

Author's Accepted Manuscript

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PII: S0165-1889(15)00174-8
DOI: <http://dx.doi.org/10.1016/j.jedc.2015.09.007>
Reference: DYNCON3246

To appear in: *Journal of Economic Dynamics and Control*

Received date: 24 July 2015
Revised date: 7 September 2015
Accepted date: 14 September 2015

Cite this article as: Shinichi Nishiyama, Fiscal policy effects in a heterogeneous agent OLG economy with an aging population, *Journal of Economic Dynamic and Control*, <http://dx.doi.org/10.1016/j.jedc.2015.09.007>

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Fiscal Policy Effects in a Heterogeneous-Agent OLG Economy with an Aging Population*

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September 17, 2015

Abstract

This paper incorporates the aging population projected by the U.S. Social Security Administration to a heterogeneous-agent OLG model with idiosyncratic wage shocks and analyzes its effects on individual households, the government budget, and the overall economy. The fiscal gap caused by the demographic change is 2.92% of GDP under the SSA's intermediate projection. The effect of the aging population is large by itself and depends significantly on how the government finances the cost of the demographic change. There is a strong trade-off between efficiency and equity, and this paper quantitatively assesses the pros and cons of stylized fiscal reform plans.

JEL Classification Numbers: D91, E62, H31.

Keywords: dynamic general equilibrium; heterogeneous agents; overlapping generations; aging population; fiscal policy.

*For providing and explaining the data used in this paper, I am grateful to Alice Wade, Michael Morris (both Social Security Administration), John Sabelhaus, Kevin Moore (both Federal Reserve Board), Patricia Neuman, Juliette Cubanski (both Kaiser Family Foundation), and Anthony Damico (independent consultant). For their helpful comments and suggestions on the earlier version of this paper, I also thank Ayşe İmrohoroğlu, Florian Scheuer, two anonymous referees, many economists at the Congressional Budget Office, and the seminar/conference participants at the Michigan Retirement Research Center, George Washington University, Congressional Budget Office, National Graduate Institute for Policy Studies, Econometric Society North American Summer Meeting, and Kansai University. I am responsible for any remaining errors.

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