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## WHY IS THE JAPANESE HOUSEHOLD SAVING RATE SO HIGH?

by

*Atsushi Maki*

### *I. Introduction*

It has recently become apparent that the Japanese economy has an international competitive power considerably higher than that of her main trade rivals. Japan's balance of trade surpluses cause alarm and the newspapers contain many articles discussing this situation under the heading of trade friction. To preserve the international free trade order, policy makers are now faced with the need to find a new basis for setting acceptable exchange rates and make great efforts in a search for new rules of fair and free trade.

Some politicians and economists, for example Secretary Schultz in his graduation announcement at Princeton University in 1985, have focused their attention, in seeking to solve these problems, on the high rate of saving of the Japanese household. While acknowledging that in the past this high savings rate has been a beneficial factor in enabling Japanese industry to invest heavily in modern facilities, they argue that under present conditions involving much lower investment levels inside Japan, this high savings rate leads to a huge capital outflow and the consequent trade surpluses. They logically conclude that a more beneficial and less disruptive use for these funds would be to stimulate increased investment and consumption within Japan.

My principle aim in this paper is to look at the present stage of household savings rates in Japan, to look at this in an international perspective and to propose a theory of saving. I will conclude that, in the light of these international comparisons, each country has its own rationale for household savings rates whether high or low. Of particular interest is the fact that Italy as well as Japan has a household saving rate in excess of 20%, and it is worth noting that in both Japan and Italy such savings seem to be associated with high costs of house purchase and levels of social security pension benefits which are inadequate for retirement, factors which rank high among the many factors justifying household saving.

Japan, of course, has its own peculiar problems when trying to modify this situation. To change housing costs it is necessary to increase the supply of land in the urban areas — and policy solutions such as improved accessibility to outlying suburban areas or in-

creased municipal taxation on farm land would be useful. And an improvement in medical services for the aged might reduce the need for household saving somewhat.

## *II. International comparisons of household saving rates*

Data for international comparisons of savings rates is available from OECD statistics and I will use figures for Japan, Canada, the U.S., France, West Germany, Italy, Sweden and the United Kingdom. These countries are all regarded as developed and can be said to have experienced "Modern Economic Growth". Though each has its own cultural tradition, economic background such as the market system and the level of technology is resemble each other. More or less common standards in data collection have enabled OECD statisticians to collate the figures on an acceptable comparative basis. Thus a good starting point for international comparisons of saving behavior is available.

Taking the average of the latest ten year period we see that Italy had the highest household saving rate at 21.7%. Next comes Japan at 20.2% and then, at a much lower level France (at 13.0%), Germany (at 12.7%) and Canada (at 11.5%) each has saving rates between 10% and 15%. In the under 10% group we find the U.K. (at 9.2%) and the U.S. (at 6.5%). Somewhat incredibly, Sweden is listed as having a household saving rate of only 0.5% in 1982. Thus one may say that the Japanese saving rate is 1.5% lower than that of Italy but 13.7% higher than that of the U.S. .

These figures suggest that the household saving rate of Japan is not exceptionally high. Since, furthermore, it would be dangerous for us to conclude that Japanese and Italian people have some peculiar psychological traits to save explaining their position, we had better look for economic factors accounting for high household savings.

## *III. International comparisons of housing and of social security*

In Japan, households generally save for house purchase and then make a purchase which will serve them of many years. In general it is not possible to purchase a house and land every square meter every year, i.e. housing unit is one of the indivisible goods, a condition which stands fairly common in another OECD countries as well as in Japan.

Private funds for retirement are connected with tax and pension systems and with personal life expectancy. The average of personally held views on life expectancy would be surely higher than the actual statistical average. Consequently, it would not be surprising to find personal provisions exceeding the provisions of any alternative, collective provisions. Furthermore, whereas the general retirement age in Western countries is 65, in Japan workers retire at 55 and then generally accept lower paid work until they are no longer prepared to accept employment. The period of retirement for which savings must be made during the years of high earning capacity is that much longer. In this connection it could be argued that the excess of pay over productivity for workers between the ages of 55 and 65 in the West is a kind of pay-out from corporate savings which, in Japan, has to be covered privately.

Let us return to the data for housing. The rate of home ownership is 65.6% in the

U.S. and 62.3% in Japan. That of the U.K., Italy and France is 59.0%, 50.9% and 50.7% respectively. In Sweden it is 38.9% and in Germany, 37.5%. For average floor area per owner occupied house for the latest available year, we have 136.1 square meters for the U.S., 103.2 for Sweden, 98.9 for Germany, 93.9 for Japan and 77.1 for France. On the average number of rooms, we find that there is no difference among countries — all figures show between 4 and 5 rooms. On the basis of these international comparisons it cannot be said that owner-occupying Japanese live in rabbit hutches though there could be same truth in that fact with regard to rented accommodation which, in Japan, is typically only a half or less than half of the floor area of owner occupied housing. Unfortunately, I do not have available international comparative data on the floor area of rental accommodation.

Housing construction costs give a further useful basis for international comparison. Thus, after excluding the cost of land, we find that through diving private housing investment by number of units constructed figures for investment per house are 770,000 dollars in the U.S., 361,000 in France, 411,000 in the U.K., 1605,000 in Germany and over 1000,000 in Italy. In Japan the figure is 615,000 dollars. Of course these sums are distorted by whatever exchange rate is used in the comparison and in any case cannot reflect such factors as amenities (central heating, unit kitchen etc.) installed or life expectancy of the construction. But the figures are relevant for this study in that they indicate the sums which are required to construct a normally accepted house in each country.

Turning now to the data on social security. Some basic facts can be seen by looking at population pyramids to relate the productive population (defined as those between the ages of 15 through 65) and the aged. Such figures indicate how many workers support each retiree or, put another way, the extent of burden per member of the labor force.

For 1982 the ratio of numbers of working age to the aged is 7.1 for Japan, 5.7 for the U.S., 5.2 for Italy, 4.8 for France, 4.5 for Germany, and 4.3 for the U.K.. This suggest that Japan is somehow a younger country than the other OECD members.

Next, we can look at the social security. Total sums involved divided by population shows that in France and Sweden it exceeds 2,000 dollars per person annually at \$2,136 and \$2,011 respectively. The U.S., Japan and Canada show less than \$1,000 at \$904, \$846 and \$663 respectively. To obtain the sum paid to each aged person on average we need to multiply the value by (the ratio of numbers of working age to the aged + 1 + the ratio of numbers of age under 15 to the aged). For example, in Italy we find that the aged benefit by about \$9,000 per annum when we will postulate the ratio of numbers of aged under 15 to the aged as 2.0.

Social security as a percent of GNP gives 18.2% for France, 16.2% for Italy, 13.8% for Sweden, 12.0% for Germany but 7.8% for Japan, 6.5% for the U.S. and the U.K. and 5.6% for Canada.

Some interim conclusions can therefore be made at this stage concerning the explanation of household savings rates. Firstly, in Sweden, and perhaps France low savings rates seem to be matched by high social security expectations. Secondly, high housing costs in Italy may be matched by higher savings rates, and in Italy there is a high rate of increase

in land values, especially in urban areas such as Milan. Thirdly, since Japan also has high housing costs after taking account of very high land values, a similarity with Italy should be noted. Overall one can say that in countries where housing costs are high and social security funds low, households will have a high savings rate and stock financial assets for the future use.

#### *IV. Household assets, liabilities, housing cost and social security in Japan*

Now let us look at the present stage of assets, liabilities, housing and social security in Japanese households. The household saving rate is about 20% and, during the latter half of the 1970s household financial assets increased annually by about \$2,500 to \$3,000. While the financial stock per household in 1965 was less than \$2,000, by 1984 it had reached \$38,500. At the same time liabilities which in 1965 were \$360 reached \$12,000 in 1984. Of this \$12,000 housing and land liabilities including mortgage loans from the government and from banks accounted for about \$10,000. Not surprisingly liabilities exceed assets for those who have purchased land and housing during the past 5 years. Generally mortgage terms are comparatively short in Japan and, on average \$3,750 per mortgage is repaid per year.

A number of additional interesting points emerge from the data. Firstly, for the nation as a whole the approximately 60% owner-occupancy rate has been rather stable over many years, and, high density areas in population tend to have a lower owner-occupancy rate. The difference is given in the figures on owner-occupancy for the nation, for urban areas and for high density population areas which are 62.4%, 57.1% and 51.2% respectively.

Secondly, the proportion of one unit structures (single houses) is lower in the high density areas while the proportion of multiple unit structures (apartment blocks) is higher. For the three categories 'nation', 'urban areas' and 'high density areas' the figures for one unit structures are for 1984, 64.3%, 57.9% and 50.9% and for multiple unit housing are 26.9%, 32.6% and 38.4%. Furthermore, it is interesting to note that the proportion of multiple unit housing is increasing, having double its proportion during the last 20 years. In Japan the trend continues to be towards urban population concentration rather than suburban diffusion.

Thirdly, the average size of housing units has increased but there remains a big difference in the size of owner occupied and rented housing. The national average rental unit size in 1968 was 38.1 square meters, in 1973 39.5 square meters, in 1978 40.6 square meters and in 1983 42.9 square meters. Owner occupied housing units averaged 97.4 square meters in 1968, 103.1 square meters in 1973, 106.2 square meters in 1978 and 111.2 square meters in 1983. Thus during fifteen years the average size of rental units increased by only 4.8 square meters while that of owner occupied housing increased by 13.7 square meters. However, given the smaller size of rental units we can note that the ratio in size between owner occupied and rental units has not changed, remaining at 2.6.

Fourthly, the size of housing units in both categories decreases with population density. Taking 1983 figures for the nation, for urban areas and for high density areas we

find owner occupied housing of 111.7 square meters, 106.6 square meters and 101.5 square meters; and for rental units 42.9 square meters, 41.9 square meters and 41.1 square meters. These difference are caused by the different costs of housing land rather house construction but it is surprising that the differences in size are so small.

Fifthly therefore we can turn to the data on land costs. Using 1985 official land costs data we find that average cost per square meter in the Tokyo area is \$983, in urban areas of over 5000,000 population it is \$371, in areas of population between 3000,000 and 5000,000 it is \$358 and in the rural town areas it is only \$270. Tokyo is therefore around four times more expensive than rural towns. House construction costs are about \$575 per square meter so that a 100 square meter house on a 100 square meter plot costs \$150,000 in Tokyo but only \$80,000 in a rural area.

Lastly we will examine the data on social security benefit for the aged. Benefit for employee's pension insurance is about \$7,000 per annum per aged, and that for mutual aged association insurance is about \$8,750. And benefit for national pension is about \$1,500.

#### *V. Saving purposes for households and a theory of saving*

The basic motivation for accumulating savings is to increase ability to purchase goods in the future. We can categorize these future goods according to the timing involved. There are:

- i) Concurrent. The future purchase of goods during working life to supplement current income living standards.
- ii) Stochastic. The future purchase of occasional large items such as a house (real assets) or expensive durable goods.
- iii) Provisional. The future purchase of goods when income is inadequate such as during retirement or periods of school fee expenditure.
- iv) Emergency. The future purchase of goods in the event of unexpected burdens such as fire, accident or disease.

To meet these objectives households save and stock financial assets over time and, for purchase such as a house, have to supplement these funds with borrowing from the government and from banks – the latter of which must be often fully repaid at the period of retirement. In these circumstances households generally have to purchase land and housing during the age period 30 to mid 40s, – a point confirmed by the Housing Survey and other data.

While the concurrent and emergency motives are important it seems that the most important motives for household saving are for stochastic purchases during working life and for provisional motives after retirement. Therefore the scale of pension benefits is a crucial factor in determining the urge to save. In Japan pension benefits are inadequate and the aged need their own financial stock in order to maintain a satisfactory standard of living during retirement.

Mortgage interest levels and personal life expectancy are two further factors affecting

individual decisions. Thus, in any theory of saving we must take account of the motives affecting individuals and the circumstances affecting them.

### *VI. Policies decreasing household saving rate*

Both fact and theory indicates that policies affecting housing and pensions are required if the Japanese household savings rate is to be reduced as a means of increasing domestic demand.

For housing, this means somehow overcoming the bottleneck of land shortage in the major city areas. Ten years ago there appears to be a movement of population from the city centers towards the suburban areas and the government planned to facilitate this by constructing a series of 300,000 inhabitant cities around the major cities. The lower cost of land appeared to make this development attractive but during the past few years population has tended to grow most rapidly in the city centers reflecting a preference for convenience and accessibility. Given Japan's lifetime employment system it is not easy for employees to move away from existing employment centers without facing undesirable commuter travel times. To solve the housing land costs problem therefore it would seem that a more fundamental long term location of industry policy is also required.

Some changes, however, could be made within the present framework, such as changing taxation levels on residential, industrial and farm use land to promote the use of land for housing and for social infrastructure. But in the meantime, increasing numbers find that they have to remain in small rental accommodation, saving hard in the hope of buying their own land and house some day – a hope that is only too often frustrated by rising land values. The pressure for land brings other mixed results. For example, while it limits the number who can enjoy the capital gains resulting from land value appreciation, it benefits greatly those who already own their own home.

Overall, pension policies are governed by the changing population pyramid. Japan's population is aging and by the end of this century Japan is likely to have a higher proportion of aged citizens than any other advanced nation. Despite this limitation, however, there is much that the government can do to improve benefits and to undertake the required financial provisions to secure the funds for the future.