

What Changes the Effects of Fiscal Policy?

: The case of Japan

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Abstract

During the past two decades, Japanese government performs huge amount of fiscal expenditure against the deep recession since 1990s and many studies pointed out that the effects were declined at least after the late 1990s. However, none of these studies tests statistically the reason they implicitly or explicitly mentioned. The purpose of the present paper is to test statistically this point using the threshold VARs in which the reasons pointed out in the literature are adopted as the threshold. If the threshold variables are statistically significant, we can decide the reason affects the effects of fiscal policy. Then we will estimate the impulse response functions in both sample periods divided by the threshold estimates and compare the effect of fiscal policy with each other.

The results of the study are as follows. First, we find the diffusion index on forecasted business conditions, those on lending attitude of financial institutions, and the budget balance-to-GDP ratio are significant so we should divide sample periods by these threshold estimates to infer true responses functions. Second, the resulting impulse response functions show the effects on other macroeconomic variables are in traditional fashion basically, but some differences are found. Especially, crowding-in of private investment will be derived in the good time on bank lending and on budget balance of the government. Finally, in the bad time on these two conditions, the demand enhancing effects of public investment should be consider weak. The growth of private consumption is small relative to that in the good time, so we have to care the existence of liquidity constrained households and the non Keynesian effects when we encounter recession later on.

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