World Economic Trend, Spring 2004, No. 5

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(summary)

The spring report focuses on three topics: a rise in productivity in the US; efforts for reducing fiscal deficits in the major countries in the world; and the world economic outlook for 2004.

1. Lessons of the United States : The acceleration of Labor Productivity by Using IT

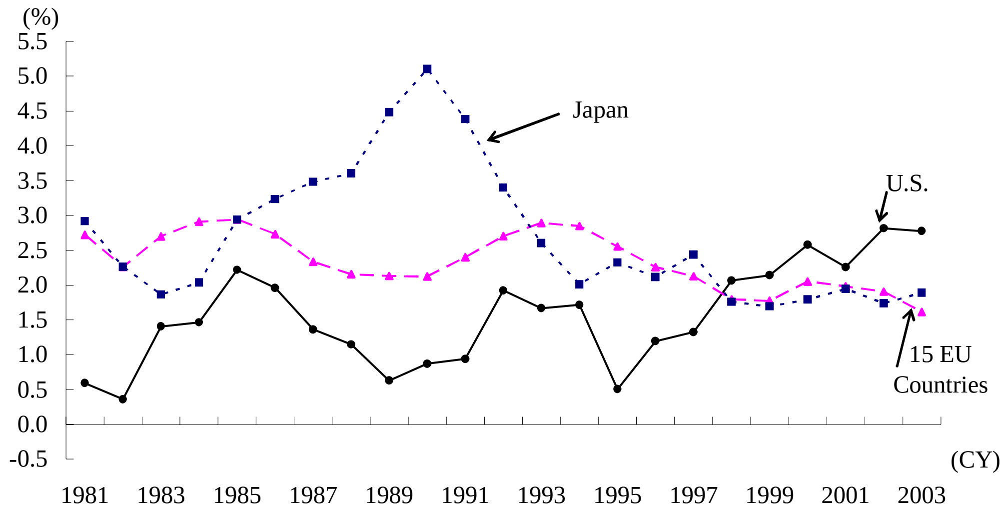
U.S. Labor Productivity Growth Has Accelerated Since the Late 1990s to Outperform Japanese and European Growth

U.S. labor productivity growth has accelerated since the late 1990s to outperform Japanese and European growth (Figure 1). Factors behind the acceleration of productivity growth seen in Northern Europe as well as the United States are (1) that these economies have a greater share of the information technology (IT) industry in their whole economies than others or they made more IT investment than others, and (2) that their labor markets are more flexible than others and their goods markets are more competitive (Figure 2).

One reason that U.S. labor productivity growth has outperformed European growth is that wholesale, retail and other IT-using services industries in the United States have achieved far higher labor productivity growth than in Europe.

Figure 1 Labor Productivity Growth in Japan, the U.S. and Europe

U.S. labor productivity growth has accelerated to outperform Japanese and European growth since the late 1990s.



(Notes)
1. Source: "Economic Outlook No. 74," OECD
2. Private sector (non-public sector) labor productivity. The Cabinet Office estimated productivity per unit working hour, based on total annual working hours. Labor productivity growth is a three-year backward-moving average.
3. Estimates for 2003.
4. The 15 EU countries are Belgium, Denmark, Germany, Greece, Spain, France, Ireland, Italy, the Netherlands, Austria, Portugal, Finland, Sweden, Britain and Luxembourg.
5. Total annual working hours for the 15 EU countries are an average for 11 countries (excluding Portugal, Greece, Austria and Luxembourg).

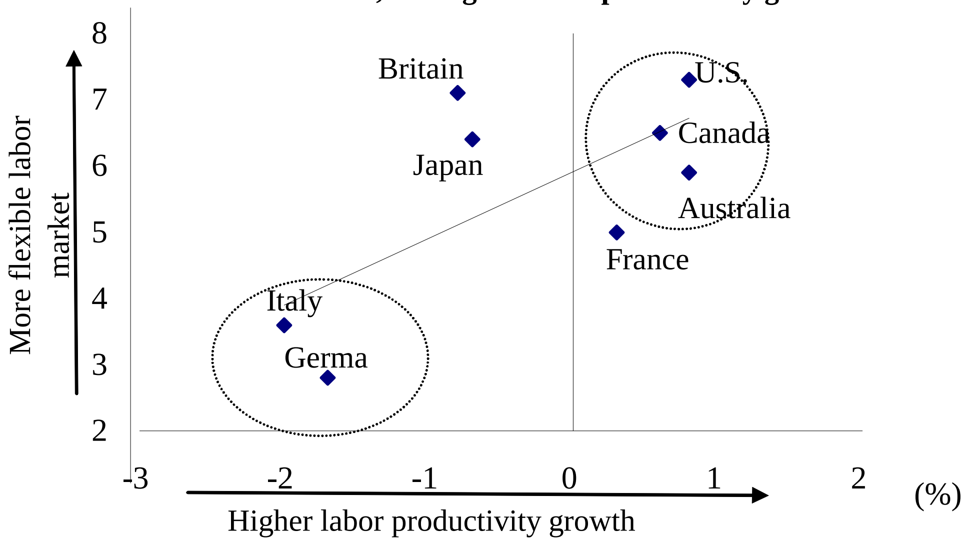
The Key to High U.S. Labor Productivity Growth Is Aggressive IT Investment Coupled with Competitive Markets That Make Such Investment Effective

Labor productivity growth includes a rise in the capital equipment ratio and that in total factor productivity (TFP). Empirical analyses indicate that the U.S. labor productivity growth since the late 1990s has depended largely on rising TFP and IT capital stock.

U.S. labor productivity growth accelerated on aggressive IT investment since the late 1990s. Behind this phenomenon have been the flexible labor market and business organizations, and competitive markets.

Figure 2 Relationship Between Labor Market Flexibility and Labor Productivity

The more flexible the labor market is, the higher labor productivity growth is.



(Notes)
1. Labor productivity is from the OECD Productivity Database and labor market flexibility indexes are from the Fraser Institute (Economic Freedom of the World Annual Report 2003).
2. Labor productivity growth is the change from the 1990-95 period to the 1995-2002 period.
3. The more flexible wages are, the higher the labor market flexibility index is.
4. The labor market flexibility indexes are for 2001.

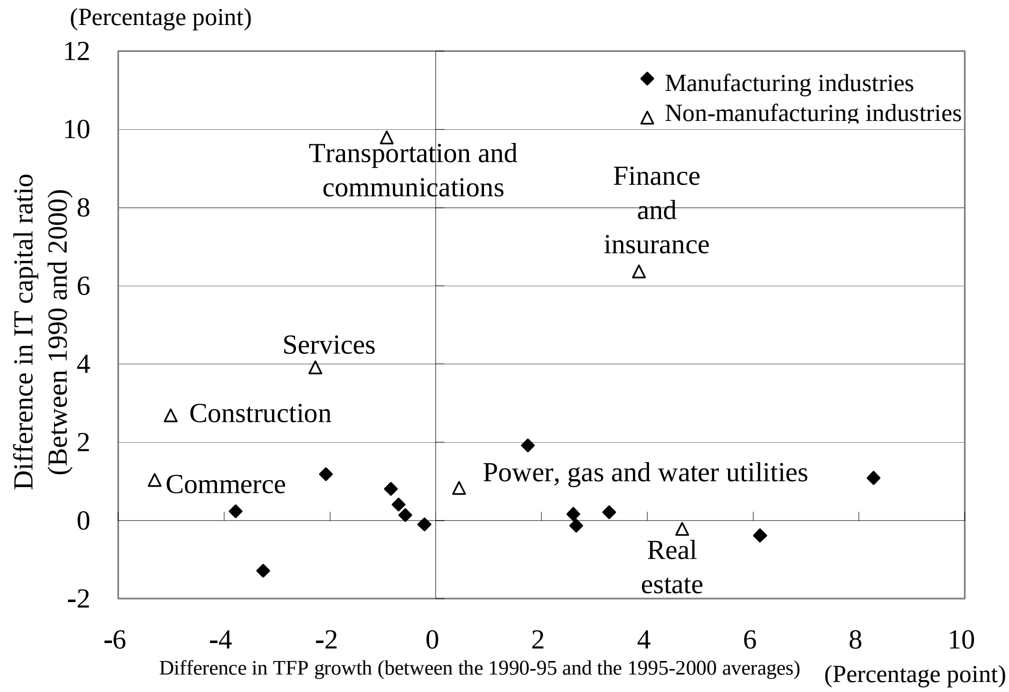
Japan Has Room to Take Advantage of IT Investment

Japan's labor productivity growth in the 1990s was slower than in the 1980s due mainly to lower TFP growth in non-manufacturing industries. Factors cited behind this include regulations, the rigid labor market and the lack of market efficiency, that is, the average TFP level of exiting firms was higher than that of staying firms.

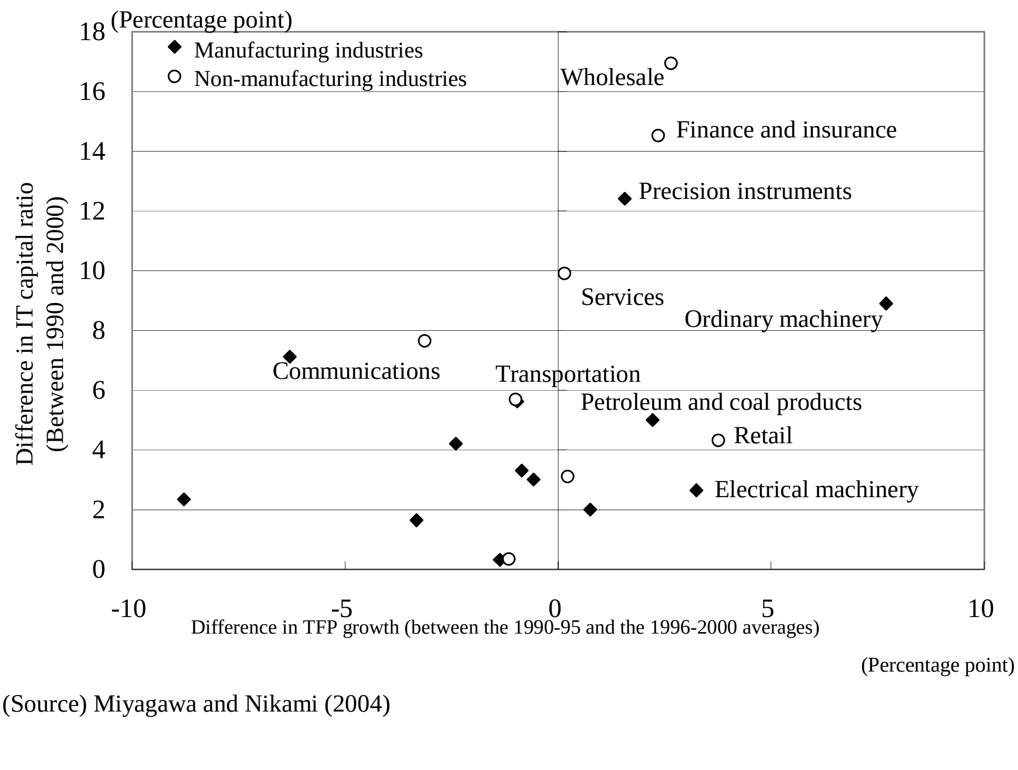
Japan has not necessarily lagged behind the United States in IT investment, under the common definition of the term. IT investment's effects can be enhanced by flexible business organizations and a flexible labor market. Japan still has room to improve these conditions for enhancing the effects of IT investment. Structural reform of the Japanese economy is expected to allow Japan to take full advantage of IT investment for accelerating labor productivity growth (Figure 3).

Figure 3 IT Development and TFP Growth

(i) Japan



(ii) U.S.



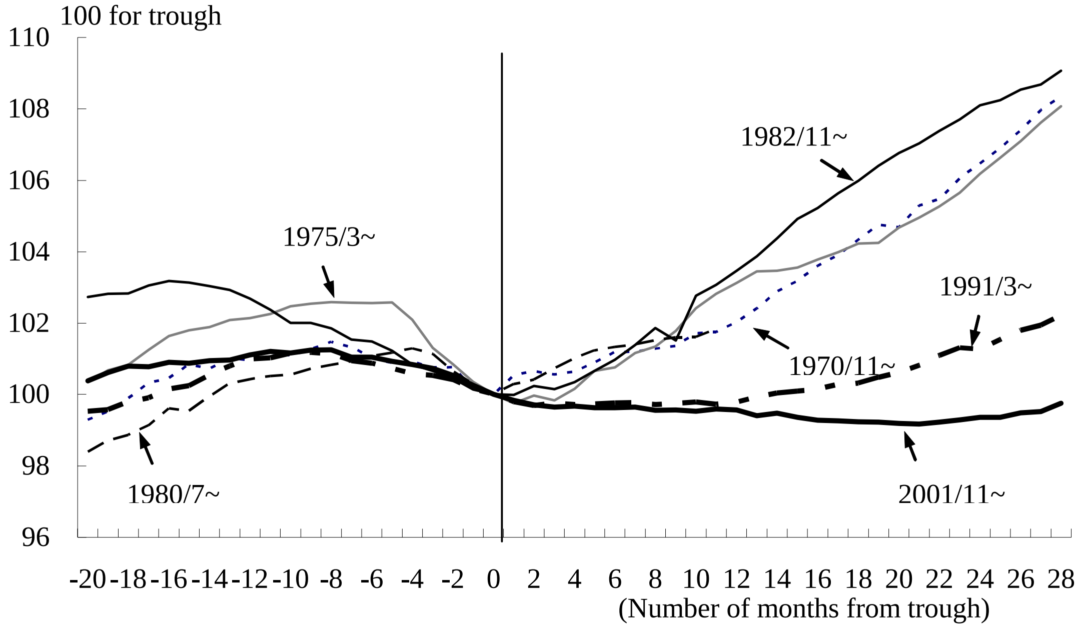
(Source) Miyagawa and Nikami (2004)

Labor Productivity Growth and Slow Employment Under Current U.S. Economic Recovery

U.S. labor productivity growth during the current economic recovery is higher than during the past recovery phases. But employment growth has been far slower (Figure 4).

Figure 4 U.S.: Present Employment as Compared with Past Recovery Phases

Present employment recovery is slower than in previous recovery phases.



(Notes) 1. Source: U.S. Department of Labor

2. Monthly nonfarm employment is indexed against 100 for the trough month.

Slow employment growth under the strong recovery indicates that enterprises have been cautious of increasing employment. The cautiousness is apparently attributable to increased employment costs including employers' share of medical bills and allowances. If the U.S. economy sustains an annual real growth of around 4%, however, employment may increase later to match economic growth.

Overseas outsourcing is cited by some people as a factor behind the delay in employment recovery. But any overseas outflow of the IT sector's employment may have only a limited impact on overall employment. Comprehensive assessment of overseas outsourcing is required, giving consideration to the fact that the U.S. economy can take advantage of overseas outsourcing to benefit from an efficient supply of goods and services.

2. Latest Deficit-Cutting Efforts of Europe and the US

Globally Expanding Budget Deficits

Budget balances have deteriorated over the past years for Japan and other major countries that tried to reduce their fiscal deficits in the 1990s. Especially, the United States, Germany and France have seen expanding budget deficits since the global economic slowdown in 2001.

Budget deficits generally boost interest rates to reduce capital accumulation, affecting economic growth. Accumulation of such deficits could make budgets more rigid. Chronic budget deficits could complicate problems during economic recession. Each country is thus trying to reduce budget deficits.

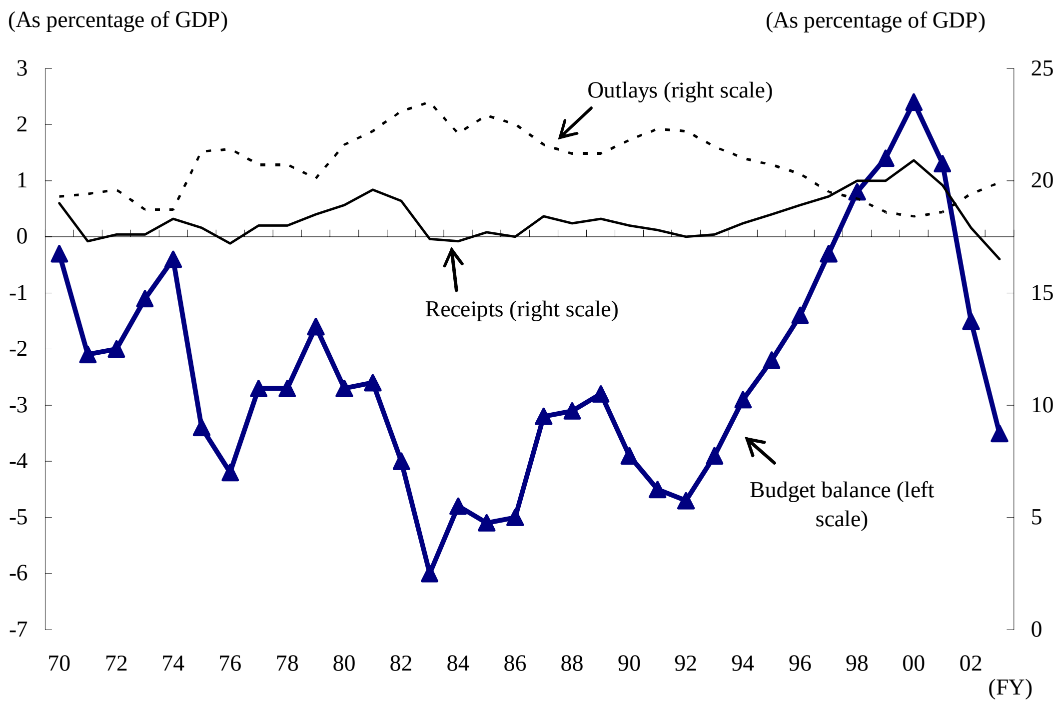
Deficit-cutting efforts include the establishment of numerical budget balance targets, reduction of spending growth and budget system reforms.

U.S. Budget Deficit Reduction Efforts: High-Level Deficits and Countermeasures

The United States achieved a budget surplus in the second half of the 1990s (Figure 5). Major factors behind the achievement included spending controls under budget rules and a personal income tax revenue increase on a long-term

economic expansion (Figure 6).

Figure 5 U.S.: Federal Budget Deficits



(Source) "The Economic and Budget Outlook: Fiscal Years 2005-2014," U.S. Congressional Budget Office

The U.S. budget balance has gone into the red since fiscal 2001. Factors behind the deterioration include a receipt decline on economic slowdown and tax cuts, and an outlay increase mainly in defense. Debt issues to cover budget deficits have recently tended to depend on overseas funds (Figure 7).

For the future, the Bush administration plans to halve an annual budget deficit in five years by capping discretionary outlay growth. As baby-boomers begin to retire in 2010, the U.S. budget will come under pressures of rising social security benefit payments.

Figure 6 U.S. Budget Deficit Reduction Measures

Gramm-Rudman-Hollings Act (December 1985, September 1987, Reagan)

<Outline>
Pursuing a balanced budget in fiscal 1991 (changed to fiscal 1993 later)
A budget deficit target was set for each fiscal year. If a budget deficit were projected at the beginning of a fiscal year to exceed a target for the year by more than a certain amount, automatic spending cuts would be implemented.
<Results>
As a real budget deficit deviated from the initial projection, the budget deficit failed to be reduced.

1990 Omnibus Budget Reconciliation Act (OBRA 90) (November 1990, Bush)

<Outline>
Receipt-expanding measures were provided along with Medicare and other specific outlay reduction measures.
Caps on discretionary outlays were provided along with the pay-as-you-go system to offset any mandatory outlay increase or any tax cuts.
Cutting fiscal 1991-95 budget deficits by some $500 billion from a baseline level.
<Results>
As receipt-expansion slipped far below the projection, the budget deficit reduction target failed to be achieved.

1993 Omnibus Budget Reconciliation Act (OBRA93) (August 1992, Clinton)

<Outline>
Like OBRA90, OBRA93 provided for specific outlay reduction measures as well as receipt-expansion measures.
The outlay caps and pay-as-you-go system were extended until fiscal 1998.
Cutting fiscal 1993-98 budget deficits by some $500 billion from a baseline level.
<Results>
As receipts increased and outlays declined faster than projected, the annual budget deficit fell dramatically.

Budget Reconciliation Act (August 1997, Clinton)

<Outline>
The act provided for a balanced budget in fiscal 2002 as agreed between the administration and Congress.
The outlay caps and pay-as-you-go system were extended until fiscal 2002.
Cutting fiscal 1998-2002 budget deficits by some $175 billion from a baseline level.
<Results>
A budget surplus was achieved in fiscal 1998, four years ahead of the initial target year of fiscal 2002.

(Source) Ministry of Finance

European Deficit-Cutting Efforts: Budget Disciplines as Conditions for Access to the Euro as the Single European Currency

Such European countries as Germany and France reduced budget deficits through spending controls and tax increases in

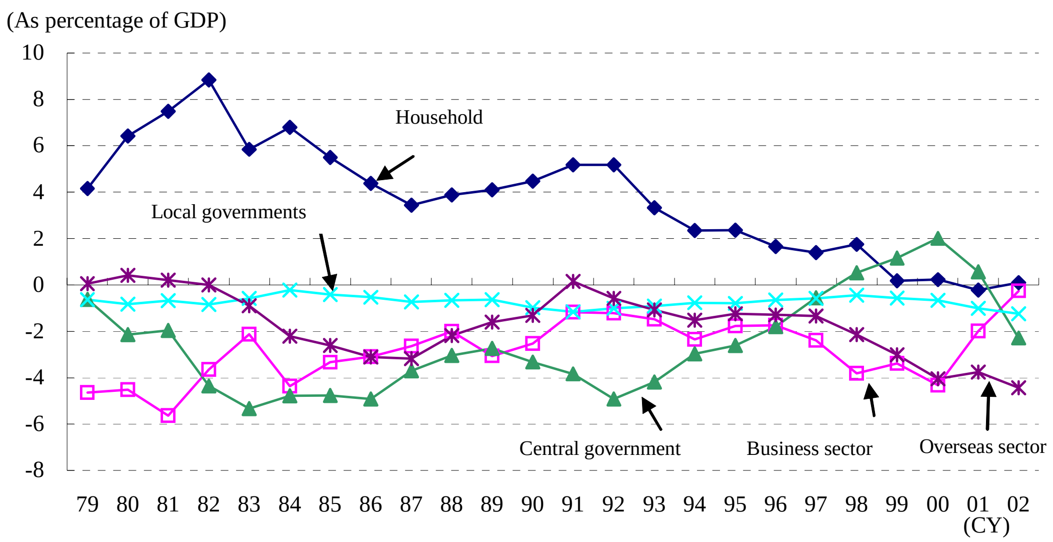
the 1990s to meet budget standards as stipulated in the Maastricht Treaty for Europe's economic and monetary integration. These efforts coincided with economic recovery to allow them to improve budget balances and meet the standards.

Following economic slowdown in 2001, German and French budget deficits have expanded beyond the threshold at 3% of gross domestic product as provided in the Stability and Growth Pact since fiscal 2002. They plan to cut their deficits below the threshold by 2005 through spending growth controls and social security reforms.

Britain has tried to reduce budget deficits under the golden rule that limits borrowings to investment purposes since the second half of the 1990s. But an annual budget deficit has recently been swelling upon rising government spending on education and social security.

Figure 7 Financial Surplus or Deficit by Sectors in the U.S.

Both the private and government setors had financial deficits in 2002.



(Source) U.S. Department of Commerce

3. World Economic Outlook

Steady Recovery Is Expected for the World Economy in 2004

After uncertainties about the future were wiped out upon the declaration of the end of military operations in Iraq, the U.S. economy began strong recovery, including increases in personal consumption and business investment in the second half of 2003. In Asia, China's high growth on robust exports to the United States spread to other Asian economies, resulting in recovery of Asia as whole. Europe has also achieved slow recovery against the background of global recovery.

The world economy is expected to accelerate growth in 2004 (Table 1). The vigorously growing U.S. economy may remain as the engine for global growth, and Asia and Europe may accelerate autonomous growth. Downside risks include the U.S. budget and current account deficits, relevant exchange rate fluctuations and developments in the Chinese economy.

Table 1 Economic Outlook by Major Region

Real GDP Growth

(%)

Country or region	2002	2003	2004		
			forecast	compared with 6 months ago	(October, 2003)
the U.S.	2.2	3.1	4.6	↗	(3.9)
Asia					
Northeast Asia	6.8	6.6	6.8	↗	(6.0)
ASEAN	4.0	4.5	5.3	↗	(4.8)
Europe	0.8	0.6	1.9	→	(1.8)
Euro Area	0.9	0.4	1.8	→	(1.7)

(Note) 1. Figures are an average of forecasts by private institutions published between August and April 2004. Cutoff date is April 10.

2. Northeast Asia includes China, South Korea, Taiwan Province of China, and Hong Kon
ASEAN includes Singapore, Indonesia, Thailand, Malaysia and Philippines.
Europe consists of Germany, France, Italy and the U.K.

"World Economic Trend" is a biannual report published by the Cabinet Office of the Japanese government. Developments of overseas economies and economic policies are surveyed from the view point of improving macroeconomic policy management of the Japanese economy.
(The original Japanese version is available at http://www5.cao.go.jp/keizai3/whitepaper.html#sekai)