Coping with Global Imbalances

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In the first quarter of 2006, the ratio of the US current account deficit to GDP was 6.4%, the highest in its history. The current account surplus equals savings minus investment. Savings minus investment consists of three elements, namely personal savings, private corporations' savings and governmental savings. Personal savings are disposable income minus private consumption and governmental savings are governmental revenue minus expenditure. In the case of the United States, private consumption and governmental expenditure are excessive. The personal savings rate of the United States has remained negative since the second quarter of 2005, reflecting consumers' attitude of depending on too much debt through credit cards and mortgages. In the US government's budget, revenue is much less than expenditure. The fiscal deficit ratio to GDP of the United States was as high as 5.6% in 2006, which, along with Japan, is the highest among the G7 countries. The main reason for the massive current account deficit of the United States should be deemed as domestically driven.

The United States should make every effort to reduce private consumption and governmental, especially military, expenditure. However, if the United States succeeds in reducing such spending, its economic growth rate will become stagnant, leading to less economic demand for the world economy. It is therefore desirable for the reduced demand on the part of the United States to be offset by more demand on the part of other countries such as Japan and China.

In the first half of 2006, the ratio of Japan's current account surplus to GDP reached 3.8%, which is the highest in its history with the exception of 1986 (4.2%), although this is due to a significant increase of the income account balance rather than the trade account balance. In order to improve the situation, Japan should either reduce savings or increase investment. Up until recently, Japan had been world famous for its high personal savings rate. But this rate declined from 10.6% in 1996 to 3.1% in 2004. We should not expect a further decline of Japan's personal saving rate, meaning that Japanese consumers cannot afford to increase their expenditure too much. In addition, Japan has been suffering from a massive budget deficit. The budget deficit ratio to GDP of Japan in 2006 is 5.6% on an annual basis and about 160% on a cumulative basis. Both figures are the highest among the G7 countries. Therefore, former Prime Minister Koizumi's Administration decided not to rely on an increase in public works spending when it tried to stimulate the Japanese economy. This policy of not relying on an increase in governmental expenditure will not be changed for sure under Prime Minister Abe's administration. In which area can we expect Japan to increase investment? The savings rate of private corporations is going up these days. In the 1990s, most private corporations were borrowing too much from banks and at that time the savings rate of private corporations was rather negative. After the bubble burst, they became very busy repaying those debts. After repaying those excessive debts, they have become financially sound with an increasing savings rate. The problem, however, is where to find investment opportunities. Certainly, there are not a few investment opportunities overseas and many Japanese corporations are investing outside the country. However, overseas investment does not increase investment in the context of income and the savings balance. Therefore, domestic investment opportunities should be found. Japanese corporations endured the 1990s without making even renewal investments in many cases. Because of this, there is a kind of pent-up demand for renewal investments. In addition, there are opportunities for investing in new products and materials. The Japanese government should encourage those investments through appropriate tax breaks and other incentives.

Let us move to China. In 2005, the ratio of China's current account surplus to GDP reached a record 7.2%, which was almost double the figure for Japan (3.7% in 2005). Of course this was the highest in China's history. The fundamental direction to rectify this situation is to restrain exports and investment and encourage private consumption. In China, there has been too much investment, bringing about concerns about excessive capacity on the supply side and possible inflation on the demand side. Therefore, rather than relying on an increase in investment, China should try to boost private consumption. As of today, the personal savings rate of China is very high because of concerns about the future due to the lack of a reliable social security system. The government of China should therefore shift its budget from a hard infrastructure to establishing a soft one for a reliable social security system so that Chinese consumers' concerns about their future lives can be removed, thereby leading to an increase in private consumption JS

COMING UP

"The Robot Industry in Japan" will be the theme of the next issue of Japan Spotlight. Robots are expected to have an increasing number of applications in our daily lives and in industry. Our writers will report on the Robot Industry Policy being promoted by METI, and explore how automobile and electronics manufacturers are using advanced robots. We will also look at a number of case studies that show how human beings may be able to interact more effectively with robots.