



Macroeconomic and fiscal implications of changes in the labor share under population aging in Japan^{☆,☆☆}

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ABSTRACT

This study examines how declining labor share affects macroeconomic outcomes and fiscal sustainability in Japan—the country with the most advanced population aging globally. While previous research has documented the global trend of declining labor share, its implications for fiscal policy in aging societies remain underexplored. Using a life-cycle general equilibrium model in the Auerbach–Kotlikoff tradition, we calibrate parameters to match Japan's economic and demographic characteristics, incorporating country-specific institutions such as public pension, health insurance, and long-term care systems. Our analysis reveals that when capital share increases by 3 percentage points between 2025–2060, it generates fiscal relief equivalent to approximately 3 percentage points in consumption tax by 2070 through enhanced capital accumulation. More significantly, this declining labor share amplifies the efficacy of pension reforms, potentially yielding savings equivalent to over 12 percentage points in consumption tax. Our findings suggest that declining labor share, when coupled with appropriate policy reforms, may benefit fiscal sustainability in rapidly aging societies with high public debt.

Introduction

In recent years, there has been growing concern about the declining trend of labor share in various countries around the world. [Piketty \(2014\)](#), using French tax data, pointed out that historically the return on capital (r) exceeds the economic growth rate (g), resulting in an expansion of capital's share over time. Subsequently, empirical studies on the increasing trend of capital share (i.e., the decline in labor share) have been conducted in various countries. While the research findings are in fact diverse, there are numerous results indicating a downward trend. However, in the context of macroeconomics, it is not clear what impact the decline in labor share has on the macroeconomy.

Since ([Kaldor, 1961](#))'s stylized facts, various studies have been conducted under the assumption that capital share remains constant in various macroeconomic models. However, in many countries, labor share has not necessarily been stable, even when not declining. [Elsby et al. \(2013\)](#) and [Karabarbounis and Neiman \(2014\)](#) have studied the decline in labor share in the United States, emphasizing the importance of technological progress. With technological advancement, some labor has been substituted by capital. As the relative price of physical investment declined and ICT capital became more affordable, some of

the simple labor tasks previously performed began to be replaced by capital. Moreover, with globalization, labor-intensive industries have become central industries in developing countries, while developed countries have specialized in capital-intensive industries, increasingly importing labor-intensive goods. These technological advances have increased returns to capital in developed countries, driving labor share downward.

Labor share is defined as the ratio of employee compensation to GDP or national income. Compensation of employees is the total value of labor income for all workers in a country. In other words, the compensation of employees is the sum of labor income of people with various backgrounds in terms of age and skills (human capital, or educational attainment). It may not be surprising that in many countries, labor share has not necessarily been constant over the decades. This is because labor markets are aging in various developed countries, including Europe and East Asia. Additionally, in many countries, college enrollment rates have increased, leading to a more educated workforce. As a result, labor input is influenced by the population distribution. If all workers were perfectly substitutable, the labor share would remain unchanged as long as the total labor input hours remained constant.

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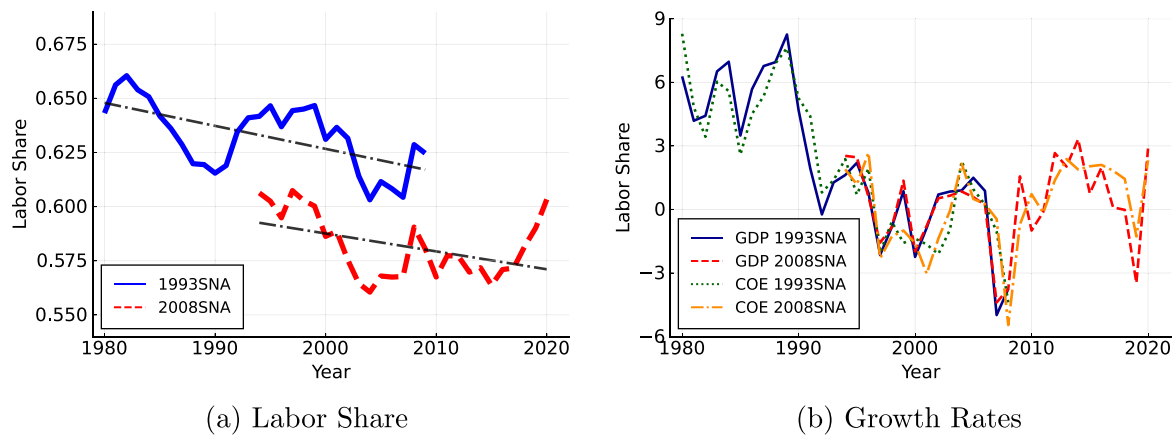


Fig. 1. Declining Labor Share and Growth Rates in Japan.

However, in reality, some labor inputs may be more easily substituted with capital than others. Consequently, demographic changes may affect the labor share. Fig. 1(a) illustrates the evolution of the labor share in Japan after 1980.^{1, 2} Although there is a level shift attributable to differences in the treatment of consumption of fixed capital between the 1993 SNA and 2008 SNA, the overall trend exhibits a modest declining tendency. Specifically, during the 1993 SNA period, the slope was approximately -0.0011 , indicating an annual decline in the labor share of about 0.0011. In contrast, recent movements based on the 2008 SNA show a slope of approximately -0.0004 , suggesting that the pace of decline has moderated in recent years. Fig. 1(b) illustrates the evolution of both GDP growth rates and labor share growth rates. While the labor share growth rate does not consistently fall below the GDP growth rate, it exhibits a tendency to remain below GDP growth in most periods. However, in the previous macroeconomic literature, there is insufficient accumulation of quantitative research on the distributional impact of differences in labor share.

This paper focuses on the Japanese economy. As shown in Fig. 2, Japan is the country with the most advanced aging population and declining birthrate in the world, with the old-dependency ratio – the proportion of those aged 65 and over to the working population – being exceptionally high among developed countries (Fig. 2(a)).³ Moreover, the fertility rate remains significantly below the replacement

rate of 2.06, making the prospects for improvement in the aging population and declining birthrate challenging. Meanwhile, the progression of Japan's aging population and declining birthrate is also causing deterioration in the fiscal situation. Social security systems such as public pension systems, health insurance systems, and long-term care insurance systems are strongly affected by demographic trends. Generally, as healthcare expenditures and long-term care insurance expenditures are concentrated on the elderly, an aging population with a declining birthrate accelerates fiscal deterioration. Due to prolonged stagnation and the progression of an aging population with a declining birthrate, Japan's public debt to GDP ratio is exceptionally high among developed countries. Under these circumstances, what macroeconomic implications does the decline in labor share bring? Furthermore, how is fiscal reform affected by the decline in labor share?

In this paper, we conduct a quantitative analysis of the impact of declining labor share on macroeconomic variables and social security system reforms using a quantitative life-cycle general equilibrium model. The basis is an (Auerbach and Kotlikoff, 1987) type large-scale overlapping generations model, with model parameters adjusted to the current Japanese economy, modeling various Japan-specific institutions such as health insurance and long-term care insurance, and conducting fiscal simulations.

The analysis results are as follows. Based on numerical results, if the labor share remains unchanged, fiscal conditions will deteriorate with the progression of the aging population and declining birthrate, indicating that a tax increase equivalent to more than 20% in consumption tax would be necessary to maintain fiscal sustainability. However, compared to this baseline scenario, it was revealed that if the labor share decreases (i.e., the capital share increases), a tax-saving effect equivalent to more than 3% in consumption tax would occur. Furthermore, the increase in capital share has an effect of enhancing the impact of partial reductions in public pensions, revealing an expected tax-saving effect equivalent to more than 12% in consumption tax. This is considered to be strongly influenced by the increase in income and consumption among the elderly associated with the rise in capital share. From the above, we point out that the decline in labor share is not only negative but also has the potential to create greater effects when combined with certain policies.

This paper builds upon two streams of prior research. The first concerns quantitative analysis using large-scale overlapping generations models. Since the seminal work by Auerbach and Kotlikoff (1987), numerous studies analyzing population aging and social security reforms through large-scale overlapping generations models have been published, including those by De Nardi (2004), Nishiyama and Smetters (2005, 2007), and Kotlikoff et al. (2007). Regarding the Japanese economy specifically, notable contributions include works by Braun and Joines (2015), Kitao (2015a,b, 2018). Imrohoroglu et al. (2016, 2017, 2019) conducted quantitative analysis of Japan's fiscal sustainability

¹ In the calculation of labor share in Fig. 1, following (Hayashi and Prescott, 2002), a portion of mixed income from “operating surplus and mixed income” has been added to compensation of employees. Also, this labor share is after removing the foreign sector (exports and imports) to ensure consistency with the subsequent model analysis.

² Throughout this paper, we consistently employ the System of National Accounts (SNA) for estimating the labor share. However, some studies utilize the Corporate Financial Statistics (*houjin kigyō toukei*); see, for example, Sugo and Nishizaki (2002) and Tanaka et al. (2018). While there are level differences between the two data sources, they generally show consistent trends in terms of directional changes. Nevertheless, it is also true that discrepancies arise between the two due to differences in calculation methods, coverage scope, and characteristics of the underlying statistics. For example, the Corporate Financial Statistics typically defines factor income as “labor costs + operating profit + depreciation”, which differs from the definition of SNA's national income. Moreover, while the SNA comprehensively covers the entire Japanese economy, the Corporate Financial Statistics only targets private profit-making corporations, excluding financial institutions and public sector employees. Furthermore, the Corporate Financial Statistics covers only companies with capital of 10 million yen or more, thus excluding some small and micro enterprises.

³ As Lechevalier and Monfort (2025) show, the term *aging* encompasses various aspects. This paper focuses on the ratio between the labor force and retirees and the associated social security system issues.

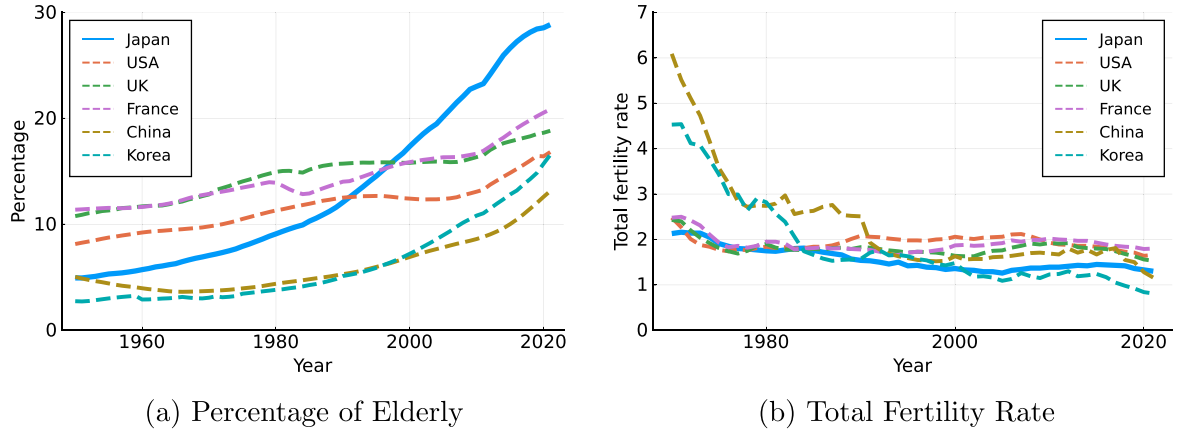


Fig. 2. Population Aging and Fertility Rate in OECD Countries.

challenges using a partial equilibrium model with more detailed modeling of Japan's fiscal aspects. These studies collectively demonstrate that, despite some numerical variations depending on assumptions about the Japanese economy, a consumption tax rate equivalent of over 30% would be necessary to sustain Japan's fiscal position. While the present study employs a similar methodological approach, its examination of declining labor share represents an academic contribution not addressed in previous research.

The second research stream concerns recent studies on the trends of labor share. Even before (Piketty, 2014)'s observations on long-term labor share decline, the possibility of decreasing labor share had been identified based on U.S. data. For instance, (Elsby et al. (2013) explain factors contributing to labor share decline through capital substitution in manufacturing and trade sectors, offshoring of labor-intensive industries, and declining unionization rates. (Karabarbounis and Neiman (2014) similarly note that the decline in the relative price of investment goods has induced firms to substitute capital for labor, contributing to labor share decline. The emergence of superstar firms has been proposed as another explanation for labor share dynamics. (Autor et al. (2017, 2020) document how firms with lower labor shares have gained market share, contributing to the aggregate decline in labor share. Meanwhile, (Koh et al. (2020) focus on the role of intellectual property products (IPP), proposing an adjustment methodology to appropriately incorporate IPP into capital and labor contributions. While this study does not aim to endogenously explain labor share trends, it offers a novel analysis of how changes in labor share, taken as given, affect macroeconomic outcomes and policy effectiveness.

This paper is structured as follows. Section “Model” explains the life-cycle general equilibrium model used in the analysis. Section “Calibration” explains how to set the model parameters, comparing them with the real Japanese economy. Section “Results” discusses the numerical calculation results of the model. Section “Concluding Remarks” summarizes the entire paper and discusses the potential directions for future research.

Model

In this section, we present a theoretical framework to analyze the relationship among demographic changes, labor share and fiscal burdens. There are two types of economic agents in the model. One type consists of individuals who graduate from high school and start working at the age of 18, and the other type consists of individuals who graduate from university and start working at the age of 22. In our model, whether or not to attend university is determined by an exogenous parameter, and we assume that they start economic activity at the age of 18 or 22. Based on their educational attainment, individuals are classified into high-skilled (h) or low-skilled (ℓ) workers, where $s \in \{h, \ell\}$. In Japan, the proportion of college graduates has increased over the past few decades, resulting in significant differences in the distribution of skills across cohorts.

Demographic transition

Time is discrete with calendar time denoted by t . The demographic structure is characterized by the population size $\mu_{j,t}$ for each age j at time t , with the total population at time t given by $\sum_j \mu_{j,t}$, where the population size is the sum of two types of individuals, i.e., $\mu_{j,t} \equiv \mu_{j,h,t} + \mu_{j,\ell,t}$.

The life-cycle structure of the model assumes that individuals begin their working life at age 18 or 22, depending on their educational attainment, and retire after reaching age $jr + 1$. In our calibration, the retirement age, $jr + 1$, is set at 65, and individuals can live up to a maximum age of $J = 105$. It should be noted that individuals between ages 0 and 17 are considered dependents and do not participate in the labor market.

Survival risk is incorporated through age- and time-dependent survival probabilities $\zeta_{j,t} \in [0, 1]$. The evolution of cohort sizes follows the relationship $\mu_{j+1,t+1} = \zeta_{j+1,t+1} \mu_{j,t}$. The model takes the population distribution of 2019 (the year immediately preceding the COVID-19 pandemic), $\{\mu_{j,2019}\}_{j=0}^J$, as the target year for calibration. Population dynamics are governed by the survival risks and fertility rates $\psi_{j,t}$ for women aged 15–49, with new cohorts entering the economy according to $\mu_{0,t+1} = \sum_{j=15}^{49} \psi_{j,t} \mu_{j,t}^{\text{female}}$, where $\sum_{j=15}^{49} \psi_{j,t}$ represents the total fertility rate and $\mu_{j,t}^{\text{female}}$ is the female population of age j at time t .

Household

We assume exogenous labor supply during working age. Labor income is determined by macroeconomic wages w_t and individual productivity levels by skill type $\eta_{j,s,t}$, which are time- and age-dependent, i.e., $y_{j,s,t} = w_t \eta_{j,s,t}$. After retirement, individuals' productivity becomes zero and they receive a public pension benefit $ss(\hat{y})$ based on their average past earnings \hat{y} . The average past earnings \hat{y}' of age j at time t evolve according to $\hat{y}' = \frac{(j-1)\hat{y} + \min(y_{j,s,t}, y^{\text{max}})}{j}$ for working-age individuals ($j < jr$) and remain constant after retirement. There is an upper limit on the earnings recorded in the past earnings history based on the current Japanese public pension system, denoted as y^{max} . The public pension benefit, $ss(\hat{y})$, consists of two components: a basic pension (*kiso nenkin*) represented by ρ_0 , and an earnings-related part (*kosei nenkin*) calculated as $\rho_1 \hat{y}$: $ss(\hat{y}) = \rho_0 + \rho_1 \hat{y}$.

Households face the following budget constraints:

$$\begin{aligned} (1 + \tau_t^c)c_{j,t} + a_{j+1,t+1} &= (1 - \tau_t^y)y_{j,s,t} + R_t(a_{j,t} + b_t) - m_j - \xi_t^* \text{ if } j \geq jr, \quad (1) \\ (1 + \tau_t^c)c_{j,t} + a_{j+1,t+1} &= (1 - \tau_t^c)ss(\hat{y}) + R_t(a_{j,t} + b_t) - m_j - \xi_t^*, \text{ if } j > jr. \quad (2) \end{aligned}$$

where c is consumption, a is asset holdings, R_t is the after-tax gross rate of return on assets, m_j represents mandatory medical expenditures that do not yield utility (detailed in Section “Medical Expenditure

and Long-term Care Expenditure”), and ξ_t^* is a lump-sum tax/transfer used to adjust the government’s budget balance in the initial steady state. τ_j^y represents the combined rate of labor income tax (τ^l), social security payroll tax (τ^p), premium for public health insurance (τ^h), and long-term care insurance (τ_j^{lc}). The premium for the long-term care insurance is age-dependent as the government imposes the premium on only individuals aged 40 and older, and $\tau_j^{lc} = 0$ for those under 40 in Japan.

Following Braun and Joines (2015) and Kitao (2015a,b), individual savings are exogenously allocated to productive capital and public debt. The government determines the portfolio allocation parameter ϕ_t to match the empirical debt-to-capital ratio. Therefore, the gross rate of return on assets is a mix of the return on capital, r^k , and the return on exogenously determined government bonds, r^d . The after-tax gross rate of return on assets, R_t , is given by $R_t \equiv 1 + (1 - \tau^k)r_t^k(1 - \phi_t) + (1 - \tau^d)r^d\phi_t$, where capital income is taxed at rate τ^k , while government bonds are subject to tax rate τ^d . The government also imposes consumption tax τ_t^c to balance the government budget.

Additionally, households face mandatory medical expenditures m_j that do not yield utility, and are subject to a borrowing constraint $a' \geq 0$. The term ξ_t^* represents a lump-sum tax/transfer used to adjust the government’s budget balance in the initial steady state and transition paths in the periods of fixed consumption tax rate.

Households are characterized by their state variables: age (j), asset holdings (a), skill level (s), and average past earnings (\hat{y}). The household’s objective function is represented by the following value function:

$$V_{j,t}(a, s, \hat{y}) = \max_{c, a'} \{u(c) + \zeta_{j+1,t+1} \beta V_{j+1,t+1}(a', s, \hat{y}')\} \quad (3)$$

Technology

On the possibility of endogenous labor share

While the Cobb–Douglas specification, which is commonly used in the literature, assumes exogenous labor share parameters, it is worth noting that labor share can potentially vary endogenously through demographic and technological channels. For instance, in production functions incorporating capital-skill complementarity as proposed by Griliches (1969), the aggregate labor share depends on the relative supplies of skilled and unskilled workers.⁴ In such frameworks, demographic transitions – particularly changes in educational attainment and age structure – can influence factor shares. Japan’s substantial increase in college enrollment rates, from approximately 14% for cohorts born in 1950 to over 50% in recent decades, exemplifies how skill composition evolves over time and potentially affects the labor share.

Time-dependent labor share

However, modeling such endogenous mechanisms quantitatively is challenging, particularly in the context of our large-scale overlapping generations framework. This challenge is compounded by the difficulty of appropriately calibrating labor supply to match target moments. Therefore, we follow the approach of treating the capital share parameter α , as exogenously varying over time, allowing us to focus on the macroeconomic and fiscal implications of labor share changes rather than their underlying determinants. This methodological choice enables us to address the central question of how declining labor share affects fiscal sustainability in an aging society, which constitutes the primary contribution of this study.

⁴ Consider a production function of the form $Y = (K + L_u)^\theta L_s^{1-\theta}$, where capital K and unskilled labor L_u are perfect substitutes, and skilled labor L_s exhibits complementarity with the $K + L_u$ aggregate. In this case, the labor share becomes $1 - \theta \left(1 - \frac{L_u}{K + L_u}\right)$, which varies with the relative supply of unskilled workers. As the proportion of unskilled labor decreases due to rising educational attainment, the labor share declines toward its lower bound of 1 - θ .

Production function is the standard Cobb–Douglas type:

$$Y_t = Z_t K_t^{\alpha_t} L_t^{1-\alpha_t}$$

where Y_t is the output, K_t is the capital stock, L_t is the labor input, and Z_t is the technology level. $\left(\frac{Z_{t+1}}{Z_t}\right)^{1/(1-\alpha)} \equiv 1 + g_t$ is the TFP factor growth rate.⁵

Production sector is competitive and the factor prices are determined from the first order condition.

$$r_t^k = \alpha_t Z_t K_t^{\alpha_t-1} L_t^{1-\alpha_t} - \delta, \quad (4)$$

$$w_t = (1 - \alpha_t) Z_t K_t^{\alpha_t} L_t^{-\alpha_t}, \quad (5)$$

where δ is the depreciation rate of capital. The aggregate asset, $A_t = \sum_s \sum_j \mu_{j,s,t}(a_{j,s,t} + b_t)$, is distributed into production sector and public debt depending on ϕ_t :

$$A_t = (1 - \phi_t)A_t + \phi_t A_t = K_t + D_t.$$

Medical expenditure and long-term care expenditure

In Japan, individuals pay only a portion of the cost of medical treatment or long-term care, and the remaining portion is covered by the public health insurance, with the co-payment rate depending on age. Each of the co-payment rate is denoted as λ_j^h and λ_j^l respectively. The out-of-pocket medical and long-term care expenses that appear in the individual’s budget constraint are as follows:

$$m_j = \lambda_j^h m_j^h + \lambda_j^l m_j^l.$$

where m_j^h and m_j^l are the expenses for medical care treatment and the long-term care respectively.

The sum of the medical and long-term care expenses by the government is as follows:

$$M_t = \sum_j \mu_{j,t} \left[(1 - \lambda_j^h) m_j^h + (1 - \lambda_j^l) m_j^l \right].$$

Government

We consider a unified budget constraint that includes the public pension system, the public health insurance system, and the long-term care system following (İmrohoroglu et al., 2016, 2017, 2019). General government revenue consists of tax revenue from labor income T_t^y , tax revenue from capital income T_t^a , revenue from consumption taxes T_t^c , newly issued government debt D_t , and lump-sum taxes ξ_t^* . From the total revenue, the government pays for public pension benefits S_t , medical and long-term expenditures M_t , government expenditure G_t , and the gross interest payment on government debt $(1 + r^d)D_{t-1}$:

$$G_t + (1 + r^d)D_{t-1} + S_t + M_t = T_t^y + T_t^a + T_t^c + D_t + \xi_t^*. \quad (6)$$

$T_t^y = \tau_j^y \sum_s \sum_j y_{j,s,t} \mu_{j,s,t}$ is the sum of tax revenue from labor income. Tax revenue from capital income and the government debt is given by: $T_t^a = \sum_s \sum_j [\tau^k r_t^k (1 - \phi_t) + \tau^d r^d \phi_t] (a_{j,s,t} + b_t) \mu_{j,s,t} = \tau^k r_t^k K_t + \tau^d r^d D_t$. The government also collects consumption tax revenue, $T_t^c = \tau_t^c \sum_j c_{j,t} \mu_{j,t} = \tau_t^c C_t$, where C_t is the aggregate consumption. Consumption tax rate τ_t^c is determined endogenously to balance the budget under transition paths.

The public pension payments consist of the basic pension, which is a fixed amount for each individual, and the earnings-related pension, which is based on the average past earnings \hat{y} : $S_t = \sum_{j=j^*+1}^J ss(\hat{y}) \mu_{j,t} = \sum_{j=j^*+1}^J (\rho_0 + \rho_1 \hat{y}_{j,t}) \mu_{j,t}$. We assume that the debt-to-GDP ratio is exogenously constant. In the initial steady state, this ratio equals the actual debt-to-GDP target, while along the transition path, we maintain the 2025 ratio. This requires a fiscal instrument to balance the government

⁵ In the numerical calculation, all variables are detrended by dividing $Z_t^{1/(1-\alpha)}$. For details, see Braun et al. (2009) and Hansen and İmrohoroglu (2016).

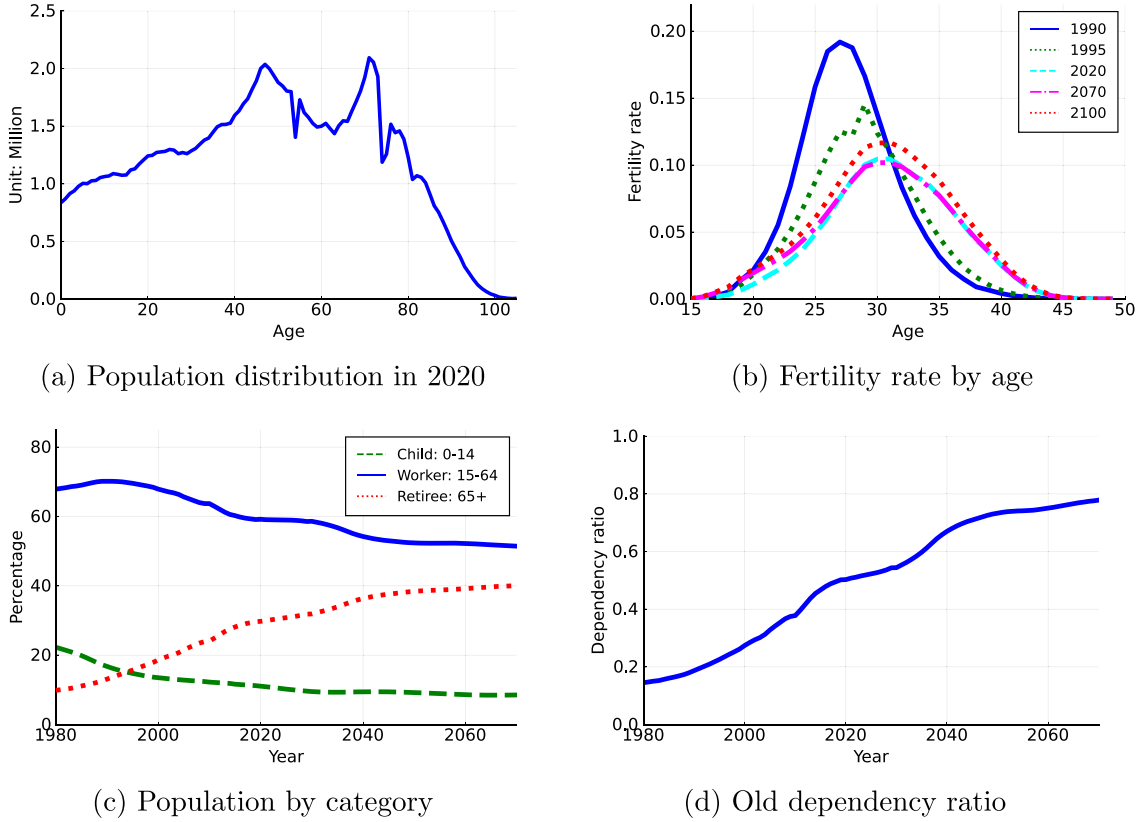


Fig. 3. Population Projection in Japan: 2020–2070.

budget, namely either lump-sum transfers or consumption taxes. ξ_t^* is the lump-sum tax (transfer) that adjusts the budget balance in the initial steady state, in which the consumption tax rate is fixed at the current level. ξ_t^* may also be used to adjust the budget balance in the transition path in the periods of fixed consumption tax rate.

Definition of competitive equilibrium

Given a set of exogenous demographic parameters $\{\mu_{j,t}\}, \{\zeta_{j,t}\}, \{\phi_{j,t}\}$, and a set of exogenous government policy variables $\{G_t, D_t, \tau_t^k, \tau_t^d, \tau_t^y, \xi_t^*\}$, a competitive equilibrium consists of individuals' decision rules, $\{V_{j,t}(a, s, \hat{y}), g_{j,t}(a, s, \hat{y})\}$ a sequence of factor prices $\{r_t^k, w_t\}$, accidental bequests $\{b_t\}$, a sequence of consumption $\{c_{j,t}\}$ for each time $t = 0, 1, \dots$, such that:

1. Individuals' solve the Bellman Eq. (3) under the budget constraints (1) and (2) with the policy functions $g_{j,t}(a, s, \hat{y})$.
2. Factor prices are determined in competitive markets: (4) and (5).
3. Accidental bequests are distributed to the individuals in the lump-sum manner:

$$b_t = \sum_s \sum_{j=1}^J \mu_{j,t} \zeta_{j,t} a_{j,t}.$$

4. The government budget constraint (6) is satisfied.
5. The capital and labor markets clear:

$$K_t = (1 - \phi_t) \sum_s \sum_{j=1}^J \mu_{j,t} a_{j,t} + b_t,$$

$$L_t = \sum_{s \in \{h, \ell\}} \sum_{j=1}^{j_r} \mu_{j,t} n_{j,t}.$$

6. The goods market clearing condition is satisfied:

$$C_t + K_{t+1} + G_t + M_t = Y_t + (1 - \delta)K_t.$$

Calibration

This section explains how the model parameters are calibrated to the Japanese economy. Although macroeconomic parameters would be available after 2020, since they may have deviated from their steady state due to the impact of the COVID-19 pandemic in 2020, we will set parameters based on the data from 2019. While the parameter targets are based on 2019 data, the transition path is calculated for the period 2004–2400. This is because neither 2019 nor 2025, the year in which the policy changes in the policy simulation, can be considered a steady state, and to express the point that the current year is in the middle of the transition path.⁶

Population

We use the official population projection provided by the National Institute of Population and Social Security Research (IPSS) in Japan released in 2023. The institute provides three variants of future fertility and mortality rate projections: low, medium and high. We use the medium variant for both parameters. The IPSS estimates future population path between 2020 and 2070. We assume that the total fertility rate, which is calculated from $\{\psi_{j,t}\}$, converges to the steady state level (i.e., TFR is 2.06) from 2070 to 2120, and set the final steady state in 2400.⁷

Fig. 3(a) shows the population distribution in 2020. As the figure shows, the population distribution is bimodal, with a large number of individuals in their late 40 s and 70 s. Since the baby boomer Jr. generation in their 40 s, the number of young people has been steadily

⁶ For more details on the calculation of transition paths, see Hsu and Yamada (2019).

⁷ Braun and Joines (2015) assume that the TFR converges to the steady state level for 100 years.

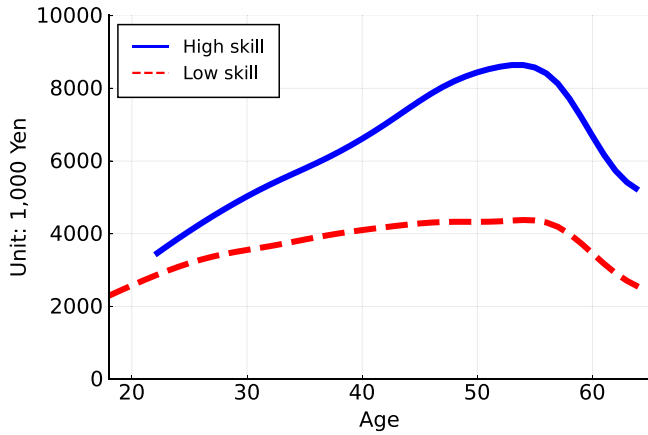


Fig. 4. Wage Profile by Skill: Basic Survey on Wage Structure.

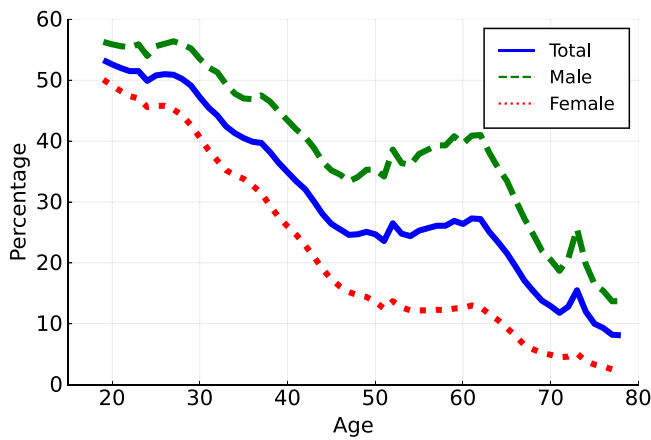


Fig. 5. Advancement Rate by Age in 2019.

decreasing. Fig. 3(b) plots the fertility rate by age. The fertility rate itself declines and the peak age of the fertility is shifting to the right. As a result, as Fig. 3(c) and (d) show, the number of workers is expected to decline and the old dependency ratio is expected to increase from 0.54 in 2020 to almost 0.8 in 2070.

Labor productivity and college enrollment rate

Earnings profiles by skill type, $\{\eta_{s,j}\}$, are estimated from the Basic Survey on Wage Structure, which is compiled by the Ministry of Health, Labour and Welfare in Japan. We use the wages of college graduates for high-skilled workers. On the other hand, the wage data on high school graduates are used for the wage profiles of low-skilled workers. In Fig. 4, we plot the average earnings between 2000 and 2019 for college graduates and high school graduates by age. As Fig. 4 shows, both high-skilled and low-skilled workers' wages are hump-shaped with age, although the level of high-skilled workers' wages is higher than that of low-skilled workers.

As for the ratio of skill types, we use the four year college advancement rate by year. In Fig. 5, we calculate the advancement rate of four year college/university by age from the Basic School Survey in 2019. In 1980s, the advancement rate was less than 30%, but it has been increasing steadily since then. Recently, more than 50% of high school graduates are entering four-year colleges/universities.

Medical and long-term care expenditure

Regarding the medical expenditures $\{m_j^h\}$ and expenditures for the long-term care $\{m_j^l\}$, we update the data used in İmrohoroglu et al. (2019). Fig. 6(a) plots the exogenous medical expenditure by age. In their working age, the medical expenditures remain low, but it starts to increase after the age of 60. In Japan, the 70% of the medical expenditures are covered by public health insurance, and the remaining 30% are paid by individuals before the age of 70: $\lambda_j^h = 0.3$. The co-payment rate is set at 20% between 70 and 74, and it is set at 10% for those aged 75 and older. Fig. 6(b) plots the long term care expenditures in 2018. Spending on nursing care is more concentrated among the elderly than spending on medical care. Regarding the co-payment rate, the long-term care insurance system was introduced in 2000, and the co-payment rate is set at 10%.

Government

Public pension: In the benchmark model, the public pension system has two components. The first-tier, called *kokumin nenkin* in Japanese, pays a fixed amount of Basic pension for each person. The second tier (*kosei nenkin*) depends on the past average earnings \hat{y} . We set the basic pension payment at 55,800 yen per month, which is then annualized: $\rho_0 = 55,800 \times 12$. The parameter ρ_1 determines the earnings-related component of the public pension (*kosei nenkin*). We set ρ_1 to 0.25 in order to match the average replacement rate of the earnings-related pension in Japan.

Tax: According to İmrohoroglu et al. (2016), we set the interest rate on government bonds, r^d , to 0.01, and the tax rate τ^d to 20% respectively. We set the marginal labor income tax rate τ^l at 6.15% to match the tax revenue from labor income in the model with the actual data. The health insurance rate and long-term care insurance rate are also set so that the total amounts in the model would match the data. Details will be discussed in Section "Model Economy in 2019". The social security payroll tax τ^s is set at 0.183, reflecting the post-2018 rate of 18.3%. For capital income tax, we follow (İmrohoroglu et al., 2017) and set τ^k at 0.1. Consumption tax rate τ^c is set to the actual number in the data before 2025, and determined endogenously after 2026 to balance the government budget.

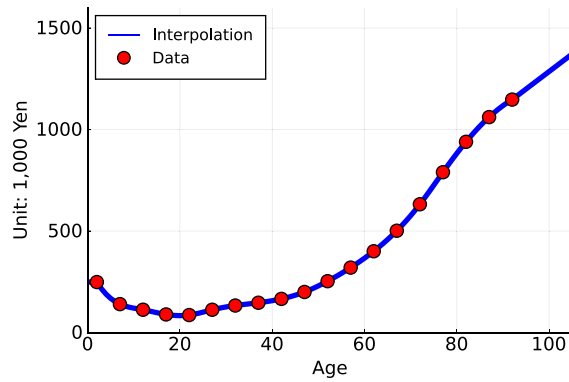
Other parameters

The calibration of our tax system involves several key parameters. The discount factor β is chosen to match the capital-output ratio (K/Y) of 2.413 in the model.

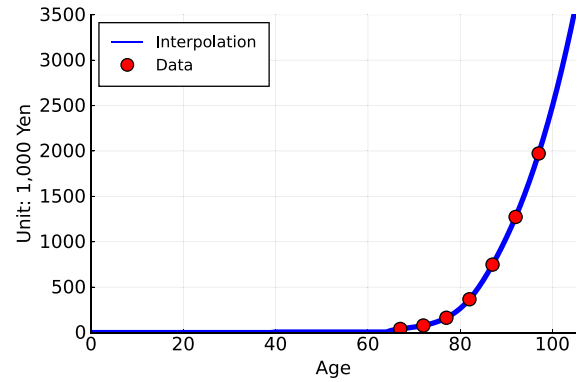
Parameters were calibrated to ensure that all values pertaining to the steady state and transition paths align with empirical data. With respect to government expenditure G_t , we set the ratio of G_t such that the G_t/Y_t ratio in the model corresponds to the empirical data. It should be noted that G excludes expenditures on public pensions and medical and long-term care insurance. For instance, the ratio of government expenditure to GDP in 2019 was 0.126. Similarly, the parameter Φ is calibrated to match the historical public debt ratio (D_t/Y_t). As of 2019, the D_{2019}/Y_{2019} was 1.6489.⁸ For future transition paths, we assumed an extrapolation of the 2025 ratios.

All the calibration parameters are summarized in Table 1.

⁸ The public debt includes public pension funds, and these government funds have been netted out. For details on the methodology of constructing public debt and government expenditure data, refer to İmrohoroglu et al. (2016).



(a) Medical expenditure by age



(b) Nursing care expenditure by age

Fig. 6. Medical and Nursing Care Expenditures by Age.

Table 1

Parameters of the model (Steady state in 2019).

Parameter	Description	Values/source
Demographics		
$\{\zeta_{j,t}\}$	survival probabilities	IPSS (2023)
$\{\psi_{j,t}\}$	fertility rate	IPSS (2023)
$\{\mu_{j,t}\}$	population distribution	Census survey and IPSS
Preferences		
β	subjective discount factor	1.003 ($K/Y \approx 2.413$)
γ	risk aversion	2.0
Labor market		
$\{\eta_{j,s}\}_{j=18(22)}^{64}$	labor productivity	BSWS
Technology		
g	TFP factor growth rate	1.0%
α	capital share	0.4254 (2019)
δ	capital depreciation rate	0.0829
Government		
τ^l	labor income tax	6.15%
τ^p	payroll tax	18.3% (2019)
τ^h	health insurance premium	6.91%
τ^{lc}	long-term insurance premium	0.75%
τ^k	capital income tax	10%
τ^d	tax on gov. bond return	20%: (Imrohoroğlu et al., 2017)
ξ^a	lump-sum tax/transfers	see text
y^{\max}	upper limit of pension contribution	10.44 million JPY
$\{m_j^h\}$	medical expenditures	Fig. 6(a)
$\{m_j^l\}$	long-term nursing care expenditures	Fig. 6(b)
D_t/Y_t	net debt to GDP ratio	1.6489 (2019)
G_t/Y_t	government expenditure to GDP ratio	0.1260 (2019)
r^d	interest rate on government bond	1.0%

Results

Model economy in 2019

Let us first verify that the parameters in our model accurately replicate the Japanese economy. Our target is the Japanese economy immediately prior to COVID-19, specifically in 2019.

The figure in the top left of Table 2 represents values derived from actual SNA (System of National Accounts) data in Japan. The units are in trillion yen; for instance, Japan's GDP in 2019 was 556.8 trillion yen, with total private consumption at 303.93 trillion yen and gross fixed capital formation at 142.21 trillion yen. Government final consumption expenditure (67.7 trillion yen) excludes expenditures on public pensions, public health insurance, and long-term care insurance to maintain consistency with our model, and includes provisions for public goods. It should be noted that our model assumes no utility derived from public goods. The two columns on the right compare

Table 2

SNA and Steady state in 2019.

Description	Data (trillion JPY)	Normalized	
		Data	Model
GDP	556.80	1.000	1.000
Expenditure			
Private consumption (excl. M and LT)	303.93	0.546	0.580
Govt consumption (excl. M and LT)	67.74	0.122	0.126
Gross capital formation	142.21	0.255	0.200
Income			
Compensation of employees	317.40	0.570	0.575
Consumption of fixed capital	140.56	0.252	0.200

macroeconomic variables when normalizing GDP to 1, for both empirical data and model projections. Compared to the data, our model estimates consumption approximately 6% higher, while fixed capital depreciation is approximately 20% lower.

Table 3 illustrates expenditure and revenue sides, respectively, showing both absolute values and ratios relative to GDP (normalized to 1). The basic pension and the earnings-related part of public pension amounted to 23.97 trillion yen and 31.65 trillion yen, respectively, in 2019. Meanwhile, expenditures on health insurance totaled 44.39 trillion yen, and long-term care insurance benefits reached 10.78 trillion yen. The middle and right columns display these values normalized to GDP equal to 1. The discrepancies between the model and actual data show approximately 10% error for national health insurance, while other categories exhibit errors of less than 10%. The revenue side, conversely, presents the scale of various funding sources. Based on the Japanese central government's budget, income tax revenue in 2024 was 19.53 trillion yen, corporate tax revenue was 12.07 trillion yen, and consumption tax yielded 21.72 trillion yen. The values normalized to macroeconomic output equal to 1 are summarized in the middle and right columns. Again, the values in the model are not far from the actual values of the Japanese economy.

Transition dynamics: Baseline scenario

Fig. 7 plots the equilibrium consumption tax rates $\{\tau_t^c\}$ from 2004 to 2070, which balance the government budget constraint (6), and the endogenously determined return on capital $\{r_t^k\}$ in the transition path. As discussed in Section "Government", our model closes the government budget constraint using the consumption tax. More precisely, we fixed tax rates and insurance premium rates other than the consumption tax, and adjusted either the consumption tax rate or lump-sum tax ξ_t^* to ensure that the government budget constraint is satisfied in each period. As plotted in Fig. 7(a), we used the actual consumption tax rates from 2004 to 2025; the lump-sum tax ξ_t^* is adjusted to balance the

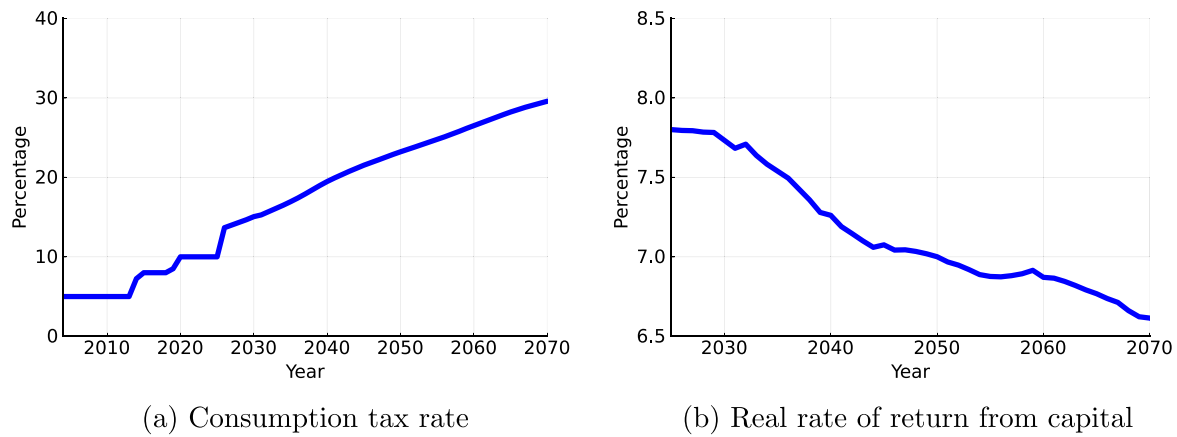


Fig. 7. Transitional Path of Consumption Tax Rate and Real Rate of Return from Capital from 2004 to 2070.

Table 3

Government budget: Data and model.

Description	Data	Normalized	
	(trillion JPY)	Data	model
Expenditure			
Public pension: 1st tier	23.97	0.043	0.046
Public pension: 2nd tier	31.65	0.057	0.057
Medical expenditure	44.39	0.080	0.088
Long-term care expenditure	10.78	0.019	0.020
Interest payment for govt debt	8.42	0.015	0.015
Revenue			
Labor income tax	19.53	0.035	0.035
Capital income tax (corporate tax)	12.07	0.022	0.026
Consumption tax	21.72	0.039	0.049
Public pension	51.96	0.093	0.105
Public health insurance	21.94	0.039	0.040
Long-term care insurance	2.38	0.004	0.004

budget. Until 2013, Japan's consumption tax rate was 5%. It increased to 8% from April 2014, and to 10% from October 2019. For the transition years of 2014 and 2019 when the tax rate changed mid-year, we used the weighted average of the respective periods as the consumption tax rate for that year.

From 2026 onward, the consumption tax rate in our model changes endogenously to ensure the government budget constraint is satisfied. Consequently, there is a jump in 2026. If we were to balance the government budget constraint solely through consumption tax, the consumption tax rate would need to increase to approximately 14% in 2026. Subsequently, the equilibrium consumption tax rate continues to increase almost monotonically. This is due to the progress of population aging in Japan. In our baseline model, only the population distribution changes along the transition path. As the proportion of elderly increases, the total expenditure on medical care and long-term care insurance rises, as indicated in Fig. 6, which shows that medical and long-term care expenditures increase for the elderly. Meanwhile, as the working population decreases, labor income tax revenue declines. To cover these costs, the consumption tax rate must inevitably increase. It continues to rise beyond 2070, reaching approximately 40% around 2120 according to our simulation results. However, it should be noted that the simulation results for this period are strongly dependent on predictions and assumptions regarding population distribution, and may change significantly in accordance with future forecast revisions.

Conversely, the return on capital r_t is projected to decline by approximately 1.4 percentage points over the 45-year period from 2025 to 2070. This phenomenon stems from the declining birthrate and aging population. As postulated by the life cycle income hypothesis, middle-aged and elderly individuals tend to accumulate greater savings than their younger counterparts. As the population distribution

increasingly concentrates toward the elderly, aggregate capital will temporarily increase. Consequently, the capital–output ratio (K/Y) will rise, advancing capital deepening. Given these factors, the marginal productivity of capital will decrease, and it is anticipated that, based on our model, returns on capital will fall by approximately 1.4% from current levels by around 2070. The potential decline in returns on capital accompanying the aging demographic has been noted by researchers such as (Blanchard, 2023), suggesting that resource distribution between capital holders and wage-dependent workers will be significantly affected.

It is important to note that we are by no means advocating that all future revenue shortfalls *should* be covered by consumption tax. We are merely calculating the potential increase in fiscal burden when converted to consumption tax terms. Naturally, the tax system, including consumption tax, should be designed considering various efficiency factors. Consumption tax has advantages compared to income tax, notably that it can generate revenue from the elderly population as well. While progressive labor income tax has the benefit of reducing ex-post income inequality, it has the drawback of being unable to collect taxes from the elderly. In contrast, consumption tax has the advantage of being able to collect taxes from the elderly population, which is expected to increase in the future. Additionally, since wealthier individuals tend to consume more, consumption tax can ensure a certain degree of fairness.⁹

Decline in labor share

Next, let us examine how fiscal burden and macroeconomic variables change when the labor share decreases. In the baseline scenario, we assumed that the capital share remained constant at 0.4254. Let us now assume that the capital share increases linearly from 2025, reaching 0.4554 by 2060. Table 4 summarizes how the interest rate, total assets, output, and equilibrium consumption tax rate change in comparison to the baseline for the years 2040, 2050, and 2060.

As the capital share increases, total assets A_t rise due to the promotion of capital accumulation. At the point of 2040, the increase is merely 0.574 percent points compared to the baseline, but by 2070, it leads to more than a 10% increase in total capital. Although we assume that the capital share begins to increase from 2025, the effects of this gradual rise in capital share become prominent only after several decades, due to both the modest pace of increase and the time required for capital accumulation. However, a mere 0.03 point increase in capital share (with other parameters held constant) promotes a 10% accumulation of capital in the future. In our model, since the total labor

⁹ Although it has been pointed out that in Japan, consumption tax applies to almost all consumption expenditures, which may exacerbate inequality since necessities like food items and luxury goods are taxed at the same rate.

Table 4
Impact of declining labor share on key variables.

Year	Change in r_t (pp.)	Change in A_t (%)	Change in Y (%)	Change in τ_t^c (pp.)
2040	0.753	0.574	1.990	-0.232
2050	1.050	3.299	4.732	-1.138
2060	1.265	7.179	8.351	-2.474
2070	0.969	10.776	11.693	-3.906

supply is exogenous, the increase in capital stock directly translates to an increase in output.

Despite the increase in total capital, the interest rate also rises slightly compared to the baseline scenario. This is due to the effect of the increase in the value of the capital share α_t itself. As the capital share increases, the consumption tax rate required to balance the government budget decreases. The effect is minimal at the point of 2040, but by 2070, it results in more than 3 percent points reduction in consumption tax. This is because the increase in capital share promotes capital accumulation, which leads to an increase in output.

Policy experiments

Finally, let us analyze how the decline in labor's share of income might potentially alter the effects of policies. In this policy experiment, we measure the effects of policies under two scenarios: one where the capital share remains constant, and another where the capital share increases by 0.03 percentage points as in the previous section.

Let us consider two policies: (i) The first policy is to increase not only the consumption tax but also the labor income tax τ_t^l . Specifically, following (İmrohoroglu et al., 2019), we increase the labor income tax rate by 5 percentage points in 2026, from 6.15% to 11.15%. (ii) The second policy is to partially cut public pensions. Specifically, we reduce ρ_1 , which was 0.25 in the baseline scenario, to 0.15. In other words, we reduce the earnings-related part of public pensions by 10% relative to past average income. Both policies contribute to improving the fiscal balance; however, while one policy places the burden on the working population, the other places it on the elderly population, resulting in contrasting effects.

Table 5 summarizes the effects of two policies in the baseline scenario. The left column presents values for the years 2040, 2050, 2060, and 2070 in the baseline scenario, with assets normalized to 1 in 2040 for clarity. The two rightmost columns illustrate the differences generated by each policy when compared to the baseline. Both the increase in labor income tax τ^l and the reduction in public pension ρ_1 diminish the fiscal burden as measured by consumption tax τ^c . Notably, a policy that reduces the earnings-related component of public pension by 10% yields a tax-saving effect exceeding 8 percentage points in terms of consumption tax. However, these two policies have different effects on capital accumulation. Cutting public pensions encourages savings to secure future living expenses, while raising labor taxes reduces the source of savings and thus hinders capital accumulation. Therefore, their effects on the real rate of return are also opposite.

Table 6 compares the effects of these same two policies under economic conditions where the capital share increases. As in Table 5, the two columns on the right calculate deviations from the baseline scenario values. The column labeled “no policy change” represents cases where there was no policy change and only the capital share increased. Again, the effect of reducing public pension is particularly substantial, with an anticipated tax reduction effect of approximately 12 percentage points when the capital share increases. This phenomenon can be attributed to two factors: the strengthened saving motive resulting from decreased post-retirement income, and the increased capital income of the elderly population due to the higher capital share, which leads to increased expenditure among this demographically significant group. Conversely, while taxing labor income also produces a consumption

Table 5
Policy experiments without declining labor share.

Year	Baseline	High τ^l	Low ρ_1
Interest rate			
2040	7.283%	0.206	-0.506
2050	7.009%	0.312	-0.580
2060	6.871%	0.398	-0.649
2070	6.610%	0.457	-0.703
Asset			
2040	1.000	-2.272%	5.857%
2050	1.031	-3.506%	6.946%
2060	1.048	-4.484%	7.926%
2070	1.058	-5.210%	8.787%
Consumption tax rate			
2040	19.586%	-4.986	-6.060
2050	23.315%	-4.773	-7.065
2060	26.644%	-4.583	-7.885
2070	29.765%	-4.399	-8.762

Note: Baseline shows levels (%). Assets are normalized to 1 in 2040. Policy columns show changes from baseline: percentage points for interest rate and consumption tax rate, percent for assets.

Table 6
Policy experiments with declining labor share.

Year	Baseline	No policy change	High $\alpha +$	
			High τ^l	Low ρ_1
Interest rate				
2040	7.283%	0.753	0.966	0.280
2050	7.009%	1.050	1.376	0.517
2060	6.871%	1.265	1.680	0.674
2070	6.610%	0.969	1.435	0.336
Asset				
2040	1.000	0.574%	-1.722%	5.926%
2050	1.031	3.299%	-0.353%	9.690%
2060	1.048	7.179%	2.332%	14.691%
2070	1.058	10.776%	4.983%	19.437%
Consumption tax rate				
2040	19.586%	-0.232	-5.111	-6.149
2050	23.315%	-1.138	-5.830	-7.950
2060	26.644%	-2.474	-7.050	-9.995
2070	29.765%	-3.906	-8.435	-12.209

Note: Baseline shows levels (%). Assets are normalized to 1 in 2040. Policy columns (including no policy change) show changes from baseline: percentage points for interest rate and consumption tax rate, percent for assets.

tax reduction effect, its impact is less pronounced than that of reducing public pensions. The increase in labor income tax constitutes taxation on the source of savings for younger generations, thereby reducing disposable income and negatively affecting capital accumulation. Nevertheless, since the rise in capital share encourages capital accumulation, the aggregate effect ultimately contributes positively to capital accumulation in the long term.

The political feasibility of such policies represents a crucial issue that must be separately considered. This is because policies that reduce current public pension payments would lower the welfare of the elderly and would almost certainly encounter political resistance. Given that Japan's current demographic distribution is skewed toward the elderly, political feasibility can be said to be a significant challenge. On the other hand, it is conceivable to make policy changes only to the pension system for future generations without altering the current mechanism of the public pension system for the elderly. However, such an approach would give rise to the well-known “double burden” problem resulting from transitioning away from the pay-as-you-go system. That is to say, regardless of which approach is taken, achieving a Pareto improvement that would enhance the welfare of all generations is extremely difficult, and it is necessary to consider how to share the burden across generations.

Table 7
Alternative government bond yield scenarios.

Year	Baseline	$r^d = 2\%$	$r^d = 0.5\%$
Interest rate			
2040	7.283%	7.023%	7.477%
2050	7.009%	6.768%	7.255%
2060	6.871%	6.698%	7.208%
2070	6.610%	6.523%	7.044%
Asset			
2040	1.000	1.036	0.986
2050	1.031	1.068	1.011
2060	1.048	1.084	1.023
2070	1.058	1.098	1.034
Consumption tax rate			
2040	19.586%	20.397%	18.094%
2050	23.315%	23.724%	21.500%
2060	26.644%	26.506%	24.348%
2070	29.765%	28.615%	26.478%

Note: Interest rates and consumption tax rates show levels (%). Assets are normalized to 1 in 2040.

Two scenarios on alternative government bond yield

In the previous analysis, we assumed that government bond yields were fixed at 1%. Despite Japan's high debt-to-GDP ratio, long-term interest rates have remained at low levels. However, there is no guarantee that such a situation will continue in the future, and government bond yields may rise. On the other hand, as (Blanchard, 2019) points out, under secular stagnation, government bond yields may continue to remain at low levels. Therefore, as assumptions regarding government bond interest rates, we consider cases of 2% and 0.5% to examine the extent of differences that arise.¹⁰

Table 7 shows the results when government bond yields are 2% and when they are 0.5%. When government bond yields are high, the equilibrium interest rate declines by approximately 0.25 percentage points in 2040. This is because the amount of total assets increases by approximately 3.6% compared to the baseline scenario in 2040. The rise in government bond yields is considered to have two effects. First, the effect of promoting savings as the gross return from savings, R_t , increases; second, the effect of increasing the interest burden on government bonds to balance the government's budget constraint. While the effect of increased savings is strong around 2040, the impact of increased government interest burden becomes stronger around 2070. This is because by 2070, aging and declining birth rates will have progressed further, and the proportion of $r^d D$ in the government budget constraint equation will become relatively larger compared to labor income taxes and other sources. As a result of both effects, the fiscal impact measured by consumption tax shows that the equilibrium consumption tax rate is higher under high interest rates in 2040, but this reverses by 2070. Conversely, when government bond yields fall to 0.5%, capital accumulation is suppressed, and the return on capital r_t^k remains at higher levels. The equilibrium consumption tax rate declines in all years, which, as expected, is due to improved debt sustainability thanks to the reduced interest burden on government bonds. While government bond yields are one uncertain factor, what we learn from this robustness check is that the equilibrium consumption tax rate may change by approximately 1 to 2 percentage points due to rises or falls in interest rates on public debt.

¹⁰ We conduct comparisons of multiple transition paths under the assumption that $r^d = 2\%$ or $r^d = 0.5\%$ continues from the initial steady state to the final steady state, rather than changing from the 1% government bond yield during the calculation of the transition process.

Table 8
Variations in demographic assumptions.

Year	Baseline	High fertility + high mortality	Low fertility + low mortality
Interest rate			
2040	7.283%	7.636%	7.017%
2050	7.009%	7.514%	6.676%
2060	6.871%	7.668%	6.426%
2070	6.610%	7.731%	6.033%
Asset			
2040	1.000	0.979	1.027
2050	1.031	0.996	1.066
2060	1.048	0.998	1.091
2070	1.058	1.005	1.106
Consumption tax rate			
2040	19.586%	17.855%	19.865%
2050	23.315%	20.616%	23.905%
2060	26.644%	22.451%	27.768%
2070	29.765%	22.922%	31.810%

Note: Interest rates and consumption tax rates show levels (%). Assets are normalized to 1 in 2040.

Sensitivity analysis on demographic projections

Finally, let us examine to what extent differences in demographic changes are likely to affect our results. The National Institute of Population and Social Security Research provides three variations for population projections: high, medium, and low variants for both mortality rates and fertility rates. Since calculating all variations would make the presentation difficult, we present here the results for the most *optimistic scenario in fiscal terms*, namely high fertility rate and high mortality rate, and the *pessimistic scenario* of low fertility rate and low mortality rate. Table 8 summarizes these results. Compared to the benchmark case where both are medium variants, the results for the optimistic scenario show very large impacts. In 2040, there is a difference of approximately 1.7% when measured in terms of the equilibrium consumption tax rate, and in 2070, a difference of more than 6% emerges. However, it should be noted that the scenario of increased mortality rates among the elderly is *not a socially desirable situation*. On the other hand, in the pessimistic scenario, the equilibrium consumption tax rate could be approximately 1.8% higher in 2070. Given how politically difficult it is to raise the consumption tax by 1%, whether demographic changes can generate a 1% saving effect in terms of the equilibrium consumption tax rate becomes a very important factor in considering fiscal policy.

Concluding remarks

In this paper, we have conducted a quantitative analysis of how the decline in labor share affects macroeconomic conditions and policy efficacy utilizing a lifecycle general equilibrium model. By calibrating parameters specifically for Japan – a country experiencing population aging and declining birth rates – we examined how fiscal consolidation policies in Japan are influenced by variations in labor share.

The findings demonstrate that the decline in labor share can stimulate capital accumulation, promote capital deepening, and potentially alleviate fiscal burden. This is attributable to the possibility that, in an aging Japan, it may foster increased capital income among middle-aged and elderly demographics who constitute the high-asset class. Furthermore, the results indicate that policies encouraging savings by partially reducing public pensions for the elderly may make a greater fiscal contribution compared to policies that tax labor income earned by workers.

Our findings suggest several critical implications for deliberations on the future trajectory of the Japanese economy. First, the decline in labor share is not necessarily entirely detrimental, as it may promote

additional savings through enhanced returns on capital, thereby potentially contributing to the amelioration of fiscal challenges. Additionally, substituting a portion of public pensions with savings predicated on self-reliance efforts could potentially enable a further reduction in the equilibrium consumption tax rate.

Nevertheless, several preconditions must be satisfied for these outcomes to materialize. Primarily, nominal interest rates from Japanese banks remain considerably low, with the nation currently in the process of gradually transitioning away from its zero interest rate policy. Unless a capital market structure that adequately secures returns on savings can be guaranteed, the anticipated effect of stimulating savings cannot be realized. Moreover, if firms allocate substantial portions of their profits to internal reserves rather than returning them as capital yields, the incentive for savings may similarly be diminished. It should be noted, however, that our analysis has several limitations. The most significant analytical limitation is that we treat factor shares and labor supply as exogenous. In the actual Japanese economy, the labor market has become increasingly complex, with advancing female labor force participation alongside a rise in non-regular employment, making it a challenging task to analyze how total labor supply will change in the long term.¹¹ Furthermore, it is necessary to analyze various factors affecting the labor share, such as the direction of technological progress driven by AI advancement, the progression of globalization, and the rise of superstar firms. These issues should be addressed in future research.

Declaration of competing interest

The authors have no relevant financial or non-financial interests to disclose. The authors have no conflicts of interest to declare that are relevant to the content of this article. All authors certify that they have no affiliations with or involvement in any organization or entity with any financial interest or non-financial interest in the subject matter or materials discussed in this manuscript. The authors have no financial or proprietary interests in any material discussed in this article.

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¹¹ Kitao and Mikoshiba (2020, 2022) construct a lifecycle model with female labor supply and conduct quantitative analysis. Kitao and Nakakuni (2025) also explores the impact of family formation and the trend of technology progress.