The Japanese Macroeconomic Puzzle: An MMT Perspective

Student Research Internship Report

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Introduction

Modern Money Theory (MMT) has been gaining heightened attention from the past few years, especially in the context of the pandemic. The school of thought moved from the fringes to the centre of the policy discussion in many first-world countries to deal with the sudden increase in expenditure.

Against this backdrop, the sceptics and enthusiasts of the theory alike look towards the case of Japan as a rare social experiment, an economic laboratory for testing MMT propositions.

MMT insists that governments that issue their sovereign currency and do not face financial budget constraints cannot be forced into insolvency and can finance any projects and payments by creating more money, which they have a monopoly over. It does not see government debt as a problem if it results in greater GDP growth but instead focuses on inflation targeting. This theory is contrary to orthodox macroeconomic principles.

MMT advocates often cite Japan as a successful experiment of MMT because it is the economy that has the highest public debt among the OECD (Organisation of Economic Co-operation and Development) economies and yet, has experienced dramatic growth in the high-powered money supply since 2013, but has low inflation, stable yen exchange rates and zero interest.

The Economy of Japan: A Backdrop

Japan has been struggling with deflation for over two decades. Japanese national figures indicate high deficits and debt without insolvency, high interest rates, or inflation, creating an economic puzzle that traditional macroeconomists cannot explain. While Japan has the highest debt-to-GDP ratio globally, it has not faced higher interest rates or inflation or been shut out of credit markets. Instead, the yields on Japanese government bonds closely track the Bank of Japan's policy rate.

In the debates on MMT, Japan is often cited as an example that supports MMT. There are five identifiable symptoms: (i) relatively high and sustained fiscal deficits; (ii) relatively high gross public debt-to-GDP ratios; (iii) zero interest; (iv) negative 10-year Japanese government bonds yields; and (v) low inflation rate to deflation. This Japanese puzzle cannot be explained by Keynesian economics.

From an MMT perspective, Japan is the perfect case for demonstrating that the classical theory concerning sovereign budgeting has certain predicaments:

- Deficits do not necessarily lead to high inflation.
- The interest rate on government bonds is primarily a policy variable under the central bank's control.

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- Sovereign governments cannot be forced to default on their debt.
- High deficits and debt need not have negative consequences for an economy that has its own non-convertible currency.

Japan's Intersection With MMT

The Japanese experience validates MMT's core arguments concerning sovereign deficits and debt. It invalidates the mainstream critique about the dangers of "excessive" deficits and debt- some of the main arguments against MMT.

Despite the overall situation and many scholars representing Japan as the poster boy of MMT, its approach to resolving its deflation crisis has been the antithesis of MMT. Instead of a robust fiscal boost, which, as MMT supporters argue, could have boosted its economy out of the recession, Japan has implemented small and inconsistent fiscal measures- 22 of which reversed course more than once. This has resulted in higher deficits and debt due to the subsequent stabilizing policies that stall growth. Instead of learning from this experience, Japan has moved diametrically opposite from MMT's recommendations by adopting unconventional monetary measures, such as Quantitative Easing, which have been largely ineffective in boosting growth or reflating the economy.

Policymakers continue to deny the Japanese association with MMT ideologies vehemently, dubbing it "an extreme idea and dangerous as it would weaken fiscal discipline" (Finance Minister Taro Aso). BOJ policy board member Yutaka Harada said, "[t]he approaches proposed by MMT will cause [runaway] inflation for sure'" (Nikkei Asia 2019).

Japan is not following MMT recommendations policy-wise; rather, it is consistently engaging in temporary and inadequate fiscal stimuli against recessions, followed by practicing austerity whenever the economy seems to be on the path to recover, adopting the path of stop-go fiscal measures.

Political-Economic View of Japan's Anti-MMT Stance

Most modern-day economies are primarily monetarist, following Chicago-school ideology. Not only sovereign governments but powerful international monetary institutions such as the IMF subscribe to this orthodox thinking.

Under such a scenario, for the governments to carry out policies that are seemingly too radical such as that of MMT, seems unthinkable, especially for advanced economies like Japan, which are closely integrated with the global financial structure. Though the Japanese crisis is deep and they have not been able to overcome the struggles of deflation even after decades, they continue to adopt the comforting traditional policy while experimenting with fragments of MMT policy suggestions.

Covid-19 Implications for Japanese Economic Policy

MMT provides an alternative policy for the Japanese government to boost inflation and support economic growth, especially given the pandemic and the accompanying financial devastation. In response to the pandemic's impact on the economy, the Abe administration rolled out a 117 trillion Japanese yen stimulus package. To date, the Japanese public debt-to-GDP ratio has exceeded 230%. However, the support for the massive coronavirus stimulus—and its success in forestalling the worst possible outcome of broad shutdowns—appears to be rooted in the MMT.

During the pandemic, many countries across the world have reverted to certain aspects of Keynesian economics. However, this shift is associated more with the fiscal ideation aspect over the monetary angle. Even the more conservative governments are far more open to this fractured fiscal Keynesianism rather than accept Keynes' views on money, let alone other scholars such as Lerner or Minsky, who are more radical.

The reason for this abstinence from the monetary side of the school of thought, which MMT encompasses, is because adopting it as the national policy would go far beyond the already herculean task of rearranging the entire taxation structures, budgetary allocations, and government expenditure. The very idea of finance, speculation, the role of the government, and the nature of money will be challenged.

This shift will call for a much higher degree of government intervention and regulation, which might go against the modern era's capitalistic spirit that values the power of the popular mandate. The people who have become accustomed to the current financial structure, instruments, and functioning would be far less open to accepting the seemingly radical and non-sensical reasonings of MMT. Thus, no government would be interested in tying the bell to the cat and suffer defeat in the next elections. As such, the political superstructure is unable to effect radical changes in the economic structure.

The speculative nature of modern financial investment and instruments that strongly influence societies' growth and development will also be immensely affected as the process of forming rational expectations breaks down. Additionally, humans, by nature, are primarily uncomfortable with authoritarian powers. They may feel this system gives too much power to the government if they understand and accept the system at all to begin with.

Conclusion

This is a mighty block between the theoretical implications of MMT and its real-life application. The real question is not whether MMT is plausible, as proven through various case studies, but whether it can be implemented in the current scenario and how to go about this transformation. One country cannot decide with ease to adopt MMT principles and have widespread acceptance among its people or continue to operate with perfect functionality in global trade and exchange. However, expecting this model to be adopted unilaterally across the globe is fictitious at present.

Nevertheless, MMT highlights various gaps and loopholes in the existing economic structure. Heterodox ideologies always get further highlighted in times of crisis. Despite the lack of open acceptance, unrest among the population and scholars looking at alternate philosophies and literature to explain/ resolve ongoing phenomena proves that the existing systems need alterations or replacement. It might not be a pragmatic solution to go against global structures, break down rational assumptions and opinions of the relatively financially illiterate population by adopting MMT against the established macroeconomic policy regime. However, it paves the way for deliberation, discussion, and possibly changing policy structures in the near future.