資料1－1

Japanese Fiscal Policy: The Path forward

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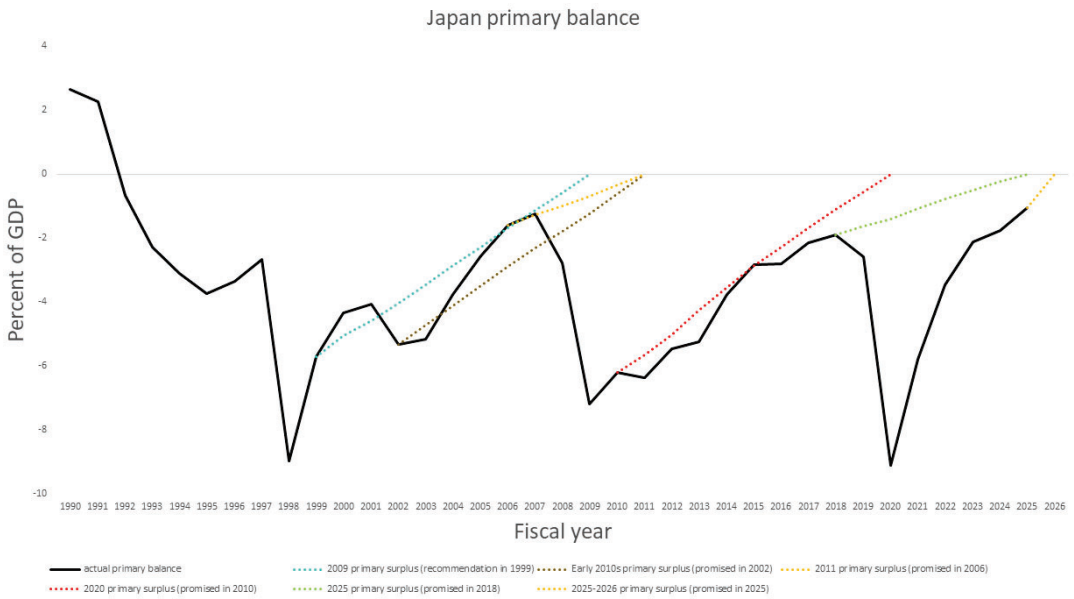
History: Primary Deficits and the Increase in Debt



Net debt ratio: from 20% in 1990 to about 130% today

Why the large rise? Two distinct reasons:

- Low growth, political constraints, and optimistic forecasts
- Sustaining weak private demand, monetary policy at the ZLB

  Less of an issue now? End of secular stagnation? Likely, but not certain.

How much to worry about a high but stable debt ratio?

- Depends fundamentally on $(r - g)$
- If $(r - g) > 0$ (standard textbook):
  - *Welfare:* Displacement of capital in portfolios; lower output later
  - *Dynamics:* Debt ratio increases even if primary deficit equals zero
  - Need a primary surplus to stabilize debt $\Rightarrow$ higher taxes
- If $(r - g) < 0$:
  - *Welfare:* Displacement not very costly ("dynamic inefficiency" result)
  - *Dynamics:* Debt ratio decreases on its own, with zero primary deficit
  - Can afford a (limited) primary deficit and still stabilize the debt ratio
- **But:** Even if $(r - g) < 0$: amplification of $(r - g)$ uncertainty. Dynamics depend on $(r - g) \times b$

The Costs of a Steadily Increasing Debt:

If forecasts of debt are for a steady increase, then doom loop:

- Higher spread $\rightarrow$ faster increase in debt $\rightarrow$ higher spread $\rightarrow \cdots$
- Costly, even in the absence of actual default
- Risk of multiple equilibria/runs/sudden stops. Worries about sustainability lead to further shifts in investors' positions.

When to worry? When investors feel that there is loss of control. No hard red line, depends on:

- Nature of investors: Domestic/foreign
- Maturity of the debt (relevance of zero maturity BOJ reserves)

Japan's Current Fiscal Position

- High debt (relevant concept must include BOJ interest-paying reserves)
- Current $(r - g)$ negative — largely due to issuance of debt when interest rate was zero

  Future $(r - g)$: reasonable forecast $(r - g) = 0$, so need at least for primary balance
- Currently: small primary deficit but still decrease in debt ratio due to $(r - g) < 0$

  But in a few years, will need at least zero primary balance.
- Put another way: Aim **at least** for nominal debt growing in line with nominal GDP
- Uncertainty plus high debt level suggest aiming for a small primary surplus.

Building a Coherent Program

- The basic tool: "SDSA" — dynamic simulations of debt under uncertainty
- *First use:* assess the distribution of the current trajectory under existing policies
  - At two horizons: 5 and 20 years (reliability of medium vs. long-term forecasts)
  - Allows assessment of implicit liabilities;
  - Anticipate contingencies, so as not to need a supplemental budget every year
- *Second use:* assess distribution of trajectories under proposed policies
- SDSAs provide a shared platform for informed discussion

  Precious for discussions of demographics, r^*, and degree of uncertainty
- Of the essence: Must be produced by an independent fiscal council

  To create a process that is visibly transparent, and credible

Implementation

- Multi-annual plan: a contingent path for primary balances, with a clear end goal
  - Of the essence: a credible medium-term trajectory for primary balances, with at least debt stabilization at the end of the horizon
- Over how many years?
  - *Too fast:* weak private demand constraint; risk of returning to ZLB — work with BOJ
  - *Too slow:* no credibility
  - Avoid mechanical year-by-year adjustment
- Implementation — choice between two approaches:
  - Annual SDSA and adjustment *ex post* each year
  - Fiscal rules, with escape clauses

Public Investment

- Should not get an automatic pass to be financed by debt
- Most needed public investment does not generate enough future fiscal revenues:
  - Defense, global warming
  - Reform-induced investments with uncertain returns: education, research
  - "Strategic investments that enhance resilience against potential crises"
- SDSA is the right tool to assess the effect on the evolution of the debt distribution
- Still, if investment is urgent and required increase in taxation cannot happen immediately:
- Accept a temporary increase (or smaller temporary decrease) in the primary deficit, so long as it preserves eventual debt stabilization
- Need for transparency: separate investment account, with spending and likely revenues