# Japan Is Not Implementing MMT

*Interview with Paul Sheard, Harvard Kennedy School Senior Fellow*
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The US and Japan run huge budget deficits every year, and because the Bank of Japan's unconventional monetary easing is effectively a form of monetary financing, it is claimed that Japan is implementing Modern Monetary Theory (MMT). I beg to differ, however.

The essential insight of MMT is that the consolidated government (the treasury and the central bank), which is a creator of money, does not face a constraint on raising funds. It is just that the institutional framework separating fiscal and monetary policy artificially creates such a constraint. In principle, the government cannot run out of money. The real constraint lies in the workings of the real economy.

To be sure, the large-scale quantitative easing undertaken by the Bank of Japan since 2013 under the leadership of Governor Haruhiko Kuroda conjures up MMT. That is because, by undertaking QE, the consolidated government changes the form of its liability from a government debt security, which has a repayment date, to a central bank current account balance (reserve) which does not need to be repaid. It is a policy that blurs the line between monetary and fiscal policy.

I believe the lesson from Japan's long-term stagnation is that the joint mobilization of monetary and fiscal policy has been insufficient. No sooner had Japan implemented zero interest rate policy and QE and expanded fiscal policy than it exited from ZIRP (in 2000) and, in the Koizumi administration, proceeded to cut public works expenditure and pursue fiscal austerity.

Also, just one year after Quantitative and Qualitative Easing was launched, in April 2014 the government proceeded to hike the consumption tax, from 5% to 8%. This incoherent policy was like placing one foot on the accelerator while putting the other one on the brakes.

The US presents a contrast. After the 2008 “Lehman shock,” the US, learning the lessons from Japan’s mistakes, arrested the downturn by mobilizing monetary policy and fiscal policy, including injecting funds to recapitalize the banks, quickly putting the economy on the path to recovery.

Now Japan is about to repeat its past mistakes. Even though there is still no prospect of consumer price index (CPI) inflation reaching 2%, the government is about to raise the consumption tax again in October (from 8% to 10%) out of concern for fiscal consolidation. Bank of Japan Governor Kuroda supports the implementation of the consumption tax increase on schedule. This is a far cry from MMT, with its monetary-fiscal integration and jettisoning of fiscal constraints.

Under MMT thinking, if the government continues with aggressive fiscal policy and the central bank prints money without limit, eventually the economy will hit a supply constraint and CPI inflation will rise. That is, inflation pressures will build up. Until that constraint becomes manifest, fiscal consolidation is unnecessary; in fact, it is harmful. To hit the constraint is to achieve the policy objective.

In an economy like Japan’s that has fallen into a long-term deflationary state, as a kind of shot-in-the-arm, MMT-like policies, that is, aggressive integrated monetary and fiscal policies, can be effective in stimulating the economy and raising the inflation rate.

Specifically, the government should tie the timing of the consumption tax hike to the BOJ’s commitment to continue to expand the monetary base (banknotes and coins in circulation and current account balances), that is, not hike until the CPI inflation rate exceeds 2% and stays above it in a stable manner. Japan is not currently implementing MMT, but if it changes policy course in this way it could become an MMT frontrunner.

(Interviewer: Motoyasu Hamajo, Editorial Department)

Paul Sheard was born in Australia in 1954. He graduated from Monash University and received a PhD and MEc from the Australian National University. He served as chief economist of Lehman Brothers, Nomura Securities, and S&P Global, and as S&P Global Vice Chairman; he has been in his current position since 2018.