero, Nicholas Bloom, and Steven J. Davis (2020). “Covid-19 is also a Reallocation Shock,” NBER Working Paper 27137.

- ▶ Use the data from Survey of Business Uncertainty to calculate the **excess reallocation**: “gross expected job gains at firms that anticipate growing over the next year plus the gross expected job losses at firms that anticipate shrinking minus the absolute value of the net change obtained by summing over all the forecasts”
- ▶ Both expected excess reallocation of jobs (above) and that of sales increased

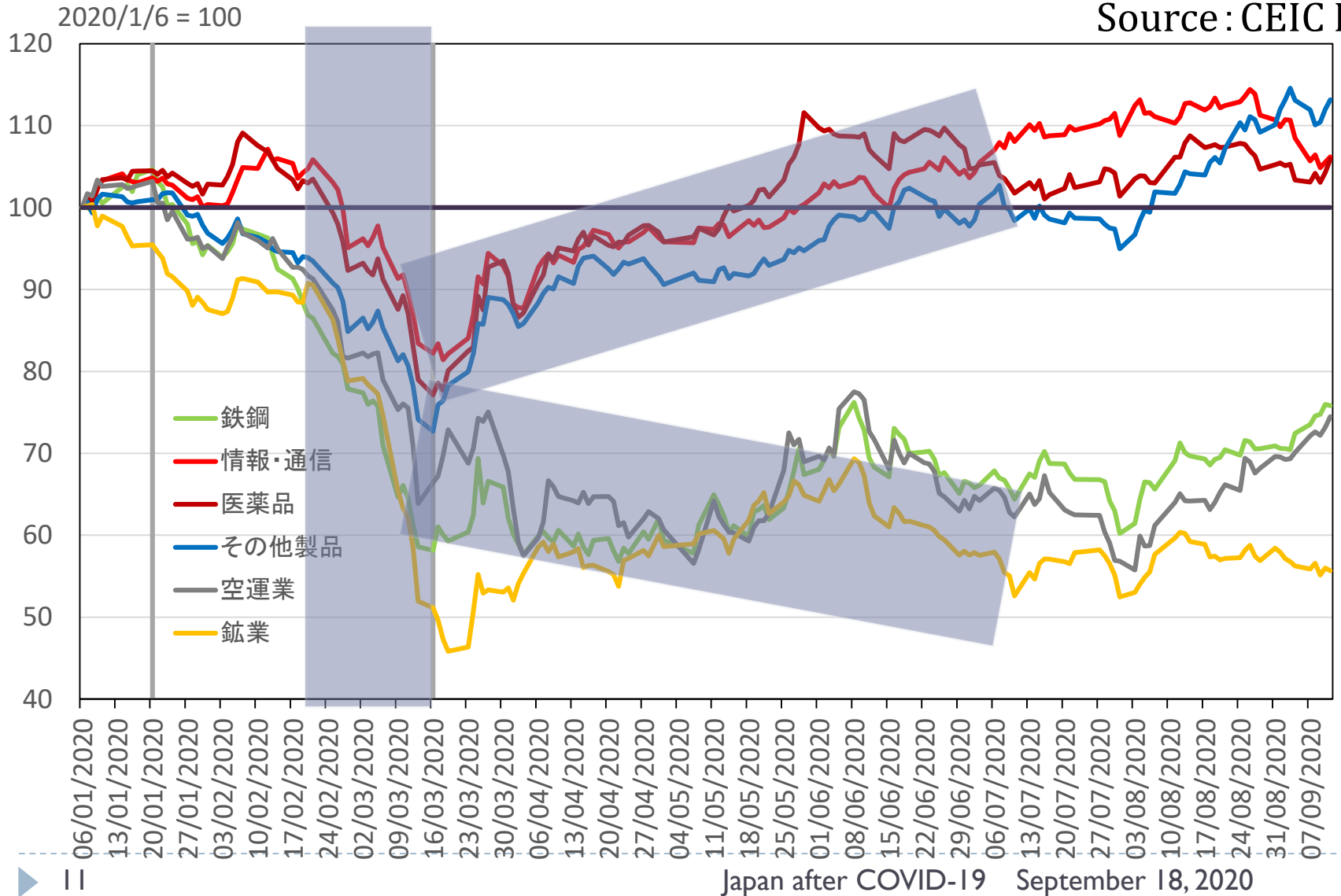


Evidence of (expected) reallocation in Japan: TOPIX by industry (January 6, 2020 = 100)



Not V, Not L, but K-shape recovery

Source : CEIC Data



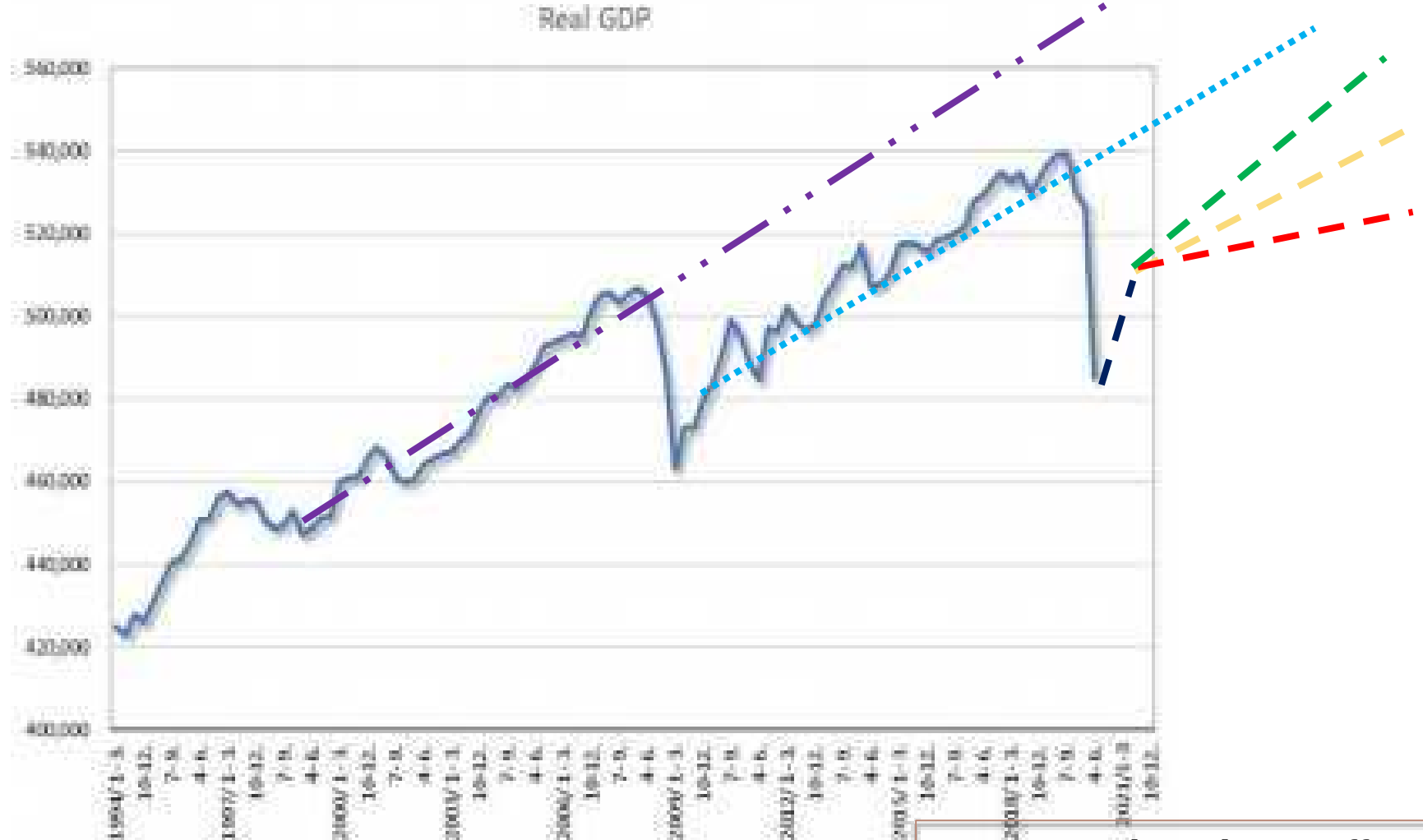
Adjustment to a reallocation shock requires economic restructuring

- ▶ **Economic Restructuring:** old and inefficient production arrangements are destroyed, and replaced by new and efficient production arrangements; “creative destruction”

Ricardo J. Caballero, 2007, *Specificity and the Macroeconomics of Restructuring*, Yrjo Jahansson Lecture, MIT Press

- ▶ Economic restructuring involves entry of new firms and exit of failing firms. It also involves reallocation of workers from failing firms to new or growing firms.
- ▶ Economic restructuring in Japan has often been very slow.

3. Japan failed to adjust to large shocks



Source: The Cabinet Office



Why Japan failed to adjust?

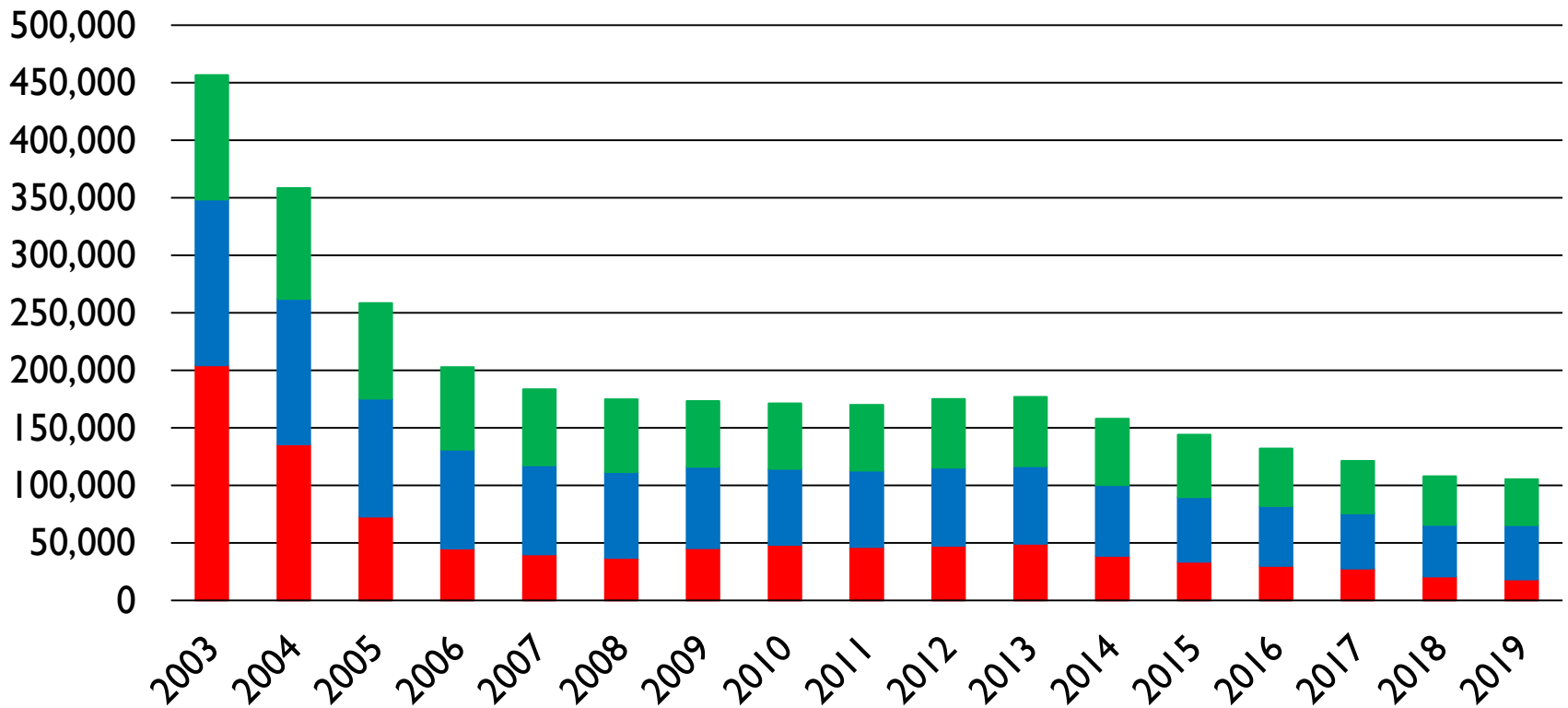
- ▶ Japan mostly relied on corporations to help their workers cope with economic shocks.
 - ▶ Lifetime employment system
- ▶ When corporations are hit by a large economic shock, the government helps them so that they can stay alive and protect employment.
- ▶ In other words, Japan tried to resist the necessary economic restructuring by helping the corporations to resist the changes.

Example: Response after the Global Financial Crisis

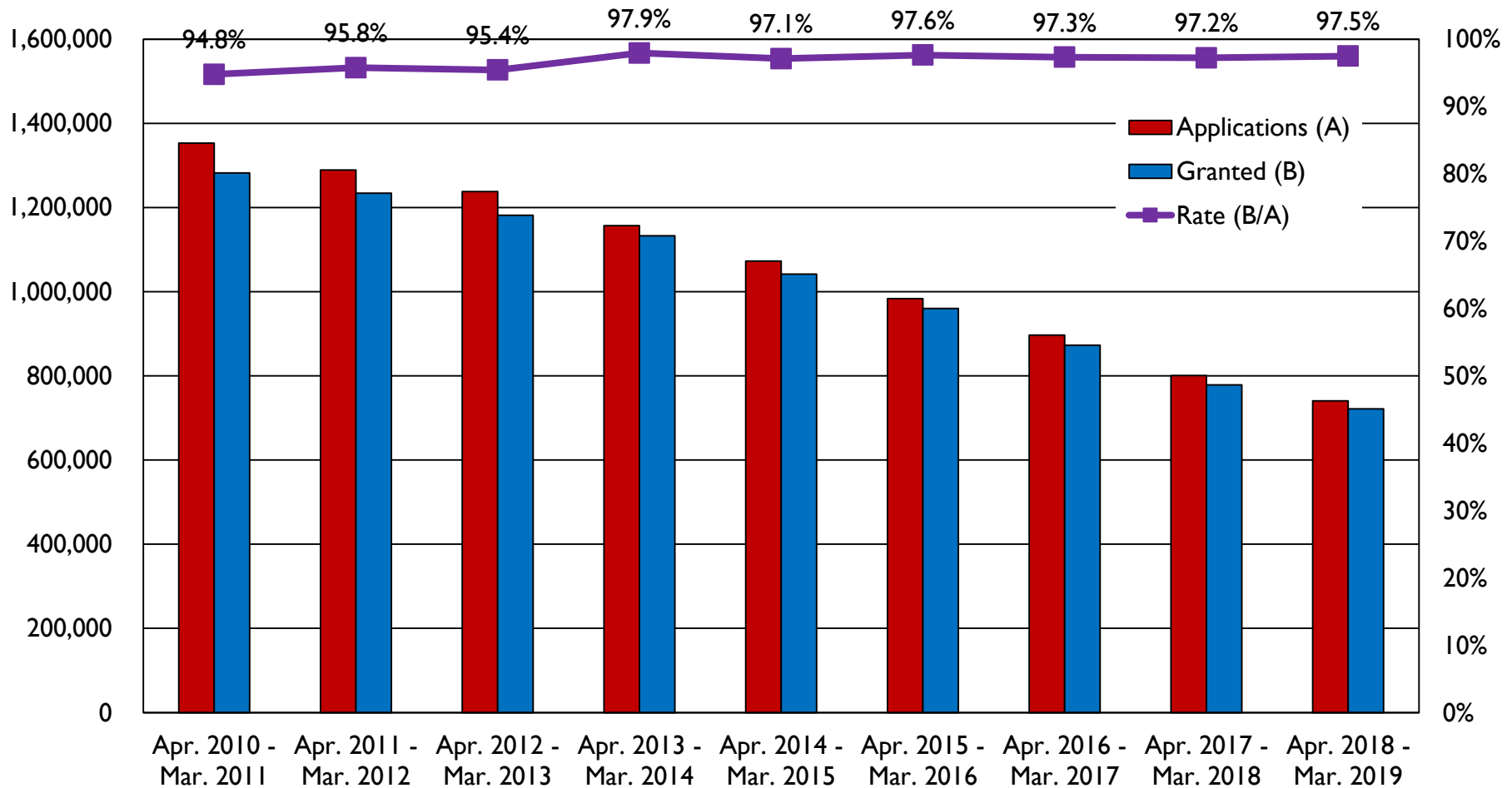
- ▶ Tried to protect SMEs by encouraging banks to roll over non-performing loans
- ▶ Nov. 2008: With a restructuring plan to recover in 5 to 10 years, a restructured SME loan can be classified normal (rather than non-performing)
- ▶ Dec. 2008: Effectively reduced the risk weight on SME loans
- ▶ Dec. 2009: SME Financing Smoothing Act: SME loan can be classified normal if there is a plan to come up with a restructuring plan
- ▶ Mar. 2013: SME Financing Smoothing Act expired but SFA continued to encourage financial institutions to help SMEs → Loan modifications continues
- ▶ Many non-performing loans were still hidden just right before the COVID-19 crisis

Non-Performing Loans at Japanese Banks (100 million yen)

- Shinkin Banks and Credit Unions
- Regional Banks
- City, (former) Long-term Credit, Trust Banks



Loan Modification to SMEs by Financial Institutions (# of loans)



4. Problems of protecting corporations to protect employment

1. Only a limited group of workers are protected
 2. Problems caused by Zombie Firms
- ▶ First is already happening

Covid-19 Shock hits non-regular workers with non-flexible jobs in social industries

Shinnosuke Kikuchi, Sagiri Kitao, Minamo Mikoshiba (2020). “Heterogeneous Vulnerability to the COVID-19 Crisis and Implications for Inequality in Japan,” CREPE Discussion Paper No. 71.

- ▶ Covid-19 shock impacts **non-regular** workers with **non-flexible** (difficult to remote work) jobs in **social** (requires face-to-face interactions and/or regular commute) industries, whose earnings are very low to start with.

Employment share (%) and average earnings (1,000 yen) by employment type (Table 4 of the paper)

Regular workers			Non-regular workers		
	Ordinary	Social		Ordinary	Social
Flexible	26.0% 5,535	24.0% 5,136	Flexible	12.9% 1,694	23.0% 1,697
Non-flex	32.8% 4,534	17.2% 3,981	Non-flex	20.2% 1,624	43.9% 1,338

Job losses are in fact concentrated

- ▶ Percentage change in the employment from January to July, 2020 for various groups of workers (author's calculation based on data from the *Labour Force Survey* (Ministry of Health, Labour and Welfare))

	All	Male	Female
Total Labor force	0.00%	-0.02%	-0.19%
Non-Farm employment	-0.57%	-0.43%	-0.73%
(in 10 thousand)	-70	-32	-45
Regular employment (<i>seiki</i>)	0.83%	0.32%	1.85%
Non-regular employment	-2.42%	-1.46%	-2.89%
Dispatched workers (<i>haken</i>)	-5.58%	-7.11%	-4.69%
Firm size 1-29 employees	-1.31%	-1.88%	-0.73%
Firm size 30-499 employees	-0.43%	-0.32%	-0.56%
Firm size 500 employees or more	-0.70%	0.04%	-1.78%

Zombie problem

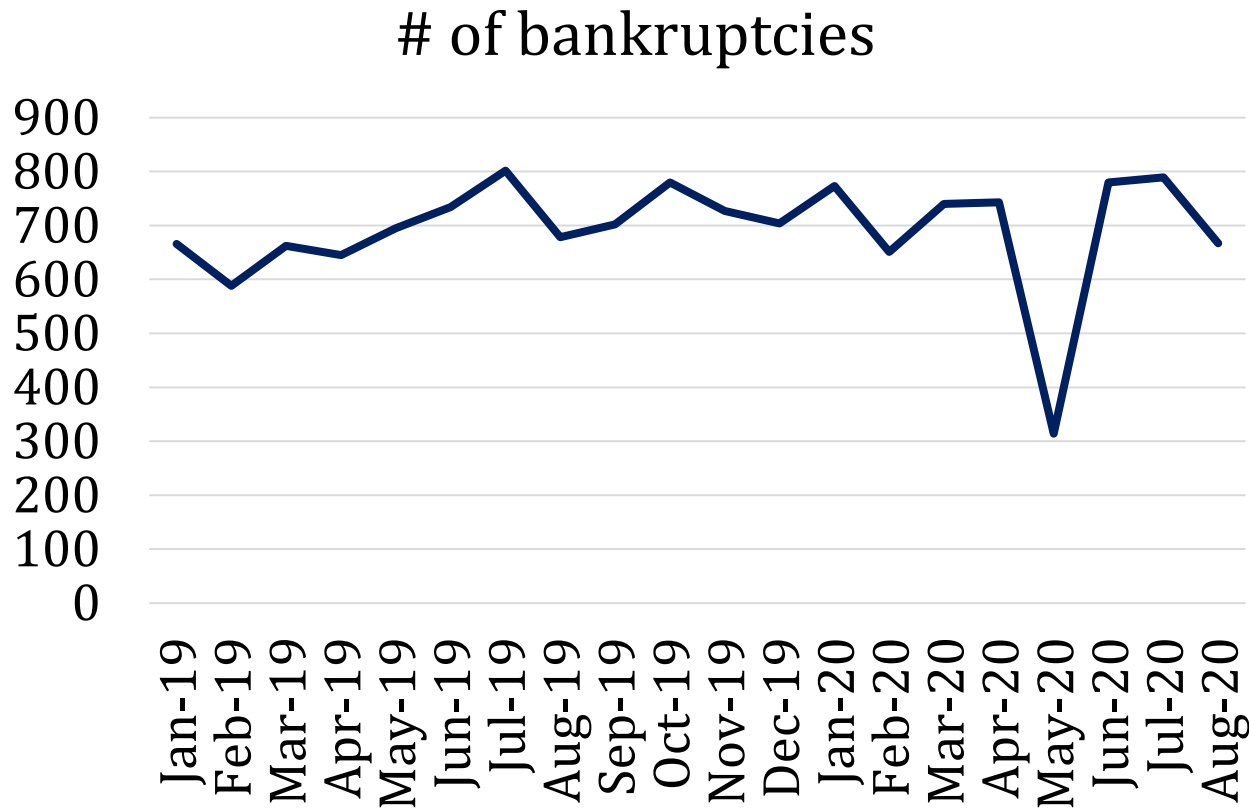
- ▶ **Zombie Firm:** a firm that is unprofitable and would cease to exist without help from creditors and/or the government
- ▶ Initially identified for Japan in the late 1990s, when under-capitalized banks hesitated to recognize losses and instead rolled over loans to weak firms
- ▶ Ricardo Caballero, Takeo Hoshi, and Anil Kashyap (2008). “Zombie Lending and Depressed Restructuring in Japan,” *American Economic Review*, 98, 1943–77.
- ▶ Zombie firms have been found to discourage growth of productive firms for Japan
- ▶ Recently, many papers find similar problem of zombies in Europe
 - ▶ Müge Adalet McGowan, Dan Andrews and Valentine Millot (2017), “The Walking Dead?: Zombie Firms and Productivity Performance in OECD Countries”, *OECD Economics Department Working Papers*, No. 1372.
 - ▶ Viral V. Acharya, Matteo Crosignani, Tim Eisert, and Christian Eufinger (2020). “Zombie Credit and (Dis-)Inflation: Evidence from Europe,” *NBER Working Paper No. 27158*.

Policies to protect corporations create zombies

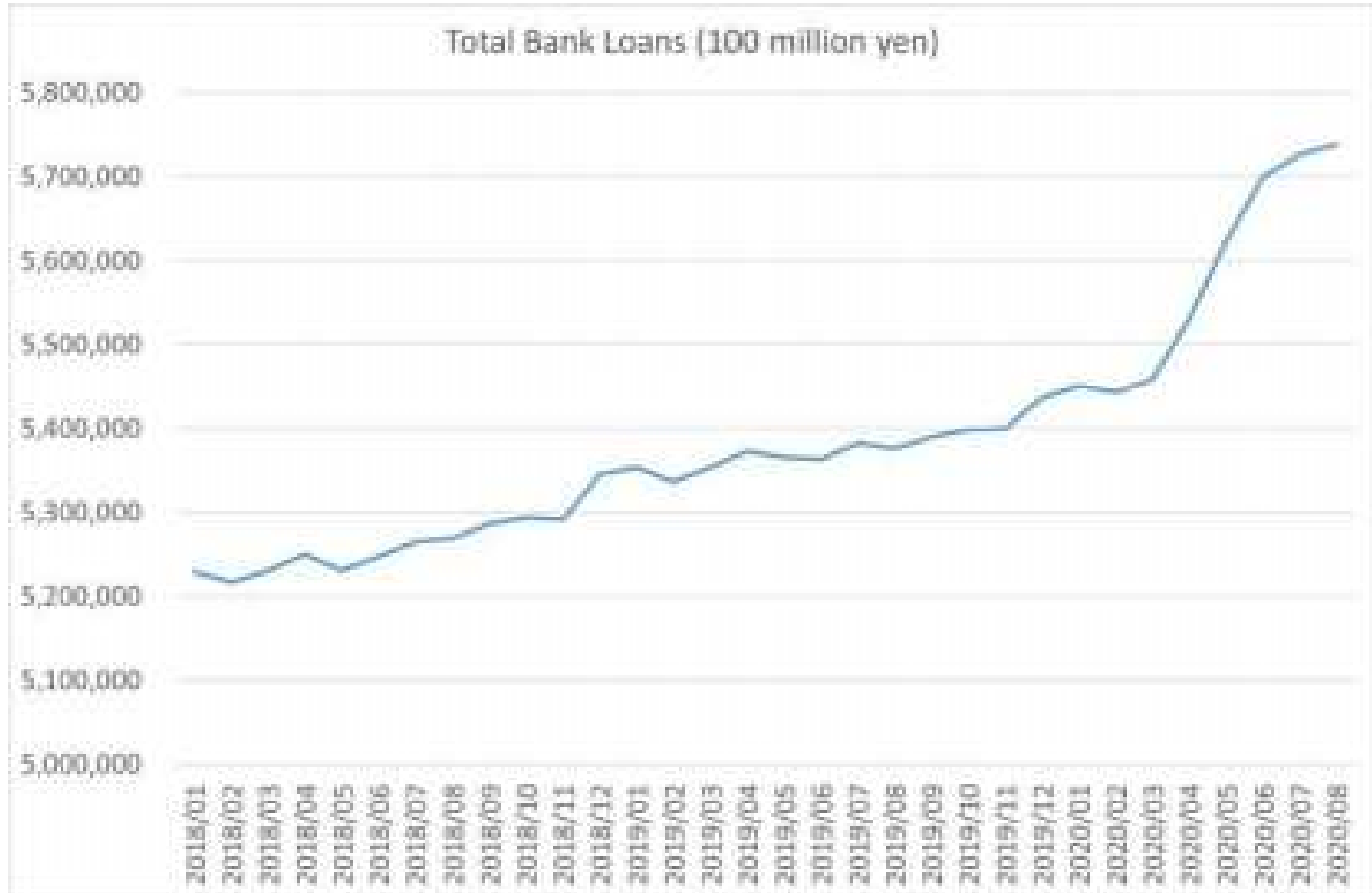
- ▶ During the COVID-19, the government protected corporations again (though some direct assistances to individuals were also tried)
- ▶ Avoiding too many bankruptcies may be the right response during the crisis, but can impede the adjustment to “New Normal”

Restructuring is not happening (yet?)

- ▶ Number of bankruptcy cases (Source: Tokyo Shoko Research)



Bank loans have increased by 30 trillion yen



Pending issues of debt overhang

- ▶ Excessive debt can impede the necessary restructurings
- ▶ Debt Overhang problem: an example

Firm has an outstanding debt of 100 million yen, but firm's value is only 80 million yen. The firm can sell 10 million yen of asset and use the proceeds to restructure the business to fit the "New Normal". The restructuring increases the firm's value by 20 million yen (100% net return). Yet, the firm does not have an incentive to carry out such restructuring.

- ▶ Need to improve resolution mechanisms → Policy statement posted at CIGS website (in Japanese) (https://cigs.canon/article/20200910_5355.html)

Summary

1. Japan seems to have gone through the pandemic with a lot less mortality than other advanced countries, but the damage for the economy has been almost the same degree.
2. Post-COVID-19 Japanese economy will be different. In this sense, COVID-19 is not only a macroeconomic shock but also a reallocation shock.
3. How to adjust to the reallocation shock is the most important economic policy issue, because Japan failed to adjust to large shocks in the past.
4. Japan mostly relied on corporations to help their workers cope with economic shocks. When corporations are hit by a large economic shock, the government helps them so that they can stay alive and protect employment.
5. This approach has serious problems.