

THE SUBSTITUTABILITY BETWEEN PRIVATE AND GOVERNMENT CONSUMPTION

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〈SUMMARY〉

In this paper we examine the relationship between private and government consumption in Japan. We begin by estimating a two-good permanent-income model using Japanese data over the period 1980Q2-2009Q1. Our empirical results show the long-run relationship exists between private and government consumption. A structural shift in that relation around 1991Q2 appears. The estimated intratemporal and intertemporal elasticities of substitution between the two types of expenditure indicate that private and government consumption in Japan are substitutes through the sample period. The substitutability becomes significantly higher, however, from 1991 onward. This suggests that the weak effectiveness of fiscal policy in recent years may be at least partly attributed to the direct crowding-out effect resulting from the high substitution.