

How to Pay for It All: Central Banking Asia Style

An Option the Candidates Missed

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The Democratic Party has clearly swung to the progressive left, with candidates in the first round of presidential debates coming up with one program after another to help the poor, the disadvantaged and the struggling middle class. Proposals ranged from a Universal Basic Income to Medicare for All to a Green New Deal to student debt forgiveness and free college tuition. The problem, as [Stuart Varney observed](#) on FOX Business, was that no one had a viable way to pay for it all without raising taxes or taking from other programs, a hard sell to voters. If robbing Peter to pay Paul is the only alternative, the proposals will go the way of Trump's trillion dollar infrastructure bill for lack of funding.

Fortunately there is another alternative, one that no one seems to be talking about – at least no one on the presidential candidates' stage. In Japan, it is a hot topic; and in China, it is evidently taken for granted: the government can generate the money it needs simply by creating it on the books of its own banks. Leaders in China and Japan recognize that stimulating the economy is not a zero-sum game in which funds are just shuffled from one pot to another. To grow the economy and increase GDP, demand (money) must go up along with supply. New money needs to be added to the system; and that is what China and Japan have been doing, very successfully.

Before the 2008-09 global banking crisis, China's GDP increased by an average of 10% per year for 30 years. The money supply increased right along with it, created on the books of its state-owned banks. Japan under Prime Minister Shinzo Abe has been following suit, with massive economic stimulus funded by correspondingly massive purchases of the government's debt by its central bank, using money simply created with computer keystrokes.

All of this has occurred without driving up prices, the dire result predicted by US economists who subscribe to classical monetarist theory. In the 20 years from 1998 to 2018, China's M2 money supply grew from just over 10 trillion yuan to 180 trillion yuan (\$26T), an 18-fold increase. Yet it closed 2018 with a consumer inflation rate that was [under 2%](#). Price stability has been maintained because China's Gross Domestic Product [has grown](#) at nearly the same fast clip, by a factor of 13 over 20 years.

In Japan, the massive stimulus programs called "Abenomics" have been funded through its central bank. The Bank of Japan [has now "monetized"](#) nearly 50% of the government's debt, turning it into new money by purchasing it with yen created on the bank's books. If the US Fed did that, it would own \$11 trillion in US government bonds, four times what it holds now. Yet [Japan's M2 money supply](#) has not even doubled in 20 years, while the US money supply has grown by 300%; and Japan's inflation rate remains stubbornly below the BOJ's 2% target. Abe's stimulus programs have not driven up prices. In fact deflation remains a

greater concern than inflation in Japan, despite unprecedented debt monetization by its central bank.

China's Economy: A Giant Ponzi Scheme or a New Economic Model?

Critics have long [called China's economy a Ponzi scheme](#), doomed to collapse in the end; and for 40 years China has continued to prove the critics wrong. According to [a June 2019 report](#) by the Congressional Research Service:

Since opening up to foreign trade and investment and implementing free-market reforms in 1979, China has been among the world's fastest-growing economies, with real annual gross domestic product (GDP) growth averaging 9.5% through 2018, a pace described by the World Bank as "the fastest sustained expansion by a major economy in history." Such growth has enabled China, on average, to double its GDP every eight years and helped raise an estimated 800 million people out of poverty. China has become the world's largest economy (on a purchasing power parity basis), manufacturer, merchandise trader, and holder of foreign exchange reserves.

This massive growth has been funded with credit created on the books of China's banks, most of which are state-owned. Even in the US, course, most money today is created on the books of banks. That is [what our money supply is](#) – bank credit. What is different about the Chinese model is that the Chinese government can and does intervene to direct where the credit goes. In a July 2018 article titled "[China Invents a Different Way to Run an Economy](#)," Noah Smith suggests that China's novel approach to macroeconomic stabilization by regulating bank credit represents a new economic model, one that may hold valuable lessons for developed economies. He writes:

Many economists would see this approach as hopelessly ad hoc, haphazard, and interventionist — not the kind of thing any developed country would want to rely on. And yet, it seems to have carried China successfully through several crises, while always averting the catastrophic financial crash that outside observers have been warning about for years.

Abenomics, Helicopter Money and Modern Monetary Theory

Noah Smith has also written about Japan's unique model. After Prime Minister Abe crushed his opponents in October 2017, Smith [wrote](#) on *Bloomberg News*, "Japan's long-ruling Liberal Democratic Party has figured out a novel and interesting way to stay in power—govern pragmatically, focus on the economy and give people what they want." He said everyone who wanted a job had one; small and midsize businesses were doing well; and the BOJ's unprecedented program of monetary easing had provided easy credit for corporate restructuring without generating inflation. Abe had also vowed to make both preschool and college free.

Like China's economic model, Abenomics has been [called a Ponzi scheme](#), funded by central bank-created "free" money. But whatever it is called, the strategy has been working for the economy. Even the once-dubious International Monetary Fund has [declared](#) Abenomics a success.

The Bank of Japan's massive bond-buying program has also been called "helicopter money"

— a policy in which the central bank directly finances government spending by underwriting bonds – and it has been compared to Modern Monetary Theory, which similarly posits that the government can spend money into existence with central bank funding. As [Nathan Lewis wrote](#) in *Forbes* in February 2019:

In practice, something like “MMT” has reached a new level of sophistication these days, exemplified by Japan. . . . The Bank of Japan now holds government bonds amounting to more than 100% of GDP. In other words, the government has managed to finance itself “with the printing press” to the amount of about 100% of GDP, with no inflationary consequences. [Emphasis added.]

Japanese officials have resisted comparisons with both helicopter money and MMT, arguing that Japanese law does not allow the government to sell its bonds directly to the central bank. As in the US, the government’s bonds must be sold on the open market, a limitation that also prevents the US government from directly monetizing its debt. But as Bank of Japan Deputy Governor Kikuo Iwata observed in a 2013 Reuters article, where the bonds are sold does not matter. What is important is that the central bank has agreed to buy them, and it is here that US banking law diverges from the laws of both Japan and China.

Central Banking Asia-style

When the US Treasury sells bonds on the open market, it can only hope the Fed will buy them. Any attempt by the president or the legislature to influence Fed policy is considered a gross interference with the sacrosanct independence of the central bank.

In theory, the central banks of China and Japan are also independent. Both are members of the Bank for International Settlements, which stresses the importance of maintaining the stability of the currency and the independence of the central bank; and both countries revised their banking laws in the 1990s to better reflect those policies. But their banking laws still differ in significant ways from those of the US.

In Japan, the Bank of Japan is legally free to set interest rates, but it [must cooperate closely](#) with the Ministry of Finance in setting policy. Article 4 of the 1997 [Bank of Japan Act](#) says:

The Bank of Japan shall, taking into account the fact that currency and monetary control is a component of overall economic policy, always maintain close contact with the government and exchange views sufficiently, so that its currency and monetary control and the basic stance of the government’s economic policy shall be mutually compatible.

Unlike in the US, Prime Minister Abe can negotiate with the head of the central bank to buy the government’s bonds, ensuring that the debt is in fact turned into new money that will stimulate domestic economic growth; and he is completely within his legal rights in doing it.

The leverage of China’s central government over its central bank is even stronger than the Japanese prime minister’s. The 1995 [Law of the People’s Republic of China on the People’s Bank of China](#) states:

The People’s Bank of China shall, under the leadership of the State Council, formulate and implement monetary policies, guard against and eliminate

financial risks, and maintain financial stability.

The State Council has final decision-making power on such things as the annual money supply, interest rates and exchange rates; and it has used this power to stabilize the economy by directing and regulating the issuance of bank credit, the new Chinese macroeconomic model that Noah Smith says holds important lessons for us.

The successful six-year run of Abenomics, along with China's decades of unprecedented economic growth, have proven that governments can indeed monetize their debts, expanding the money supply and stimulating the economy, without driving up consumer prices. The monetarist theories of US policymakers are obsolete and need to be discarded.

"[Kyouryoku](#)," the Japanese word for cooperation, is composed of characters that mean "together strength" – "stronger by working together." This is a recognized principle in Asian culture and it is an approach we would do well to adopt. What US presidential candidates from both parties should talk about is how to modify the law so that Congress, the Administration and the central bank can work together in setting monetary policy, following the approaches successfully modeled in China and Japan.

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