

## Summary of Discussion

This roundtable is a part of an international project conducted by the Economic and Social Research Institute of the Cabinet Office, Government of Japan. Japanese and U.S. economists discussed how the COVID-19 pandemic has changed the global economy and what kind of policy challenges lie ahead. In three sessions of about an hour each, the participants covered many important issues. The meeting was held under Chatham House rules. Here is a brief summary of main points that emerged from the discussion.

### Session #1

This session identified several challenges that many countries face in the post pandemic world. The participants also discussed what we can learn from various macroeconomic and health outcomes of the pandemic among advanced countries.

#### *Various macroeconomic and healthcare outcomes of the pandemic*

- Oft-cited trade-off between the decline in economic activity and the human suffering caused by the infection in the pandemic is not obvious in a simple scatterplot graph.
- The variation of experiences in different countries seems to be more due to policy differences and/or luck.
- There must be a lot to learn from the various experiences.

#### *New form of capitalism*

- In the immediate post-pandemic world, countries face the challenge to restore economic growth. Such a challenge is not new for Japan. The Kishida administration is trying to achieve a positive feedback between growth and distribution under the slogan of “new form of capitalism.”
- Even before the pandemic, the Japanese government provided generous support for struggling corporations and allowed many low-productivity corporations to survive and the economy to stagnate.
- A growth strategy should focus on promising medium-size companies instead of providing support to all firms. Redistribution policies should support workers experiencing temporary job losses. Developing a more efficient labor market to help workers easily find high-performing firms is also important.

#### *Intangible capital and digital transformation*

- Digital technologies have been a key for economic growth, and they played a pivotal

- role in mitigating the impact of the pandemic by enabling work from home (WFH).
- WFH is positively associated with intangible capital investment. High value-added industries that had high levels of intangible capital benefited more from the use of WFH.
  - We can observe an interesting difference in the impacts of intangible investments between Japan and the US. In the U.S., accumulation of intangible assets at very successful firms seems to have led to higher industrial concentration. In Japan, the lack of investment in intangible capital limited productivity growth before the pandemic.

### *Global supply chains*

- During the pandemic, governments interfered with global supply chains by restricting exports of key medical equipment and ended up exacerbating supply shortages, although fear of retaliation often prevented further restrictions.
- After the pandemic, the composition of demand changed sharply and created serious strains. For example, small changes at the retail level ended up generating progressively larger changes as we move up the supply chains (the so-called bullwhip effect).
- In the post-pandemic world, countries will try to address the vulnerabilities of supply chains by planning to stockpile key materials, for example. But, it is unrealistic to think that countries will be able to stockpile all the key materials necessary to deal with the next pandemic. Pandemics present a global problem, and can be better mitigated with global solutions, such as forming an international consortium to deal with them.

### *Green transformation*

- Green transformation, like digitalization, is an important prerequisite for the post-pandemic society. In order to encourage people to change their attitudes and behaviors, the presentation of explicit indicators and the introduction of carbon-pricing for corporate decision-making processes will contribute to the further progress of greening.
- Green initiatives will trigger demand, production, and further investment, which will serve as a catalyst for the virtuous cycle of the economy, but at the same time, we need to pay attention to negative impacts on the supply side, such as the transition costs of adjusting to the new equilibrium.

## Session #2

The second session covered issues related to the social safety net, labor market and work arrangements, and health outcomes and policies. Participants offered several lessons from the pandemic experience and predictions about the future.

### *Working from Home*

- The pandemic has witnessed a strong shift to work-from-home (WFH) arrangements.
- WFH arrangements are popular among workers and may have increased productivity, due to a reduction in commuting costs and other work-related expenditures.
- WFH arrangements also appear to have had some positive effects on health, through reduced exposure to air pollutants and infectious diseases other than Covid-19.
- The large shift to WFH has likely shifted the long-run, post-pandemic equilibrium regarding work arrangements, now that forced experimentation has proved successful and will likely reduce any stigma or career disadvantages associated with working remotely.
- WFH has had uneven penetration across industries and jobs, according to the potential flexibility of work arrangements and the need for in-person interactions with co-workers and customers.
- This uneven penetration of WFH has potentially adverse consequences with respect to social inequality, as those in higher-skill/higher-income jobs have been better able to shift to WFH, and hence suffered less, in terms of employment and income, from the pandemic. This strengthens the need for policies that may aid in the broader adoption of WFH, including better broadband access and childcare arrangements.
- The Covid-19 recession and associated employment decline hit women harder than earlier recessions, because of the different industrial composition of affected industries (e.g., a stronger decline in services relative to manufacturing) and because of the increased needs to care for dependent children and elderly family members. However, U.S. survey evidence suggests a significant share of increased family responsibilities have been assumed by men.

### *Dealing with Employment Shocks*

- A key issue that countries confronted during the pandemic was how to limit the lasting effects of a large, potentially short-term negative employment shock. Two alternative strategies arose: subsidizing firms to retain employees (even if not

currently working) versus allowing layoffs to proceed but providing those laid off with income support. The first approach preserves incumbent firms and firm-worker matches and allows a fast return to pre-shock production and employment conditions, while the second facilitates labor-market reallocation and the disappearance of unproductive firms. Which approach is better depends on the length of the shock and the extent to which shifts in labor demand among firms are long-lasting, which is hard to assess except in retrospect. Some combination of the two approaches may be desired, and the right policy mix is likely to be country-specific. Differences between Japan and the U.S. in terms of the flexibility of labor reallocation and the importance of firm-worker matches may lead to different policies.

- A rapid response to large employment shocks requires a well-designed social safety net and robust supporting infrastructure. Both were lacking in the U.S. pandemic response, when a large share of workers who lost jobs were outside the regular unemployment insurance system and antiquated state computer systems were unable to process novel payment patterns.

#### *Health Care Systems and Health Outcomes*

- The pandemic revealed some problems in the Japanese health care system. Though there are a large number of hospital beds overall, the number of hospitals that could accept Covid-19 patients was limited due to a shortage of medical personnel. In addition, there was a lack of clear division of roles among hospitals according to patients' conditions. Overcoming these challenges can be facilitated by basing hospital selection on the patient's situation, increasing financial transparency among hospitals, and reforming payment arrangements from fee-for-service toward fixed capitation, to help conserve on resources and reduce excessive provision of low-value services.
- It appears likely that the Covid-19 pandemic will have significant long-run negative health consequences, beyond the “long Covid” symptoms of some survivors of the disease. In the U.S., for example, there has been a large increase in the incidence of chronic health conditions since the onset of the pandemic.
- On the positive side, the same type of productivity improvements that have accompanied the forced adoption of WFH arrangements has also appeared in the shift toward technology-based medicine, like telemedicine. As with WFH, such arrangements are likely to persist, in part (at least in the U.S.) because of changes in regulations that had previously limited the extent of such practices.

### **Session #3**

The third session covered issues related to macro and international economics, the financial system and financial regulation and an assessment of government responses to the pandemic.

One broad observation is that some aspects of the pandemic are unique, which means that we should not necessarily assume that the next downturn will be similar nor should we assume that policies that worked well this time would be appropriate in the future.

#### *Information and trust in government*

- Regarding government policies, many people were naturally cautious with respect to the risk of getting infected. This means that the provision of accurate and timely information rather than direct government interventions was found to be more effective in changing people's behavior at the right time.
- Trust in the government or various institutions is essential in harnessing this channel.

#### *International economics*

- On the international front, many developing countries have been forced to take large-scale fiscal measures urgently, and this creates future risks. Having floating exchange rates will be helpful.
- There are substantial reforms that are needed to improve systemic resilience, including Global Financial Safety Net enhancement (IMF, Fed swap lines), reform of the US Treasury security market, and sovereign restructuring mechanisms. More regulation is needed for non-bank financial institutions.
- It is also necessary to build up the global infrastructure of public health cooperation, to counter future pandemic threats.

#### *Financial system and financial regulation*

- Regarding the financial system, banks appear to be healthy but various problems with the financial system were exposed during the pandemic. Challenges remain in monitoring risks associated with the status of the large liquidity supports to firms, or risks associated with financing climate changes, or the use of cryptocurrencies.
- It is possible that new zombie firms have been created via the support from governments. It would be wise to reform bankruptcy procedures.

### *Monetary and Fiscal Policy*

- Central banks in the world have been very active in mitigating the impact of the pandemic, although there is some concern that they went beyond the previously recognized red lines.
- Some of the unprecedented actions included massive asset purchase programs that for the first time in many countries included buying private sector assets, a shift away from a focus on inflation, and close coordination with fiscal authorities.
- It would be desirable for central banks to clarify their reaction functions for intervening in the future.
- Now that inflation is rising, there is a question of whether central banks will have the independence to contain it.
- Government debts around the world have skyrocketed. Excessive reliance on public finances has been made possible by monetary policy, and central banks are facing the risk of large interest rate hikes.

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