

# 2012 Policy Conference on Japan's Fiscal Sustainability

Canon Institute for Global Studies

Debt and Fiscal Imbalance in Japan and the U.S.

Selo Imrohoroglu  
University of Southern California  
Marshall School of Business  
June 1, 2012, Tokyo

# Fiscal Imbalance Initiative

- Fiscal imbalances can have adverse long-term macroeconomic consequences.
  - Although fiscal imbalances may be *temporary* situations, they confront citizens with uncertainty about how the imbalances will ultimately be repaired by some worrisome combination of **tax hikes, reductions in government expenditures, and outright defaults on government bonds and entitlements**.
- **Designing responsible, effective economic and social policy**—and understanding its true costs and economic impact—**requires dispassionate, scientific analysis** of the intertemporal dimensions of taxes and government expenditures over time.
  - The Congressional Budget Office, the Treasury, and other government entities engage in budget forecasts that are supposed to provide input into the conduct of fiscal policy. However, these forecasts are shackled by scoring rules and other bureaucratic restraints that prevent them from making realistic evaluations of the likely macroeconomic ramifications of legislation.

# Fiscal Imbalance Initiative

- The Becker Friedman Institute, University of Chicago
- Initiative to nurture more credible evaluations of current and alternative fiscal policies, based on a broad array of the best macro- and microeconomic research.

# Plan for my comments

- The fiscal imbalance in the U.S.
- What are some politically feasible (not claiming possible) solutions?
- The fiscal imbalance in Japan
- What are some possible solutions

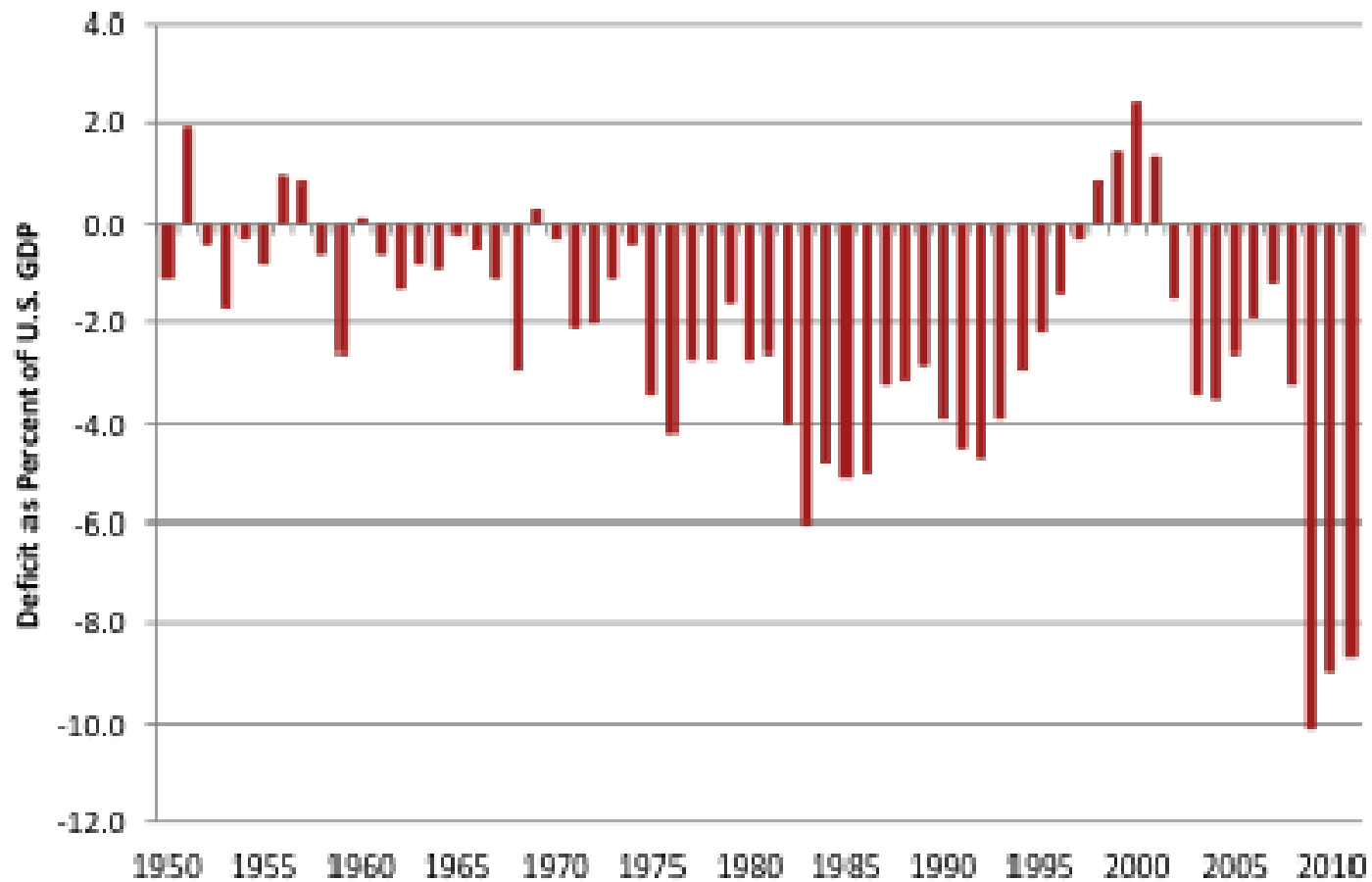
# THE FISCAL CLIFF

**How America Can Avoid a Fall  
and Stay on Top**

AYŞE İMROHOROĞLU, PHD,  
AND  
SELAHATTİN İMROHOROĞLU, PHD

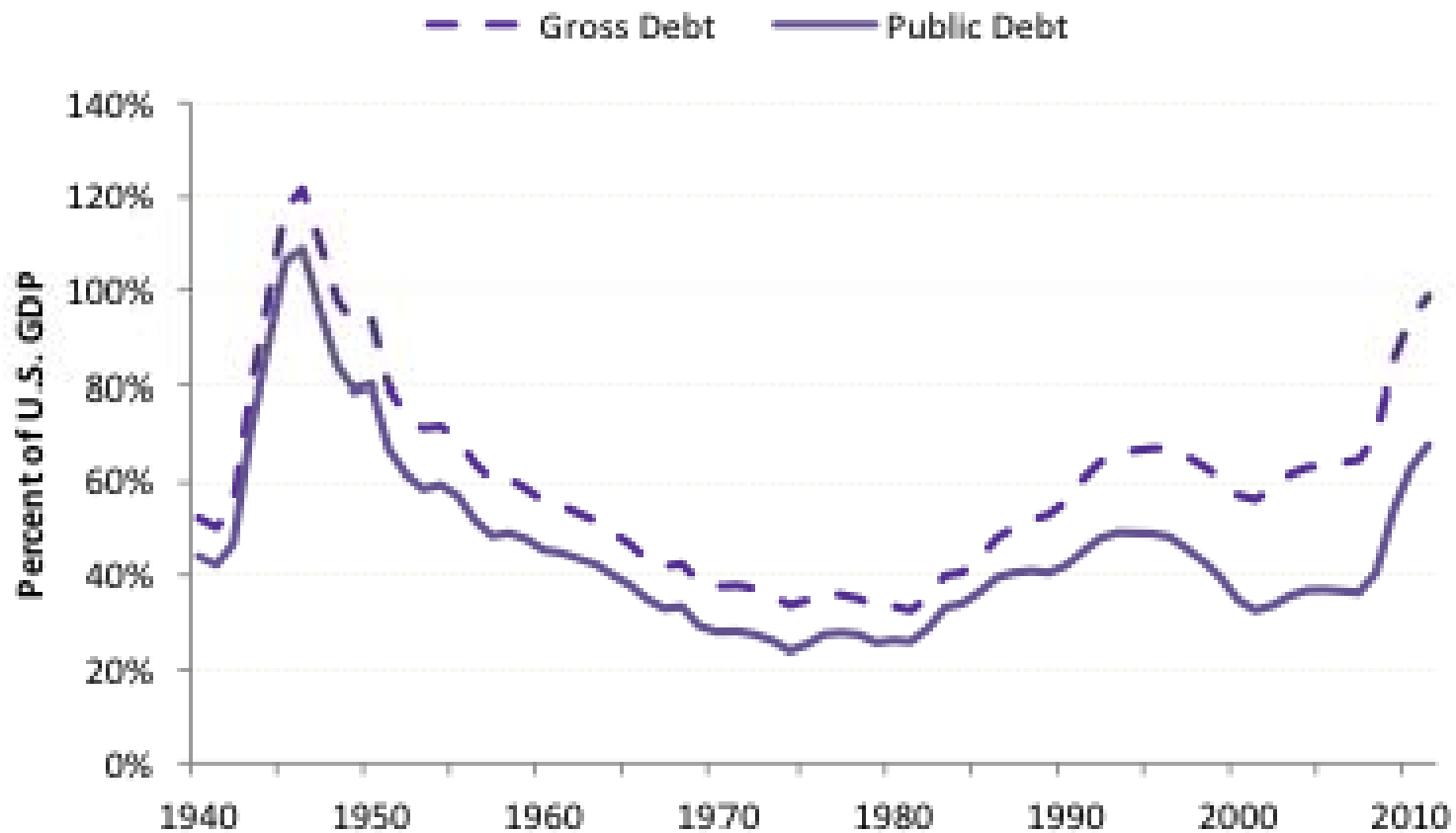
**INTRODUCTION BY BRIAN BAKER,  
PRESIDENT OF ENDING SPENDING, INC.**

# U.S. Budget Deficits



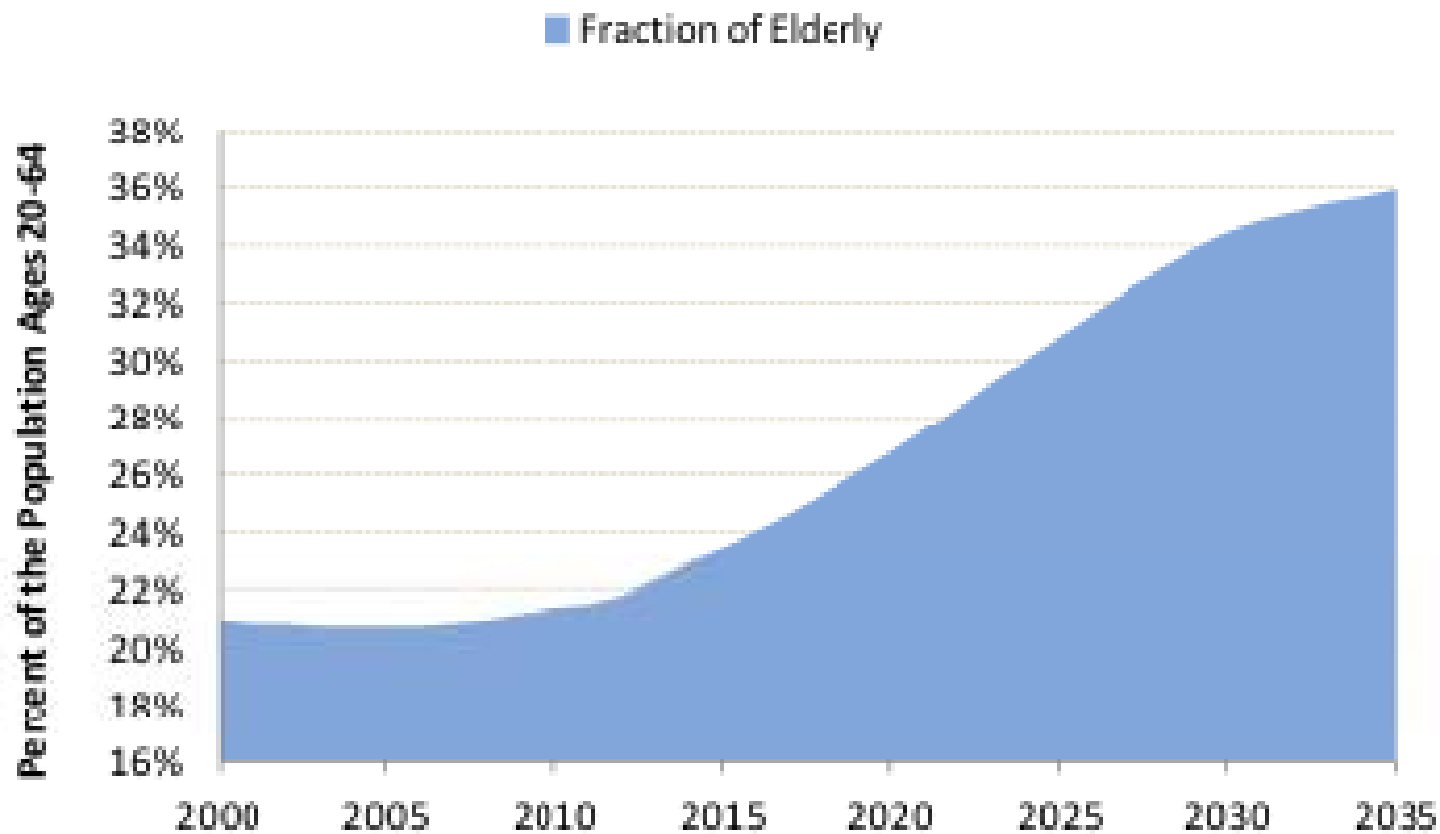
Source: Office of Management and Budget (2012), Table 1.2

# U.S. Debt



Source: Office of Management and Budget (2012), Table 7.1.

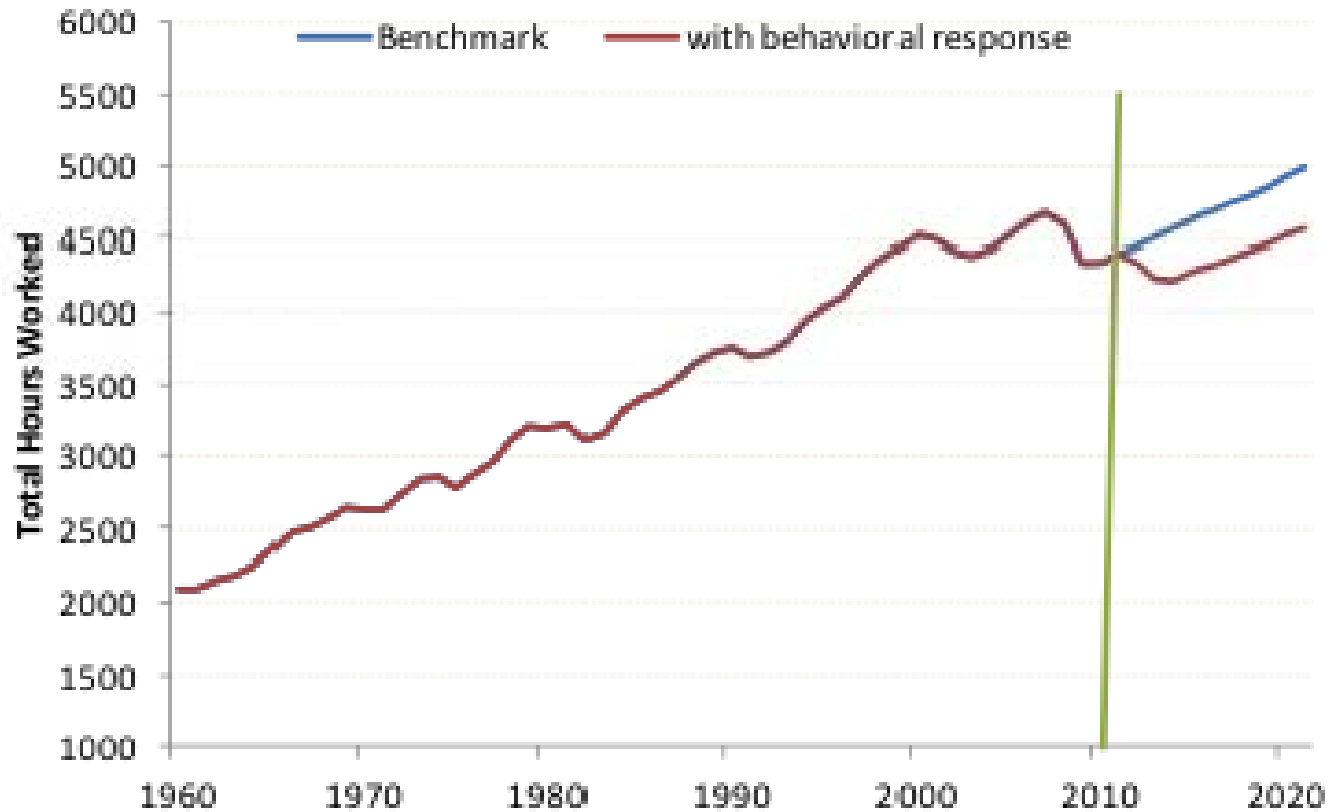
# U.S. Aging



Source: Congressional Budget Office(2010a).



# CBO: Marginal Tax Rate 25% $\uparrow$ 35%



Source: Authors' calculations.

# Simpson-Bowles Solution

1. Eliminate tax deductions to increase government revenues and lower income tax rates.
2. Reduce and reform government expenditures on public health care, Social Security, other entitlement programs, and discretionary side.

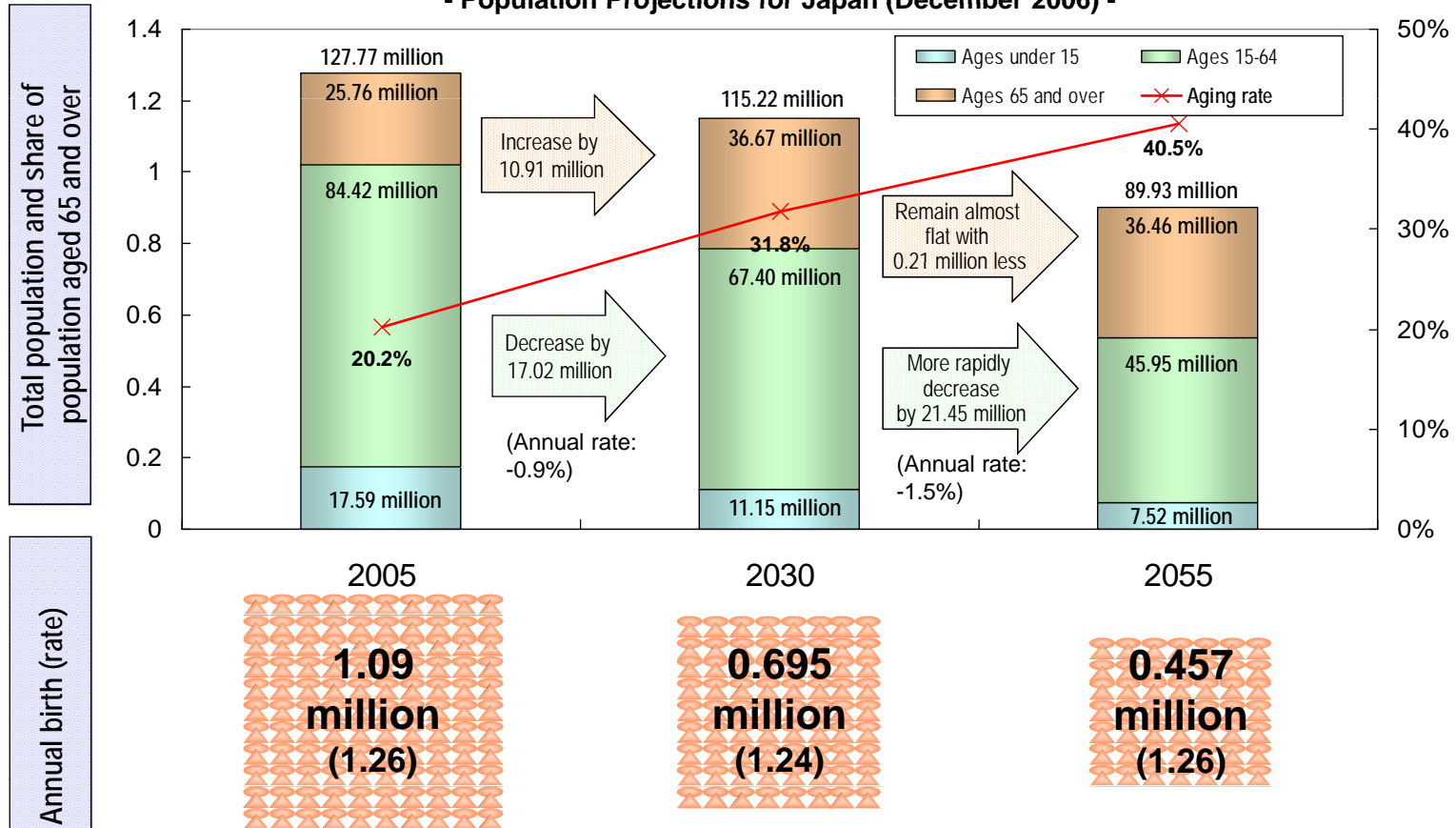
\$4 Trillion over the next 20 years

# Aging in Japan

- Most severe among advanced economies
- Large expected fiscal burden
- If taxes are used exclusively, 30% increase

# Japan will rapidly age with fewer children

- Population Projections for Japan (December 2006) -



Source: National Institute of Population and Social Security Research, "Population Projections for Japan" (December 2006) (with medium variant fertility and medium variant mortality)

# Japan's Economic and Social Policy Options: Go Big or Go Home

- Rise in retirement age
- Tax policy (rise in earnings tax, capital tax, consumption tax, change in progressivity)
- Fall in social security benefits
- **Rise in fertility**
- **Rise in female labor force participation**
- **Rise in female wage (by a shift from contracted to regular)**
- **Rise in immigration (selective in age, skill, duration of stay)**

# An Accounting Model

- State vector =  $\{i,j,e\}$  at each time  $t$
- Age:  $i$  (adult age), (1 to 100, both dependents and adults)
- Gender:  $j = \{m,f\}$
- Employment state:  $e$ 
  - “regular” employee (seishain, seiki-koyou)
  - “contingent” (hi-seishain, hi-seiki-koyou)
  - unemployed and not in labor force
- Immigration state,  $\gamma$ : years since immigration,
  - 1 for the first year of immigration, etc.
  - 0 denotes natives.
- Time:  $t$

# Japanese Microeconomic Data and Social Insurance Institutions

- Empirical age-income and age-consumption profiles
- Close the model with a linkage from these to age-asset profiles
- Aggregate individuals
- Calculate the path of JGB into the future
- Policy experiments to see what is “big”
- General equilibrium model to design policies