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GLOBAL SAVINGS AND FINANCIAL IMBALANCES A VIEW FROM EUROPE

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Mr. Feldstein has set the stage with his usual clarity of mind. Household savings in the United States are historically low. There are good reasons to believe that these savings will be picking up at some stage. How can the consequent slowing down of US private consumption be absorbed without too significant negative effects on the world economy ?

I would like to tackle this question from the European angle :

1. **Firstly, one has to observe that there is no “excess” savings in Europe contrary to some uninformed views.**

The Euro area current account is in global balance : from 2000 to 2004 the cumulated surplus over those five years amounted only to 13 Billion (i.e. 2,6 Billion a year on average).

This trend has continued in 2005. In total, if you look at gross savings related to GDP, the Euro area in 2004 was at 20 % which is equal to gross fixed capital formation (in the US, figures show a 6 % deficit and in Japan a 2,5 % surplus)¹.

So there is no overall “savings glut” in Europe.

2. **Secondly, the composition of savings and dissavings is different in Europe from the situation in the US.**

. Indeed, **household savings have remained positive** at their historical levels (gross savings ratios to disposable income have hovered around 14 % over the last 6 years) while net household debt has remained stable.

. The **corporate sector is almost in balance** (8,8 % gross savings to GDP versus gross fixed capital formation of around 10 %), but, given improved profits, corporate indebtedness has significantly reduced over the last 4 years.

. Lastly, **the public finances of the Euro zone are in bad shape** : continued deficits (close to 3 %) high debt ratios to GDP (71 % average).

¹ 2004 : US gross savings : 13,8 % of GDP ; gross fixed capital formation : 20,1 %.

Japan gross savings : 26,3 % of GDP ; gross fixed capital formation 23,9 %.

Source :ECB

So, the problem is not in the household or in the corporate sector, but in inadequate fiscal policies.

3. Thirdly, most European countries have not indulged in the housing leverage mechanisms that have so powerfully boosted consumption in the US.

Residential investment in Europe has not grown as fast as in the US over the last years (14,5 % cumulative growth in the US versus 2,5 % in France, for example).

This can be explained, in part, by very different housing financing mechanisms that characterize most European countries. For example :

- the possibilities to renegotiate conditions after rate decreases are lesser than in the US ;
- the possibility to “extract cash” out of housing wealth through using property as a collateral, or through extended loans, is not common practice in countries like France, Germany or Italy. “Home equity withdrawal” is not a continental European practice.

Therefore Europe has not “benefited” (if one can say !) from the residential wealth engine that has boosted consumption in the US.

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So what should Europe do to answer the question put by Marty Feldstein regarding the external responses to a rebalancing of savings in the US. (I will not deal with Asia which has, contrary to Europe, a large real surplus in savings).

I shall focus on the following points.

1. First, the things we should NOT do :

- **European countries should not increase their fiscal deficits** to boost demand. The debt ratios are so high and the future consequences of aging population on our social and health care systems are such that any relaxation of fiscal policies would be harmful. On the contrary, it is of the essence for growth to regain budgetary discipline through expenditure reductions ;
- **European countries should not try to match the sophisticated financial devices that allow household to extract cash from house price increases.** I consider that that the overextended position of US households is a systemic weakness and that Europe is, in this regard, in a more “normal” position, even if low interest rates provide a permanent temptation to get into more debt.

2. The things we should be doing :

- **reforming our ailing health care and pension systems ;**
- **opening up and liberalizing our labour and goods market which are much too rigid ;**

- **extending working hours to boost output and increase durably our potential growth** (which has been revised downward to 2 % recently). Some steps have been recently taken in these directions by European Governments (public sector pensions, labour market flexibility...) but they remain too modest ;
- Finally, I shall add that **energy conservation** is also a structured obligation for all our countries. In this respect, the nuclear energy policy of France engaged more than thirty years ago has produced remarkable results (75 % of electricity consumption in France comes from nuclear plants) and has lessened our oil dependency.