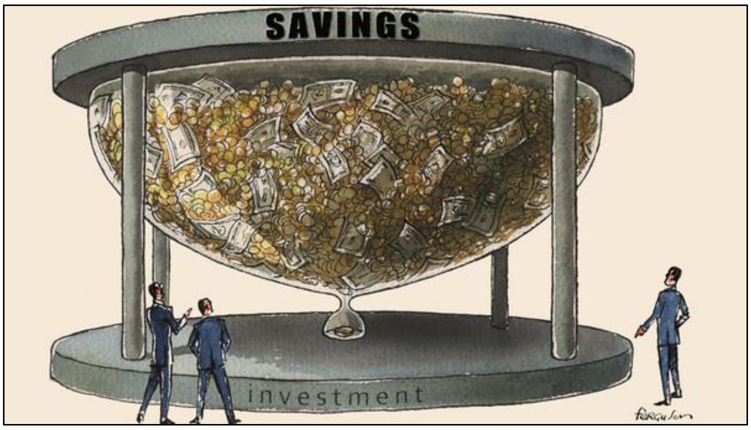
Corporate surpluses are contributing to the savings glut

Martin Wolf, *Financial Times*, November 17, 2015



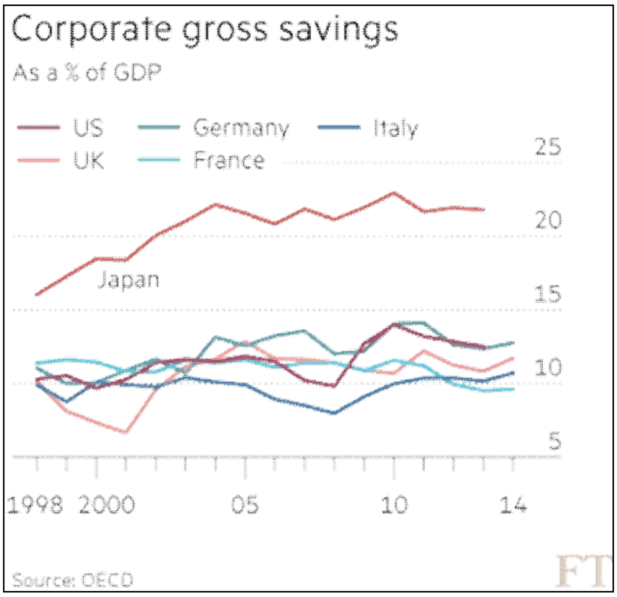
The notion of a "savings glut" helps explain the ultra-low real interest rates we have seen since the global crisis of 2007-09. But the idea of "secular stagnation" suggests that this glut had emerged even before that. To explain why this was so, we must look at the behaviour of the corporate sector.

Where, then, do corporations fit into an analysis of the shifting balance between planned savings and investment? The answer starts with the fact that companies generate a huge proportion of investment. In the six largest high-income economies (the US, Japan, Germany, France, the UK and Italy), corporations accounted for between half and just over two-thirds of gross investment in 2013 (the lowest share being in Italy and the highest in Japan).

Because corporations are responsible for such a large share of investment, they are also, in aggregate, the largest users of available savings, but their own retained earnings are also a huge source of savings. Thus, in these countries, corporate profits generated between 40 per cent (in France) and 100 per cent (in Japan) of gross savings (including foreign savings) available to the economy.

In a dynamic economy, one would expect corporations in aggregate to use the excess savings of other sectors, notably those of households — thereby generating both buoyant demand and growing supply. If investment is weak and profits strong, however, the corporate sector will, weirdly, become a net financer of the economy. The result will be a mixture of fiscal deficits, household financial deficits and current account surpluses (that is, capital account deficits). In Japan, fiscal deficits offset huge corporate surpluses. In Germany, a capital account deficit offsets corporate and household surpluses.

Since the crisis, the corporate sectors of the big high-income economies have run surpluses of savings over investment, with the exception of France. The surplus savings of Japanese corporations are, amazingly, close to 8 per cent of gross domestic product.



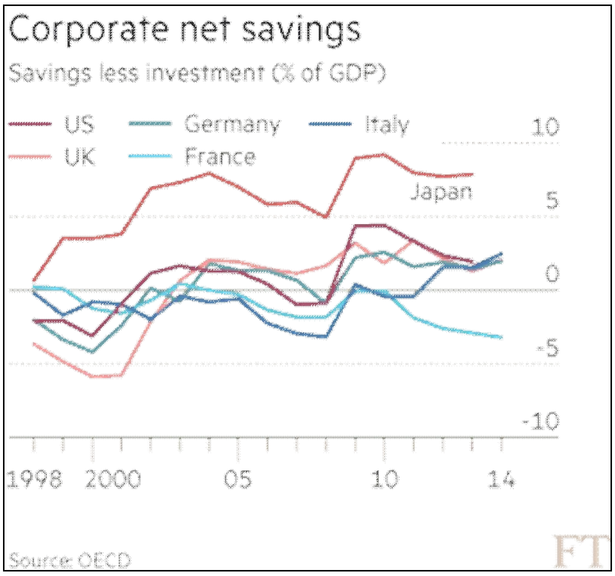
The corporate sectors have therefore contributed substantially to the savings glut. This is not just a post-crisis phenomenon. Even in the run-up to the crisis, corporate sectors ran surpluses in Japan, the UK, Germany (except in 2008) and the US (except in 2007 and 2008). A [US Federal Reserve paper]() notes that the Great Recession has been partly responsible for these surpluses, but it adds that even in the half-decade before the crisis, rates of corporate investment “had fallen below levels that would have been predicted by models estimated in earlier years”.

The rise in the surplus of corporate savings over investment is driven by a combination of strong profits and weakening investment. This weakening of investment is both structural and cyclical. Moreover,the weakening is widespread. Nevertheless, Japan’s corporate savings glut is unique in scale. Any analysis of Japan’s economic challenges that does not start from this fact is essentially worthless.

It is also important not to confuse the excess of corporate savings over investment with the widely noticed accumulations of cash by many companies. Businesses can acquire cash not only by hoarding retained earnings but also by borrowing or by selling assets.

The observation that a structural surplus of savings over investment appears to have emerged in the corporate sectors of the big high-income countries is highly significant. It is significant for the growth of potential supply, since it reflects relatively feeble investment, but it is also significant for the shape of aggregate demand.

If the corporate sector runs a structural surplus of savings over investment, other sectors must run offsetting structural deficits. If the government is to be in financial balance, either households or foreigners must run these deficits. In the eurozone, this logic has led to huge current-account surpluses (a financial deficit for foreigners). For the UK and US, it is likely to mean renewed household deficits — a perilously destabilising possibility.



Why is corporate investment structurally weak? The [ageing of societies] is one reason: by slowing potential growth, it lowers the level of investment needed.

Globalisation is another: it motivates relocation of investment from the high-income countries. Another reason is technological innovation. Much investment today is in IT, whose price is collapsing: constant nominal investment finances rising real investment. Again, much innovation seems to reduce the need for capital: consider the substitution of warehouses for retail stores. Another explanation could be that management is not rewarded for investing.

Together, all this might explain why, to take the US example, the ratio of corporate investment to profits has declined substantially since 2000.

The behaviour of the corporate sector also raises important policy questions. Corporate taxation, for example should surely encourage both investment and the distribution of profits. The way to achieve these joint objectives could be through higher tax rates on retained earnings, together with full deductibility of both investment and dividends.

Beyond this, it has to be accepted that, so long as the corporate sector runs a structural financial surplus, macroeconomic balance is likely to require fiscal deficits. Moreover, if the corporate sector is unable to invest even its own savings, savings in the rest of the economy are bound to have a low marginal value. In such a world, both ultra-low real interest rates and high equity prices are not at all surprising. They are to be expected. So stop complaining.