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# Fiscal Policy under Debt Feedback Rule: the Case of Japan

Jun-Hyung Ko  
Hitotsubashi University

Hiroshi Morita  
Hitotsubashi University

April, 2011

## Abstract

The Japanese government is facing a huge amount of accumulating public debt. However, previous empirical literature do not consider this debt effect on fiscal policy and macro economy. In this paper we incorporate the debt dynamics in a VAR model in the spirit of Favero and Giavazzi (2008). Inclusion of the debt feedback rule in the VAR can overcome the misspecification problem and explain more relevant debt path as well as fiscal stance. Main findings are as follows. First, in the pre-bubble period, the fiscal authority increased primary balance when public debt was in the high level. However, this phenomenon disappear in the post-bubble period. Second, impulse response functions to the government spending shock reveal that the stance of fiscal policy in the pre-bubble period was more active. Third, the forecast of debt dynamics in the pre-bubble period is stable, but become explosive in the post-bubble period.

**Keywords:** fiscal policy, public debt, VAR

**JEL classification:** E31; H60; E62