Monetary, fiscal policies must work together

Of late, the axis of the Abe administration’s economic management has been conspicuously tilted toward fiscal policy. Leaders of the Group of Seven major economies agreed during the G7 Summit in Mie Prefecture in late May to advance fiscal policy in tandem with monetary policy and structural reforms. In early June, Prime Minister Shinzo Abe decided to postpone a consumption tax hike scheduled for April, whereas some observers speculated in autumn a new economic stimulus package to stem an economic downturn. Now that Biritain has voted to leave the European Union, sending global stock and currency markets into a panic, the Abe Cabinet will likely find it more difficult to manage the Japanese economy.

How should we respond to the sudden surge in debate on fiscal policy in recent months? Are fiscal measures necessary to overcome deflation? Will the market be ready to return fiscal policy to its former quiescence? Many questions need answers.

In answering those questions, I would like to refer to “controlled inflation,” over which there was a heated debate about 15 years ago. According to the macroeconomic viewpoint, the creation of a moderate level of inflation was considered an effective way to help revitalize the Japanese economy that had stagnated since the bubble economy burst. As the time to the scheduled fiscal stimulus expenditure approached, the government decided to introduce a 2% inflation target.

The main difference is that whereas under the existing QE method, the central bank buys government bonds underwritten and held by commercial banks and injects money into the banking system, the government could have helicopter money flow immediately into the economy in the form of fiscal spending. It will be really serious if the Bank of Japan continues to hold government bonds on its balance sheet indefinitely. Then, why did the government receive 10% money in the air? There can be no other reason but to underscore the importance of implementing monetary and fiscal policies simultaneously to banish deflation.

After the Bank of Japan adopted the bold monetary easing measure by increasing the volume of money in the economy. However, this seems to have generally allowed the banks to increase the outstanding balances in current accounts that they hold at the central bank, instead of bringing about an upward in personal consumption and corporate investment.

Of course, the Bank of Japan’s monetary policy has played an important role in helping the country’s efforts to overcome deflation, but it has stopped short of becoming instrumental in expanding demand. Against this background, the central bank decided to introduce a negative interest rate policy for the first time in Japan’s history. It is too early to determine whether this unprecedented monetary policy has been successful or failure, many people doubt whether a central bank policy alone is sufficient to combat economic woes.

‘Helicopter money’

Later, a number of pundits in Japan and abroad have been talking about “helicopter money,” a concept first broached by Nobel laureate Milton Friedman. He thought that central banks could lift a flagging economy by dropping an immense amount of newly printed bills from the sky into an economy.

How does helicopter money differ from the Bank of Japan’s ongoing massive quantitative easing (QE) policy? Helicopter money does not refer to an aircraft. Instead, it means that the central bank would keep printing money to purchase and potentially hold newly issued government bonds — monetizing debt while freeing the government from redeeming such debt. In other words, the Bank of Japan would directly transfer new government bonds, a measure prohibited under the Public Finance Law because of fears that there would be no fiscal restraint.

A modest level of inflation could be effective in lowering the debt-to-GDP ratio

The concept of helicopter money is expected to be further and more frequently taken up. But we should stay prudent in allowing the Bank of Japan to directly underwrite government bonds. We are reminded that the Bank of Japan is a nation’s central bank and its monetary policy connotes the importance of applying fiscal stimuli and monetary policy in an integrated way — and what the concept explicitly means — letting the central bank monetize government debt.

In one of my drawer, I keep a 100 trillion Zimbabwe dollar note issued by Zimbabwe’s central bank in 2009. Trapped in an economic crisis that triggered hyperinflation that reached its zenith in 2008-2009, the African country had no choice but to print banknotes of higher denominations.

I don’t think Japan will encounter an economic debacle of a similar scale. Still, we need to engage in debate over helicopter money in a precise and prudent manner.

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