

Export or domestic demand-led growth in developing Asia?

In recent years, some developing Asian countries claim to have started shifting emphasis from export-led to domestic demand-led growth policies with a view to achieving a more balanced growth strategy. This part of ADO 2005 evaluates empirically how far this shift has gone. The evaluation—based on an analysis of five countries—finds no evidence that the last decade has been marked by such a shift at the expense of a decline in net exports. It also finds that periods of expansionary domestic demand and deteriorating net exports signaled an ensuing crisis.

Introduction

Since the Asian financial crisis erupted in 1997, countries in the Asia-Pacific region have been immersed in a search to identify what policies led to the crisis and subsequent recession, and what alternative set of policies would lead them back to a path of sustained and higher growth (Felipe 2003). The majority view has been that the crisis was the consequence of a fundamental flaw in precrisis financial policies, which led to currency overvaluation, overborrowing, and overlending for the domestic economy, and speculative bubbles in the nontradable sectors that eventually burst (for an overview see Jomo 1998, Seguíno 2000, and Lim 2004).

As part of the “package of solutions” to reinvigorate these economies, a number of policy makers in the region (some of them more openly, e.g., in Thailand, and some others less so, e.g., in Malaysia) proposed shifting to a “new development paradigm” based on *domestic demand-led growth*. This way, it is argued, the Asian countries hit by the crisis are making efforts at diversifying their economic base away from overreliance on external trade, the basis of the so-called *export-led growth model*. During the last 4 years, articles in the press have analyzed and followed this alleged shift.¹ Thailand’s Prime Minister Thaksin Shinawatra, for example, announced upon taking

the helm of government in January 2001 that he was determined to move the country away from mass manufacturing for exports into domestic demand-led growth through a series of policies. The country’s policy makers are making big efforts toward shifting economic policy in an attempt to reduce the country’s overdependence on external demand and foreign capital. The high growth rates achieved by Thailand in recent years seem to vindicate the new approach. However, Mr. Thaksin’s approach is not, strictly speaking, just a transformation from export-led growth into domestic demand-led growth, if by the latter a series of policies to boost domestic demand is meant (this will be properly defined in the section “Definition of domestic demand- and export-led strategies,” below).

His policies are based on what has been referred to as a “dual-track” strategy (Lian 2004) of relying on external demand (first track) and simultaneously developing domestic demand and supporting domestic enterprises (second track). Though it is true that his policies emphasize private consumption, they try to boost the demand of domestically produced goods and services (Box 1.3).

Since becoming prime minister in 2001, Mr. Thaksin’s objective has been to alter Thailand’s production structure with a view to reducing the country’s dependence upon exports. The key is to create demand among households and businesses

Box 1.3 What is *Thaksinomics*?

In August 2004, the Government of Thailand published a white paper entitled “Facing the Challenge: Economic Policy and Strategy.” This explains clearly the economic agenda that Prime Minister Thaksin has been trying to implement since January 2001. The message is that his policies try to balance past excessive dependence on external demand, urban-based mass manufacturing, and unproductive asset-building, with structural development in domestic demand, traditional sectors (e.g., agriculture, small and medium enterprises, and rural households) and entrepreneurs, and improvement in the pricing power of Thai goods and services. Thus, Mr. Thaksin intends to revive domestic demand (by boosting private consumption and by developing the traditional sectors), in addition to exports. This is what has been referred to as a dual-track strategy, as opposed to the single-track model followed by many countries in the region, namely, production for export. Mr. Thaksin’s dual-track strategy is five-pronged:

- *Revitalizing growth at the*

grassroots level. The key policy initiatives are embodied in the following programs: “one *tambon* [village] one product,” SME and entrepreneur promotion, farmers’ debt suspension, Village and Urban Community Revolving Fund, the People’s Bank of the Government Savings Bank, SME loans, venture capital, and asset capitalization.

- *Jump-starting key sectors.* The paper contains ideas for the key sectors of the economy. With regard to agriculture, for example, it argues that it is crucial to identify new demand for Thai agricultural products both domestically and abroad. For manufacturing, the Government has set up a new Entrepreneurs Promotion Board to create 50,000 new SME businesses. In tourism, the policy sets out to promote Thailand aggressively and to capture the upper middle classes of Chinese, Indians, and Europeans. In terms of real estate, the Government has disregarded the standard prescriptions of “fire sales” and driving asset prices to their true bottom. Instead, it has promoted asset

reflation. Finally, in the financial sector, the Government has put in place a financial sector master plan to create a more efficient and competitive financial system.

- *Enhancing economic efficiency and long-term competitiveness.* The Government has identified a series of industries to promote, namely automobiles, tourism, software, food, fashion, health care services, hospitality, rubber, and furniture.
- *Providing a stable and supportive macroeconomic environment to facilitate growth while maintaining overall policy discipline.* The Government has raised tax revenues, consolidated spending, balanced the budget, and retired public foreign debt.
- *Promoting the external sector through market expansion and fostering financial stability through regional and global cooperation.* Under the dual-track strategy, the external sector is as important as the domestic. Thus, exports remain a cornerstone of the strategy.

Source: Asian Development Bank staff.

without creating another bubble (i.e., to avoid a household-led spending boom fueled by borrowing such as in the US). Moreover, Mr. Thaksin’s strategies aim at boosting domestic demand and strengthening local enterprises as well as developing indigenously owned production capacity.²

Malaysia is also making an effort at diversifying its economic base. The Republic of Korea is reported to have gone into a debt-led consumption binge after the Asian financial crisis, which led to the 2003 crisis of credit card defaults and weak consumption demand that is the cause of low growth.

It is therefore important to analyze whether

the empirical evidence indicates that a shift from export-led growth to domestic demand-led growth is indeed taking place across Asia, and the consequences of this shift. In particular, do the data appear to confirm this move toward a domestic demand-led growth strategy? More precisely, this part of *ADO 2005* attempts to answer the following three questions:

- Does the evidence indicate that countries are switching from export-led growth to domestic demand-driven growth?
- Did the export-led strategies partly contribute to the Asian financial crisis?

(iii) What lessons can be drawn from the different country experiences?

Structure

In order to address the three questions, this part of *ADO 2005* analyzes growth from the point of view of the aggregate demand components. The approach is very simple, based on the analysis of the information provided by the basic demand-side macroeconomic accounting identity, according to which output equals the sum of consumption, investment (i.e., domestic demand), and net exports.

The section after this, “Export-led growth strategy,” offers a summary and discussion of the strategy as well as a summary of some recent critiques of it. These have led (at least in the view of some authors) to the theoretical rationale for the alleged need to shift to a domestic demand-led growth approach. The next section, “Definition of domestic demand- and export-led strategies” defines the two types of growth strategies for purposes of the subsequent discussion.

The empirical work is carried out in the form of three complementary analyses (the sections “Demand-side growth-accounting exercise,” “Decomposition analysis,” and “Comparing expenditure shares”). Since the objective of this part is limited to an ex post, factual, and descriptive analysis of whether a shift to domestic demand-led growth is taking place, the methodology used is very simple. Output (GDP) from the demand side is looked at. This way, the latter is made up of the domestic demand components—consumption and investment—and net exports (exports less imports); and this is seen from the point of view of an accounting identity, i.e., there is no attempt at *modeling* in the sense of understanding *ex ante*, *causal*, or *behavioral* relationships. The first of these three sections, “Demand-side growth-accounting exercise” presents the results of such an exercise performed on the aggregate demand components of a selected group of Asian countries, namely, People’s Republic of China (PRC), India, Korea, Philippines, and Thailand. Growth accounting appor­tions overall GDP growth to the contribution of each component of demand. Thus, overall growth of output is the sum of the growth rate of each component multiplied by its share in GDP. For

example, the contribution of private consumption growth to overall GDP growth is calculated as the product of the growth rate of consumption times the share of consumption in GDP. Expressed as a percentage of the overall growth rate, it is the ratio of this product to the growth rate of GDP. The exercise provides a long-run view of these five countries in terms of the contribution of growth in domestic demand components and net exports to overall growth.

The second of these three sections, “Decomposition analysis of stances in the private, government, and trade sectors,” broadens the analysis of the five countries by looking at the expansionary versus nonexpansionary (or even contractionary) stances or positions of the private sector, government or fiscal sector, and external trade sector over the last 20 years, in terms of aggregate demand “injections” (private investment, government spending, and exports) versus “leakages” (private savings, taxes, and imports) of the three sectors. Over the last three decades, there have been substantial changes in demand-side parameters, such as import coefficients, tax efforts, and savings rates, along with jumps in flows such as annual exports, investments, and government spending. The analysis in this section looks at how output has responded to these shifts, using a simple decomposition of demand injections versus leakages. The discussion helps identify whether the component of demand in question has an expansionary or nonexpansionary contribution to aggregate demand (naturally, ex post, total injections must equal total leakages).

It should be pointed out that, while the growth-accounting exercise provides a long-run picture over three decades (1973–1983, 1983–1993, and 1993–2003) in terms of the growth contribution of each demand component to overall growth, the stances provide an annual graphical picture over 20 years of the different phases of growth of the five countries by identifying expansionary and nonexpansionary factors (private, government, and external sectors) in effective demand.

The last of these three sections, “Comparing expenditure shares,” completes the empirical analysis with a comparison of the shares of aggregate demand components for a large number of Asia-Pacific countries—classified according to

three income groups—with the shares of a group of small open European economies. Since it is impossible to carry out the growth-accounting and stance analyses for all Asia-Pacific countries, the analysis of the demand shares provides an overall picture.

The last section of this part of *ADO 2005* provides a summary and some conclusions.

Methodology

Some words on methodology are important. First, the demand-side growth-accounting and stance exercises are not, strictly speaking, an economic model in itself (nor based on a model), so no causal inferences should be drawn. The former is simply a device to split and apportion, *ex post*, the growth of output from the demand side. The latter also provides an *ex post* classification of how the private, government, and trade sectors contribute to expansions or contractions in output, where, by definition, the sum of the three is zero. Second, the analysis does not take into account any supply-side considerations (e.g., the relationship between exports and technology upgrading, often brought up in the discussions of the benefits of export-led growth). Third, although the analysis is an exercise in positive economics, it leads naturally to the normative observation that the problem being considered should not be an either/or choice between domestic demand-led growth and export-led growth, but a need to actually give both domestic demand growth and net export growth due importance and proper balance. This is especially crucial since developing countries need precious foreign exchange for their economic development, which net export earnings provide. Finally, it is virtually impossible to clearly discern a structural change from export-led growth into domestic demand-led growth with 3-year data. If this is happening, it will take years, perhaps a decade, for the data to show. Hence, the analysis covers three decades and unveils episodes of the two strategies mentioned.

Synopsis of conclusions

The analysis leads to the conclusion that the more successful phase of development of the selected countries has been associated with significant investment increases and capital accumulation, as well as with significant export growth that

brought about trade surpluses or reductions in trade deficits. For the countries badly hit by the Asian crisis in 1997–98, the instabilities were preceded by unbalanced growth in demand components, with domestic demand highly expansionary, and increasing trade deficits. This was the result of currency overvaluations, overborrowing and overlending in the domestic private sector, and rise of speculative bubbles that most economists agree triggered the loss of confidence, substantial currency depreciation, and capital flight during the crisis. The harsh adjustments during the crisis resulted in the collapse of domestic demand (especially investments) as net exports recovered sharply. Thus, it was not the export-led strategy that contributed to the crisis—it was the promotion of debt-financed domestic demand growth at the expense of net exports that precipitated it.

The analysis suggests that the best periods seem to be those when both domestic demand and net exports exhibit significant and continuous growth or improvements, as in the case of the PRC and India today, or in postcrisis Thailand. This was also the case of the post-Plaza Accord period of the second half of the 1980s in Korea and Thailand, when the reputation of the “Asian miracle” reached its peak. Periods when domestic demand was highly expansionary at the same time that net exports deteriorated signaled an ensuing crisis, as the experiences of Korea, Philippines, and Thailand show.

The comparisons between the upper-medium and low-income Asia-Pacific countries show that, during the last decade, 1993–2003, the high-performing Asian countries outpaced the European countries in terms of growth in both exports and net exports. The Asia-Pacific middle-level and low-income countries, on average, improved their trade deficits during the last decade. However, the low-income countries still have very high trade deficits that need to be reduced (or, alternatively, the gap between aggregate domestic demand and domestic production has to be narrowed). But there is no evidence that countries in the Asia-Pacific region have recently been exhibiting growing domestic demand shares at the expense of net exports.

Inasmuch as the analysis suggests that healthy growth for developing countries should be the

result of growth in both domestic demand and net exports, the last section includes a general discussion about how the international trade system should be more responsive to the needs of poorer countries with a view to allowing them to benefit from international trade. It is proposed that, to provide developing countries with the proper environment in which to achieve improvements in their net exports, the international trade system should provide them with mechanisms to reduce their large trade deficits. This requires (i) a more open international trade system—richer and trade-surplus countries can contribute by opening up their agriculture, industry, and services markets to the developing world; and (ii) use of price and non-price mechanisms by poorer and deficit-ridden countries to improve their productivity and competitiveness in the world market.

Export-led growth strategy

Overview

Export-led growth is a term used loosely to refer to a strategy comprising the encouragement of and support for production for exports. The rationale lies in the belief of many economists that trade is the engine of growth, in the sense that it can contribute to a more efficient allocation of resources within countries as well as transmit growth across countries and regions. Exports, and export policies in particular, are regarded as crucial growth stimulators. Exporting is an efficient means of introducing new technologies, both to the exporting firms in particular and to the rest of the economy, and exports are a channel for learning and technological advancement. Moreover, the growth of exports plays a major part in the growth process by stimulating demand and encouraging savings and capital accumulation, and, because exports increase the supply potential of the economy, by raising the capacity to import.

Mercantilist economists believed that the wealth of a country should be measured by the extent of the accumulation of precious metals and placed a great emphasis on achieving trade surpluses. Classical economists, on the other hand, argued that trade was welfare improving because it led to an efficient use of resources in each country, in the sense that countries would

produce and export the products in which they have a comparative advantage, and import the products in which they have a comparative disadvantage. It could even be said that the purpose of trade, from a classical point of view, is imports. Exports are simply the way to pay for imports. In this sense, there is also an emphasis on the importance of exports, although of different nature.

As a development strategy, the classical belief was that development could be transmitted through trade. Classical economists justified the benefits of exports with the traditional argument of comparative advantage. Accordingly, opening up a country's market to the international markets allows a country more efficient production and allocation of resources as the country can concentrate on the production of goods in which it has a comparative advantage based on its factor endowments. Thus, world trade markets allow producers and consumers of the participating countries to benefit from lower prices, higher-quality products, more diverse supply of goods, and higher growth. The export-led growth model seemed initially to have been vindicated with the success of Asia's miracle countries, which achieved extraordinarily high growth between the 1970s and mid-1990s, supposedly through export promotion. Since the eruption of the Asian crisis, however, some sectors have expressed increasing doubts as to the feasibility of export-led growth for many developing countries (Felipe 2003).

Recent decades have brought about other important justifications for export promotion. Some of these are:

- Participating in trade, especially export production and promotion, exposes a country to the latest and most advanced production and marketing techniques, and a “learning-by-doing” process that brings about dynamic innovation and technological diffusion into the economy. It also drives a country to higher production and to economies of scale, which lead to increasing returns (Felipe 2003).
- Many development economists use the “two-gap or three-gap” models of Taylor (1993) to justify the need to earn foreign exchange via exports. According to these models, the investment-savings gap and the foreign exchange gap are major obstacles to the

growth and development of many developing countries. Since countries need precious foreign exchange for their development needs (capital goods, industrial raw materials, oil, and food), export earnings are a more efficient means to finance these needs than foreign debt since the latter is vulnerable to adverse exogenous shocks and currency risks that may lead to debt defaults.

- A similar argument (McCombie and Thirlwall 1994) claims that large balance-of-payment deficits, spurred by large import propensities or elasticities, may be a hindrance to growth for many developing countries. Thus, moderate trade deficits, or trade surpluses, are more desired. This, of course, implies that export growth should be in pace with, or ahead of, import growth.
- Felipe (2003) also argues that export-led strategies allow an expansion of aggregate demand without much inflationary pressure and without the danger of a wage-price spiral, compared with strong domestic demand injections. This partly stems from the real appreciation of the currency that results from large export earnings, which tame inflation and allow real wages to rise.

A rationale for domestic demand-led growth?

It is important to mention that while the literature on growth and development considers the export-led growth strategy, the “domestic demand-led growth strategy” is not a term defined and used (hence it has to be defined here, in particular for purposes of empirical implementation—see “Definition of domestic demand- and export-led strategies,” below).³ Therefore, it is not straightforward to place the “debate” between export-led and domestic demand-led growth strategies in a theoretical context.

In recent years, however, a series of economists have hypothesized that, the Asian crisis had very different roots and that after several decades of being presented as the optimal growth strategy, the export-led growth model that the Asian countries followed ultimately gave in and even harmed the growth prospects of developing countries. These economists have put together a critique of the export-led growth model and proposed a shift toward domestic demand-led growth.

Palley (2002), for example, has argued that the emphasis on export-led growth of most Asian countries had a series of negative effects. First, it prevented the development of domestic market growth. Second, it put developing countries in a “race to the bottom” among themselves. Third, it placed workers in developing countries in conflict with workers in industrial countries. Fourth, there is a relationship between export-led growth and financial instability through the creation of overinvestment booms. Fifth, due to the emphasis placed on global goods and commodity markets, this model has aggravated the long-trend deterioration in developing-country terms of trade. And finally, and most important, export-led growth has reinforced the dependency of developing countries on industrial countries, thus rendering them vulnerable to slowdowns in industrial-country markets (e.g., as in the slowdown of the semiconductor world market in 1996–97 right before the Asian crisis). Export-oriented economies are dependent on foreign (mostly Western) demand. The problem is that recessions in Europe, US, or Japan translate into slow growth in the developing world. Summing up, Palley (2002) argued that the export-led growth model that the Asian countries followed for several decades is no longer an optimal strategy.

Blecker (2002, 2003) has also contended that the adoption of a development strategy that relied on high rates of growth of manufactured exports is the root cause of the problems that led to the crisis, for such a strategy led to growing excess capacity, intensified competitive pressures, and disappointing growth performance. In a similar vein, Kaplinsky (2000) and Erturk (2001–2002) have suggested the possibility of *immiserizing growth* as a result of the creation of excess capacity in export-oriented manufacturing industries. During the 1990s, too many developing countries entered the more advanced product categories, thus creating excess capacity and fostering falling prices.

Blecker (2002, 2003) has also argued that reliance on export growth suffers from a “fallacy of composition.” The reason is that, if too many countries try simultaneously to rely on export-led growth policies to stimulate growth in a given set of global demand conditions, the market for developing countries’ exports is limited by the

capacity of the industrial nations. If demand in the industrial countries stagnates, it translates into overinvestment and excess capacity in developing countries. As Asian countries plunged into the crisis, the first policy option they all considered as a means of resuming growth was the export-led strategy. However, the difficulty with this strategy is that the fallacy of composition problem has been exacerbated, since during the last decade the PRC has been added into the equation. Export-led growth operates through a hierarchical process with less-developed newcomers replacing more maturing export economies as their wages grow. The PRC poses an entirely different problem for it has a fairly large supply of labor so that it can keep wages very low and, seemingly, for a long time.

Blecker summarizes his views as follows: “the current emphasis on export-led growth in developing countries is not a viable basis on which all countries can grow together under present structural conditions and macroeconomic policies” (Blecker 2003). Palley (2002) has gone further and contends that the export-led growth model followed by many developing countries during the last few decades was part of the “Washington consensus” emphasis on trade liberalization.⁴ As a solution, Palley proposes a new development paradigm based on domestic demand-led growth.⁵

Definition of domestic demand- and export-led growth strategies

The analysis is performed in terms of the macroeconomic accounting identity:

$$GDP \equiv Y \equiv C_p + C_g + I + X - M \quad (1)$$

where GDP stands for gross domestic product, C_p is private consumption, C_g is government consumption, I is gross domestic investments or gross domestic capital formation (GDCF), and X and M are exports and imports, respectively, of goods and services. An export-led growth strategy is referred to as one that results in:

high export growth, accompanied by high GDP and income growth;

and

improvement in net export growth, i.e., higher export growth than import growth.

Conversely, growth is *strictly speaking* domestic demand-led if domestic demand is growing, accompanied by GDP and income growth.

The share of each component in output is defined as: (C_p/Y) is the share of private consumption, (C_g/Y) is the share of government consumption, (I/Y) is the share of investment, and $((X-M)/Y)$ is the share of net exports.

A convenient way of categorizing the different possibilities for the two strategies is as follows. The first three terms on the right-hand side of identity (1)—consumption of the private and government sectors plus investments—are the domestic demand components, while $(X-M)$, or net exports, is the other component of aggregate demand. Thus, the following cases can arise:

- Domestic demand is growing and net exports are deteriorating (becoming a smaller positive number or larger negative number). If GDP growth is positive, then growth must be domestic demand-led. This is the only case where one can, *strictly speaking*, refer to domestic demand-led growth.
- Domestic demand and net exports are growing. Thus, growth is due to both domestic demand and net exports. Which one is contributing more to growth is simply an empirical issue. If domestic demand is growing faster, it can be said that growth is demand led, but *weakly speaking*.
- Domestic demand is deteriorating and net exports are increasing. If growth is positive (which is often not the case since domestic demand is usually a much larger component of GDP), growth must be net export led. If growth is negative, the recession is due to a decline in domestic demand.
- Both domestic demand and net exports are decreasing. Obviously, there is an economic recession and negative growth rates are due to declines in both domestic demand and net exports.

It must be pointed out that, as GDP is separated into the domestic demand and net export components, the share of domestic demand will be much larger than the net export share,

usually constituting more than 90% of GDP when net exports are positive. (When net exports are negative, the share of domestic demand will be more than 100%.) This is because much of the export earnings will go to import purchases, and since net exports track the difference between these two trade variables, the magnitude becomes quite low compared with domestic demand. This is true even in the most successful export-led growth cases where export growth is in double-digits.⁶

Demand-side growth-accounting exercise

In this section, a growth-accounting analysis on the components of demand is performed. As indicated above, the objective of this exercise is to apportion overall growth between domestic demand and net exports. Technical details are shown in Box 1.4.

The five countries chosen—PRC, India, Korea, Philippines, and Thailand—provide a relatively wide spectrum of experiences and results. The first two are the oft-touted Asian success stories of the most recent decade due to their opening up to international trade, and the latter three were countries affected by the Asian financial crisis in 1997–98. Table 1.3 gives the shares of the expenditure components of GDP at constant prices for the five countries. Table 1.4 shows the average annual growth rates of GDP and of demand components over the 10-year intervals of 1973–1983, 1983–1993, and 1993–2003. Table 1.5 provides the growth rates of the expenditure components weighted by their shares in GDP. This gives, in growth rate terms, the contribution of each component to the growth rate of GDP. Finally, Table 1.6 displays, as a percentage, the contribution of each aggregate demand component to overall GDP growth.

Box 1.4 Demand-side growth accounting

Real output from the demand side is given by the national income and product accounts as:

$$GDP \equiv Y \equiv C_p + C_g + I + X - M \quad (1)$$

where GDP stands for gross domestic product, C_p is private consumption, C_g is government consumption, I is gross domestic investments or GDGF, and X and M are exports and imports of goods and services, respectively.

In growth rate terms:

$$\begin{aligned} \hat{GDP} \equiv & (C_p/GDP) \times \hat{C}_p \\ & + (C_g/GDP) \times \hat{C}_g + (I/GDP) \times \hat{I} \\ & + (X/GDP) \times \hat{X} - (M/GDP) \times \hat{M} \end{aligned} \quad (2)$$

where the symbol $\hat{\cdot}$ denotes growth rate of the variable.

The above simply states that the growth rate of GDP is the sum of the products of the shares in GDP times the growth rates of private consumption, government consumption, gross domestic invest-

ments and exports, less the product of the share of imports and its growth rate.

Real values were derived for 1973, 1983, 1993, and 2002 using the United Nations Statistics Division data, which have a continuous series of expenditure component measures from 1973 to 2002 in constant 1990 prices. Data for 2003 were derived from the 2002 data above and the latest growth data from ADB's *Key Indicators 2004* or the latest IMF *International Financial Statistics*. For the Philippines, the United Nations Statistics Division has a complete continuous series from 1973 to 2003. India did not have data for 2003 at the time of writing (December 2004), so its data end in 2002.

Average annual growth rate of a variable, denoted \hat{x} , was derived, say, for 1973 to 1983, as:

$$\hat{x} = \left(\frac{(x_{1983} - x_{1973}) / x_{1973}}{10} \right) \quad (3)$$

For a continuously increasing positive x , the above method will yield a higher annual average growth rate than taking the 10 actual annual growth rates of x from 1973–74 up to 1982–83, and then averaging them.¹

The method employed here also uses the GDP estimate without taking into consideration the statistical discrepancy between the value-added GDP estimate and the expenditure GDP estimate. That is, the GDP in the denominators of the shares in equation (2) uses equation (1) exactly without including the statistical discrepancy. This allows the expenditure shares to sum up to exactly 100%, and for equation (2) to sum up exactly to the GDP growth rate.

¹ This is because the base year in (3) is always the value of 1973, while averaging the actual annual growth rates uses base years from 1973 up to 1982.

Source: Asian Development Bank staff.

Table 1.3 Shares of expenditure components in real GDP, 1990 prices, %

		Domestic demand (1)=(2)+(3)+(4)	Private consumption (2)	Government consumption (3)	Gross domestic fixed capital formation (4)	Net exports (5)=(6)-(7)	Exports of goods and services (6)	Imports of goods and services (7)
1973		99.1	55.7	9.4	34.1	0.9	5.0	4.1
1983		100.2	54.3	12.1	33.7	-0.2	13.2	13.4
1993	PRC	100.8	49.1	13.1	38.6	-0.8	18.6	19.3
2003		94.2	39.6	12.0	42.6	5.8	24.4	18.6
1973		101.6	70.8	9.1	21.7	-1.6	6.7	8.4
1983		103.1	71.8	10.3	21.0	-3.1	6.5	9.6
1993	India ^a	102.8	68.7	11.9	22.2	-2.8	8.6	11.5
2002		101.1	62.8	12.0	26.4	-1.1	16.7	17.9
1973		100.5	64.1	15.7	20.7	-0.5	16.4	16.9
1983		96.7	55.1	12.8	28.8	3.3	27.7	24.4
1993	Korea	100.2	52.3	10.5	37.4	-0.2	33.9	34.1
2003		94.3	52.9	12.2	29.2	5.7	45.7	40.0
1973		100.4	69.0	11.4	20.0	-0.4	19.0	19.5
1983		102.3	63.0	9.8	29.6	-2.3	21.9	24.2
1993	Philippines	107.2	74.8	10.0	22.4	-7.2	31.3	38.5
2003		105.7	73.8	9.2	22.7	-5.7	39.3	45.0
1973		114.4	68.7	10.0	35.7	-14.4	17.1	31.5
1983		109.5	63.5	13.1	33.0	-9.5	19.6	29.1
1993	Thailand	105.9	55.1	8.7	42.0	-5.9	39.6	45.5
2003		85.3	55.4	8.7	21.2	14.7	65.7	50.9

^a India's 2003 data not available as of December 2004.

Sources: United Nations Statistics Division; Asian Development Bank. 2004. *Key Indicators 2004*.

Table 1.4 Average growth rates of expenditure components based on constant 1990 prices, %

		Expenditure on GDP	Private consumption	Government consumption	Gross domestic fixed capital formation	Exports of goods and services	Imports of goods and services
1973–1983		9.0	8.6	14.7	8.8	40.6	52.3
1983–1993	PRC	16.1	13.6	18.0	19.8	26.7	27.7
1993–2003		14.2	9.5	12.2	16.7	21.8	13.3
1973–1983		5.0	5.2	6.9	4.5	4.4	7.2
1983–1993	India ^a	5.6	5.0	8.1	6.5	10.9	8.7
1993–2002		8.0	6.4	8.1	11.6	26.0	18.7
1973–1983		10.6	7.7	6.8	18.7	24.8	19.8
1983–1993	Korea	12.2	11.1	8.2	18.9	17.2	21.1
1993–2003		7.3	7.5	10.1	3.5	13.3	10.3
1973–1983		6.4	5.0	4.0	14.2	8.8	10.4
1983–1993	Philippines	1.5	3.6	1.8	-1.3	6.4	8.2
1993–2003		4.7	4.5	3.5	4.9	8.5	7.2
1973–1983		8.9	7.5	14.7	7.5	11.7	7.5
1983–1993	Thailand	13.3	10.2	5.6	19.7	37.0	26.4
1993–2003		3.6	3.7	3.6	-3.1	12.6	5.3

^a India's 2003 data not available as of December 2004.

Sources: United Nations Statistics Division; Asian Development Bank. 2004. *Key Indicators 2004*.

Table 1.5 Growth rates of expenditure components weighted by their share in GDP, %

	Expenditure on GDP (1)=(2)+(6) =(3)+(4)+(5) +(7)-(8)	Domestic demand (2)= (3)+(4)+(5)	Private consump- tion (3)	Gov- ernment consump- tion (4)	Gross domestic fixed capital formation (5)	Net exports (6)= (7)-(8)	Exports of goods and services (7)	Imports of goods and services (8)
1973–1983	9.0	9.2	4.8	1.4	3.0	-0.1	2.0	2.1
1983–1993 PRC	16.1	16.2	7.4	2.2	6.7	-0.2	3.5	3.7
1993–2003	14.2	12.7	4.7	1.6	6.4	1.5	4.0	2.6
1973–1983	5.0	5.3	3.7	0.6	1.0	-0.3	0.3	0.6
1983–1993 India ^a	5.6	5.8	3.6	0.8	1.4	-0.1	0.7	0.8
1993–2002	8.0	7.9	4.4	1.0	2.6	0.1	2.2	2.1
1973–1983	10.6	9.9	5.0	1.1	3.9	0.7	4.1	3.3
1983–1993 Korea	12.2	12.6	6.1	1.1	5.4	-0.4	4.8	5.1
1993–2003	7.3	6.3	3.9	1.1	1.3	1.0	4.5	3.5
1973–1983	6.4	6.7	3.4	0.5	2.8	-0.3	1.7	2.0
1983–1993 Philippines	1.5	2.1	2.3	0.2	-0.4	-0.6	1.4	2.0
1993–2003	4.7	4.8	3.4	0.3	1.1	-0.1	2.6	2.8
1973–1983	8.9	9.3	5.1	1.5	2.7	-0.4	2.0	2.4
1983–1993 Thailand	13.3	13.7	6.5	0.7	6.5	-0.4	7.3	7.7
1993–2003	3.6	1.0	2.0	0.3	-1.3	2.6	5.0	2.4

^a India's 2003 data not available as of December 2004.

Sources: United Nations Statistics Division; Asian Development Bank. 2004. *Key Indicators 2004*.

Table 1.6 Contribution of demand components to GDP growth, %

	Expenditure on GDP (1)=(2)+(6) =(3)+(4)+(5) +(7)-(8)	Domestic demand (2)= (3)+(4)+(5)	Private consump- tion (3)	Gov- ernment consump- tion (4)	Gross domestic fixed capital formation (5)	Net exports (6)= (7)-(8)	Exports of goods and services (7)	Imports of goods and services (8)
1973–1983	100.0	101.4	52.9	15.2	33.3	-1.4	22.3	23.6
1983–1993 PRC	100.0	101.1	45.9	13.6	41.6	-1.1	21.9	23.1
1993–2003	100.0	89.6	32.9	11.3	45.4	10.4	28.6	18.1
1973–1983	100.0	106.1	73.9	12.7	19.6	-6.1	5.9	12.1
1983–1993 India ^a	100.0	102.3	63.2	14.8	24.4	-2.3	12.5	14.8
1993–2002	100.0	98.8	54.7	12.0	32.1	1.2	27.9	26.7
1973–1983	100.0	93.2	46.6	10.0	36.5	6.8	38.3	31.5
1983–1993 Korea	100.0	103.1	50.0	8.6	44.5	-3.1	39.0	42.1
1993–2003	100.0	86.3	53.7	14.6	18.0	13.7	61.9	48.1
1973–1983	100.0	105.3	53.6	7.2	44.5	-5.3	26.4	31.7
1983–1993 Philippines	100.0	140.4	154.5	11.8	-25.8	-40.4	94.6	135.0
1993–2003	100.0	102.4	71.7	7.4	23.3	-2.4	56.4	58.8
1973–1983	100.0	104.0	57.6	16.5	29.9	-4.0	22.5	26.5
1983–1993 Thailand	100.0	103.2	48.8	5.5	48.8	-3.2	54.7	57.9
1993–2003	100.0	28.6	56.0	8.6	-36.1	71.4	137.3	65.9

^a India's 2003 data not available as of December 2004.

Sources: United Nations Statistics Division; Asian Development Bank. 2004. *Key Indicators 2004*.

People's Republic of China

The tables show that the PRC registered high domestic demand growth in the first two decades, 1973–1993, while its net export position deteriorated and was negative.⁷ This happened even as the growth of exports posted annual averages of more than 20% (since imports increased more than exports). The last decade, 1993–2003, however, saw not only continuing large growth in domestic demand components, but also a strong shift from negative net exports (or trade deficits) to high positive net export (or trade surplus) positions, as export growth accelerated and import growth decelerated. Thus, the PRC's growth experience during the last decade points to high growth in both the domestic demand components and in the net export component. Domestic demand contributed around 90% to the double-digit GDP growth of the PRC in 1993–2003, while net exports contributed around 10% (Table 1.6). It is also important to point out that, in all three decades, investment growth outpaced consumption growth (Table 1.4), so that the last decade saw a larger contribution of investment than consumption to GDP growth, an increase in the share of capital formation (to more than 40%), and a continuing decline of the share of private consumption. It must be emphasized that in the last decade the share of net exports in GDP grew substantially—reflecting the transition from a negative contributor to growth to a high positive contributor.

India

India registered positive average annual GDP growth during the three decades, but lower than the PRC. The first two decades (1973–1993) were marked by growth in domestic demand as net exports deteriorated. During the last decade, when India opened up to the international market, the country exhibited even higher growth, with higher growth in the domestic demand components, but now the trade deficits improved so that net exports contributed slightly to overall GDP growth. During this decade, the growth rates of exports and imports more than doubled, with exports outpacing imports, leading to the decline in the trade deficits (net exports became a smaller negative number). As in the PRC, investment increased more than consumption

in the last decade, with the consequence that the share of capital formation increased, while that of private consumption fell. But the high share of consumption still made this component of demand the largest contributor to growth in the last decade. Finally, the last decade saw an increase in the share of net exports to GDP (actually a decline of its negative share to GDP) and a slight decline in the share of domestic demand to GDP.

Korea

The high-growth decade for Korea was 1973–1983, when it started being touted as an “Asian tiger”. During this decade, the domestic demand components of GDP grew very fast. Export growth exceeded 20% annually and surpassed import growth such that the country registered net export growth. At the same time, there was strong domestic demand growth. The trade surplus position reversed during 1983–1993 as the country began exhibiting trade deficits in the early 1990s, even if exports continued growing at a very high rate. The very high GDP growth during this decade, therefore, was due to high growth of domestic demand, with net exports deteriorating and turning negative toward the 1990s. Trade deficits continued until the Asian crisis. The last decade, 1993–2003, reversed the trade deficits, and the country returned to positive net exports starting in 1998, at the height of the Asian crisis. Because of the significant contraction of the economy in 1998, the growth rate of the last decade was lower than those registered during the last two decades, though still respectable. The last decade saw a slower growth of consumption and investment than in the previous decades, with investment actually losing share of GDP (reflecting the investment collapse of 1998). Net exports contributed to GDP growth in this last decade, and increased its share in GDP, while the share of domestic demand fell.

Philippines

The Philippines exhibited respectable growth during 1973–1983, with domestic demand growing significantly. The decade 1983–1993 was a difficult period for the Philippines, marked by the economic collapse of 1984–85 and 1991–92. Average annual growth was low during this

decade, which saw a decline in investment and low growth in consumption. Trade deficits also worsened, contributing to the low growth. The decade, therefore, was characterized by stagnation, with net exports not improving by the end of the decade (1993). The last decade (1993–2003) saw an improvement in growth rates, but net exports continued to be negative and did not improve in absolute terms, though they did improve as a percentage of GDP. The Philippines, therefore, is the only case among the five countries analyzed where all three periods, including the last one, were marked by growth in domestic demand and deterioration in net exports, although there was an improvement in terms of the share of net exports to GDP (to a smaller negative number).

Thailand

Thailand registered very high growth in the first two decades, 1973–1983 and 1983–1993, with both investment and consumption growing very fast. This was accompanied by deteriorating net exports in the two decades.⁸ The deterioration of net exports during 1983–1993 was accompanied by spectacular growth rates in both exports and imports. The last decade saw a significant fall in the GDP growth rate, as a consequence of the Asian crisis, which hit Thailand in 1997–98, and resulted in steep GDP and investment declines. Because of this, investment fell during the decade while consumption grew slowly and net exports turned from negative to largely positive. Thailand's GDP growth in 1993–2003 stemmed largely from improvements in net exports, which contributed 71% of the country's overall growth.

Thus, Thailand's post-Asian crisis improvement in net exports was the main contributor to growth during the last decade, rather than domestic demand.

Summary of results

Table 1.7 summarizes the results of the growth-accounting exercise. The overall picture that emerges from the analysis of the selected countries indicates that during the first two decades, but more especially during the second, domestic demand was the main driver of growth, as net exports deteriorated. The last decade of 1993–2003, on the other hand, was accompanied by significant improvements in the net exports position of the selected group of countries (with the exception of the Philippines). This is true for countries experiencing continuous growth (PRC and India) and for the countries hit by the Asian crisis (Korea and Thailand). The PRC and India registered high domestic demand growth in the last decade, simultaneously with net export growth (and very high export growth). Korea and Thailand saw net exports swing from negative to highly positive and contribute significantly to growth, as the domestic demand components grew more slowly.

In the Asian tigers such as PRC, Korea, and Thailand, export growth actually decelerated in the last decade relative to the second decade, but export growth was still in double digits. On the other hand, the growth rate of imports decelerated more with the consequence that all three countries saw improvements in their net export positions.

Export growth accelerated very strongly in

Table 1.7 Phases of domestic demand- and net export-led growth in selected Asian countries: A summary

Period	PRC	India	Korea	Philippines	Thailand
1973–1983	DD increasing, NE negative and deteriorating	DD increasing, NE negative and deteriorating	DD increasing, NE positive and improving	DD increasing, NE negative and deteriorating	DD increasing, NE negative and deteriorating
1983–1993	DD increasing, NE negative and deteriorating	DD increasing, NE negative and deteriorating	DD increasing, NE negative and deteriorating	DD stagnant, NE negative and deteriorating	DD increasing, NE negative and deteriorating
1993–2003	DD increasing, NE positive and increasing	DD increasing, NE negative but improving	DD increase slows, NE positive and improving	DD growing moderately, NE negative and deteriorating	DD growing slowly, NE positive and improving

DD = domestic demand, NE = net exports.

Source: Asian Development Bank staff.

India during the last decade, much more than imports, leading to the reduction in the country's trade deficit. The Philippines had the slowest growth in exports in the last decade, and was the only country with deteriorating net exports.

The net export share to GDP improved in all five countries. Even countries with negative net exports (or trade deficits) improved their positions. India was able to reduce its trade deficit in terms of magnitude. Trade deficits increased in magnitude in the Philippines, but declined in terms of the share in GDP. Tables 1.3 and 1.6 show that the share of domestic demand and its contribution to growth decreased during the last decade. Conversely, the share of net exports and its contribution to growth increased.

The conclusion is that there is no evidence that the net export position of the selected countries deteriorated during the last decade. And as a consequence, there is no evidence that growth during the last decade was domestic demand-led and at the expense of the net export position.

Decomposition analysis of stances in the private, government, and trade sectors

In this section, the stances of the private sector, the government (fiscal) sector, and trade sector for the five selected countries are analyzed. (The technical details of the aggregate demand decomposition analysis are provided in Felipe and Lim, forthcoming.) The private sector stance, or direct "own" multiplier on output, is given by (I_p/s_p) where I_p denotes gross private investment and s_p is the savings rate out of GDP. If (I_p/s_p) is larger than GDP, then private investment is larger than private savings (or, alternatively, private disposable income is smaller than private spending, composed of private consumption and private investments). Under these circumstances, the private sector is exhibiting an "expansionary stance" on aggregate demand, i.e., demand injections are larger than demand leakages. The government or fiscal stance is (G/t) where G is government spending and t is the tax effort out of GDP. If (G/t) is larger than GDP, then government spending is larger than tax revenues, and the government exhibits an expansionary stance on aggregate demand, i.e., it exerts positive net injections on aggregate demand. Finally,

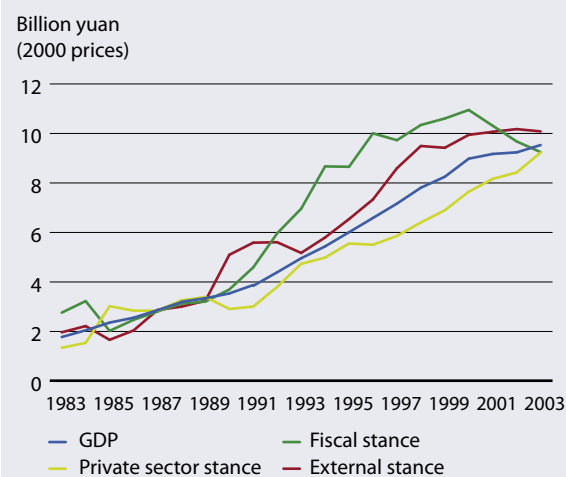
the external sector stance is (X/m) , where X denotes exports of goods and services and m is the propensity to import out of GDP. If (X/m) is larger than GDP, exports exceed imports, and the trade or external sector is exhibiting an expansionary stance on aggregate demand, i.e., export injections exceed import leakages. The period covered in this analysis is 1983–2003, using real values in the national income accounts for aggregate demand components.

The results are presented in Figures 1.18–1.22, which plot the stances of the three sectors vis-à-vis GDP.

People's Republic of China

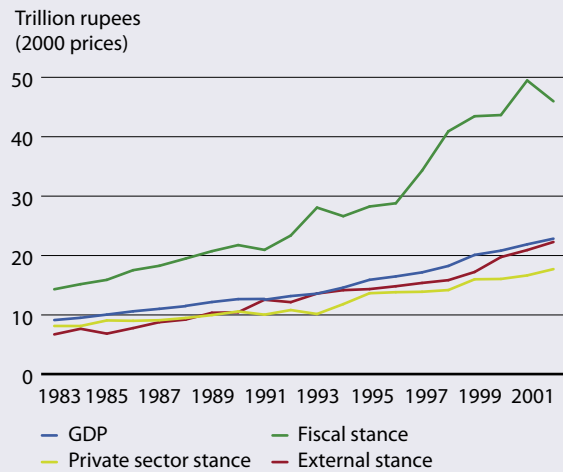
The PRC's slow transformation into a market economy and its participation in world trade has brought almost uninterrupted high growth to the country from the late 1970s until the present. The very high private savings rates (above 35%) have allowed the private sector "stance" to be nonexpansionary throughout most of the second and last decades, while maintaining a very high share, as well as growth, of GDCF (Figure 1.18). Since the early 1990s, the fiscal stance has been expansionary. The external stance became expansionary in 1990 and has remained positive until

Figure 1.18 Private sector, fiscal, external stances relative to real GDP, People's Republic of China, 1983–2003



Sources of original data: Asian Development Bank, *Key Indicators* (various issues); International Monetary Fund, *International Financial Statistics* (various issues); United Nations Statistics Division.

Figure 1.19 Private sector, fiscal, external stances relative to real GDP, India, 1983–2002



Sources of original data: Asian Development Bank, *Key Indicators* (various issues); International Monetary Fund, *International Financial Statistics* (various issues); United Nations Statistics Division.

now. The major expansionary stances in the last decade came from the government and external sectors.

In recent years, the PRC Government has reduced the expansionary fiscal stance in an attempt to avoid overheating of the economy. This explains why the external sector has emerged as the leading expansionary sector in recent years.

India

As in the PRC, relatively high private savings rates for a low-income country have allowed a nonexpansionary private sector stance and, at the same time, have supported a GDCF of around 20–25% of GDP during most of the second and last decades. Figure 1.19 shows the consistent nonexpansionary stance of the private sector. This sector's stance falling below GDP seems to be widening in recent years as the private savings rate is close to 30% of GDP.

Imports have been increasing since the 1990s but at lower rates than in the other countries. Export growth, however, has outpaced import growth in recent years leading to smaller negative net exports and to a small nonexpansionary external stance.

The very low tax effort (below 10% of GDP during most of the 1983–2003 period) and high

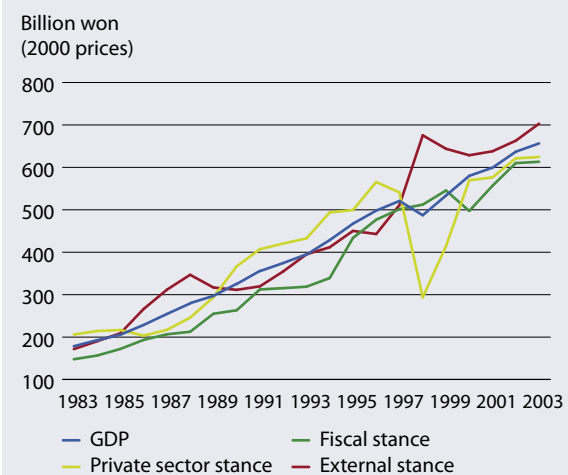
government spending have made the government the only sector with an expansionary stance. This impact of the fiscal expansionary stance on aggregate demand, though large and increasing in recent years, is moderated both by the growing gap between GDP and the private sector stance and by the improvement in the external stance.

Korea

Figure 1.20 shows that an expansionary private sector stance and nonexpansionary external stance during 1983–1985 were reversed in the second half of the 1980s. This shift to an expansionary external stance took place at the time the optimism about the Asian miracle was at its height. This high foreign exchange-earning capacity of the country was an important component of the country's success.

The appreciation of the won, high short-term capital inflows, speculative bubbles, and the fixed exchange rate regime of the 1990s, however, brought back an expansionary private sector despite the country's very high private savings rates. This was accompanied by a reversal to a nonexpansionary (and at times contractionary) external stance between 1990 and 1997. This contributed to a loss in confidence in Korea in the period right before the Asian crisis.

Figure 1.20 Private sector, fiscal, external stances relative to real GDP, Korea, 1983–2003



Sources of original data: Asian Development Bank, *Key Indicators* (various issues); International Monetary Fund, *International Financial Statistics* (various issues); United Nations Statistics Division.

As Korea became enmeshed in the crisis, the deep recession and sharp currency depreciations in late 1997 and throughout 1998 effected a sharp reversal, with the private sector stance shifting sharply from expansionary to highly contractionary, and vice versa in the case of the external stance. This situation continues, though is quite subdued compared with the situation in 1998–1999. In recent years, Korea has experienced difficulties in increasing its GDP growth rate due to weak consumption demand. The fiscal stance has historically been nonexpansionary except in 1998–1999 as a result of the Asian crisis. Therefore, the only expansionary sector in Korea in the post-Asian crisis period has been the external sector, as net exports remain significantly positive.

Philippines

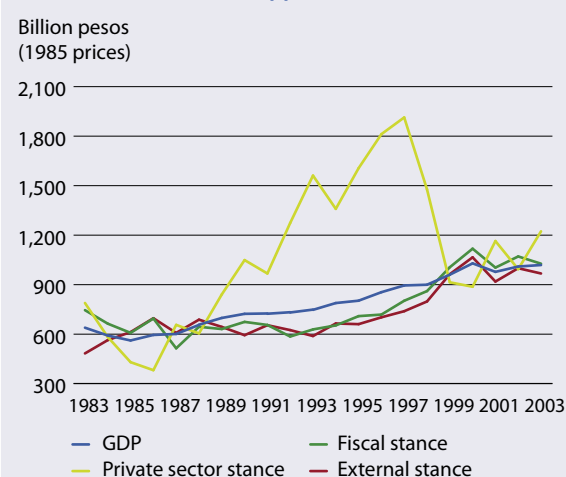
The Philippines' economic history since the 1980s has been marked by alternate periods of growth and recession. The sharp recession and crisis in the mid-1980s caused a sharp reversal in the private sector stance from highly expansionary in 1983 to highly contractionary. Correspondingly, the contractionary external stance in 1983 turned expansionary in 1985–1988.

Economic recovery in the late 1980s brought the private sector increasingly back to very positive territory in the 1990s, even though 1990–1993 were years of stagnation. The most expansionary period of the private sector was 1993–1997. Accompanying the high expansionary stance of the private sector were increasingly negative net exports, which returned in 1989 and rapidly increased in the 1990s (reaching more than 10% of GDP).

The Philippines was also hit by the Asian crisis in the second half of 1997 and throughout 1998. The sharp currency depreciation, initial high interest rates, and a slight recession tamed the high expansionary stance of the private sector (making it briefly contractionary in 1999 and 2000) and brought net exports to positive territory in 1999 and 2000.

The ensuing economic recovery (though weak and slow) returned the private sector to expansionary territory and the external sector to a contractionary position in recent years (2001 to 2003), but at much lower levels than before the Asian crisis.

Figure 1.21 Private sector, fiscal, external stances relative to real GDP, Philippines, 1983–2003



Sources of original data: Asian Development Bank, *Key Indicators* (various issues); International Monetary Fund, *International Financial Statistics* (various issues); United Nations Statistics Division.

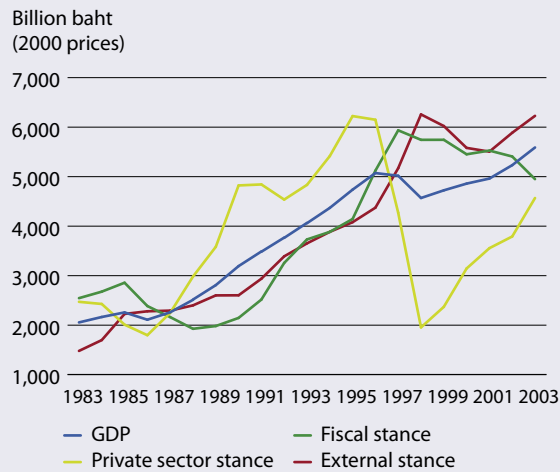
High government injections and deficits in the mid-1980s were met with fiscal austerity in 1987–1992 due to debt overhang as the country joined the decade-long debt crisis that afflicted most Latin American countries during 1982–1992. Philippine fiscal deficits remained high in 1987–1992, but this is not reflected in Figure 1.21 because much of the government spending was due to debt payments, and net lending and bailouts of government corporations. Fiscal surpluses were attained in 1994–1997 but these were reversed in 1998 due to the crisis. The Philippines now faces another fiscal crisis as the tax effort has continued its decline since the crisis, and as debt payments and failing government corporations (especially the National Power Corporation) are absorbing much government spending. The fiscal stance turned expansionary in 1999, but weakly so for the reasons given just above.

Summing up, recent years in the Philippines have been marked by an expansionary stance in the private and fiscal sectors, and a contractionary one in the external sector—but even then, these levels are much lower than before the Asian crisis.

Thailand

Like Korea, Thailand's private sector stance

Figure 1.22 Private sector, fiscal, external stances relative to real GDP, Thailand, 1983–2003



Sources of original data: Asian Development Bank, *Key Indicators* (various issues); International Monetary Fund, *International Financial Statistics* (various issues); United Nations Statistics Division.

moved from expansionary to nonexpansionary in 1985–1987, and its net exports turned from negative into positive in 1986–1987 (Figure 1.22). Net exports turned slightly negative in 1988–1989. Thus, like Korea, Thailand was at its most “miraculous” during the second half of the 1980s, when its net exports were either positive or in slightly negative territory, and its private sector was not too expansionary.

Also like Korea, currency overvaluation, high short-term capital inflows, speculative bubbles, overlending and overborrowing, and a fixed exchange rate regime made the private sector’s stance significantly expansionary from 1989, which continuously strengthened during 1990–1996. Correspondingly, its external stance was significantly contractionary throughout the 1990s, especially in the few years before 1997, the year of the outbreak of the Asian crisis (which, of course, originated in Thailand).

The fiscal stance was largely nonexpansionary during 1987–1995. More so than in Korea, there were very severe private sector and trade sector adjustments during the Asian crisis and its aftermath. The private sector became very highly contractionary, especially in 1999 and 2000, and it remains significantly negative. The external stance

turned very highly expansionary, especially in 1998 and 1999, and has remained that way.

The fiscal stance was expansionary (with fiscal deficits) during 1997–2000 because of a decline in the tax effort and social and economic spending due to the Asian crisis. These were restrained in 2002 and 2003 as tax efforts improved (unlike in the Philippines, where the tax effort has continued to decline).

Thailand has shown a continuous and increasing import propensity from the mid-1980s to the present, with a short respite in 1998 (because of the Asian crisis), but since then export growth has outpaced import growth. Thus, as in Korea, 2002 and 2003 saw the trade sector as the only one providing a significant expansionary stance to aggregate demand. Nevertheless, the reduction in the nonexpansionary stance of the private sector during the last few years is, to some extent, the result of Prime Minister Thaksin’s policies. For the time being, the private sector stance is still nonexpansionary. However, if it becomes overexpansionary, then the authorities must be cautious that the situation does not revert to that of the precrisis period, that is, a highly expansionary private sector stance leading to significant trade deficits financed by large foreign borrowings (making the economy very vulnerable to interest and exchange rate shocks).

Therefore, despite the attempts of the prime minister at switching from export-led to domestic demand-led growth, net exports still provide a key ingredient to Thai growth, while the private sector and fiscal stances—the domestic demand sectors—have actually been nonexpansionary in recent years. If anything, Mr. Thaksin’s policies must be seen as an attempt at increasing aggregate output vis-à-vis aggregate demand (domestic absorption). If one thinks of net exports ($X-M$) equivalently (through the national accounts) as the difference between aggregate output (GDP) and domestic absorption (the sum of consumption plus investment and plus government expenditures), it seems that the Government’s five-pronged strategy (Box 1.3) aims to boost the former rather than the latter.

Summary

The three questions posed at the beginning of this part of *ADO 2005* can now be answered.

(i) *Does the evidence indicate that countries are switching from export-led growth to domestic demand-driven growth?*

The answer to this question is a clear “No.”

The external sector is the one with the strongest expansionary stance in recent years in three out of the five countries studied, namely, PRC, Korea, and Thailand. For Korea and Thailand, it is the only sector providing an expansionary stance. For the PRC, the Government is very consciously reducing its expansionary stance to avoid overheating. Since its private sector has historically exhibited a nonexpansionary stance (due to the country’s high savings rate), the trade sector provides a major force in the expansion of aggregate demand.⁹

In India, the high fiscal expansionary stance is growing, but growing nonexpansionary and offsetting pressures from the private sector and improving net exports (though still negative) are reducing this expansionary domestic demand pressure on aggregate demand.

In the Philippines, the post-Asian crisis years saw a return to expansionary stances in the private and fiscal sectors, and negative net exports, though the expansionary stance of the private sector and negative net exports are substantially lower than before the Asian crisis.

(ii) *Did the export-led strategies partly contribute to the Asian financial crisis?*

Again, the answer to this question is a clear “No.”

Korea, Philippines, and Thailand followed a growth strategy characterized by a bias against exports during the years before the Asian crisis. This bias has been well documented and consisted of overvaluation of the currency, overlending and overborrowing in the domestic private sector, and creation of speculative bubbles in the nontradable sectors. This resulted in highly negative net export positions, and the exaggerated expansionary stance of the private domestic sector. For Korea and Thailand, this hurt the strong Asian miracle image they had achieved in the second half of the 1980s. The Asian crisis and its aftermath have

been a painful reversal of the earlier situation in these three countries.

These results directly contradict the arguments of Palley (2002) presented earlier—namely that the export-led growth strategy was partly to blame for the Asian crisis and led to biases against the domestic demand sector. In fact, the above simple analysis has shown that it was an overexpansionary stance in the private sector and growing trade deficits that marked the immediate period before the Asian crisis for Korea, Philippines, and Thailand.

(iii) *What lessons can be drawn from the different country experiences?*

The most obvious result coming out of the above analysis is that the “best” periods for the selected countries have been those when both domestic demand and net exports exhibited impressive growth. This corroborates the earlier justifications for export-led growth, especially the argument that developing countries need precious foreign exchange to finance their import needs. It must be pointed out that this corresponds to the definition of domestic demand-led growth weakly speaking (both domestic demand and net exports are increasing). The PRC has demonstrated that this kind of growth can be sustained for long periods. India adopted this type of strategy in the late 1990s, and as a result its high domestic demand growth is accompanied by impressive export growth and improvements in its trade deficits. Thailand and Korea followed this strategy in the second half of the 1980s, when their reputation as Asian tigers was at a peak. A deviation from this strategy seemed to have led them toward the Asian crisis. The above analysis indicates that they actually have reverted to the earlier strategy of promoting both domestic demand and net export components of the economy during this postcrisis period.

Comparison of expenditure shares of open European countries and selected countries in the Asia-Pacific region

For comparison purposes, the expenditure shares of a group of small open developed economies in Western Europe (Belgium, Denmark, Nether-

lands, Sweden, and Switzerland) are analyzed and compared with those of the developing countries of Asia-Pacific.

The Asia-Pacific countries are divided into three groups: upper-income economies (UA), middle-income countries (MA), and low-income countries (LA). The LA group coincides with the World Bank's latest categorization of low-income countries.¹⁰ The MA group coincides with the World Bank's countries in Asia-Pacific that are categorized as lower-middle-income countries. The UA group comprises those economies in Asia-Pacific that are above the income brackets for the lower-middle-income countries as categorized by the World Bank.¹¹

Figures 1.23 and 1.24 show the average shares of exports and imports, respectively, in GDP for the European countries, UA economies, MA countries, and LA countries.

Figure 1.23 indicates that the European and UA economies have significantly higher shares of exports in GDP than the MA and LA countries. The UA economies have by far the highest share of exports among all countries and their export share increased the most between 1983 and 2003. For all categories of countries, the shares of exports and imports grew fast between 1983 and 2003.

Changes in the import share are quite

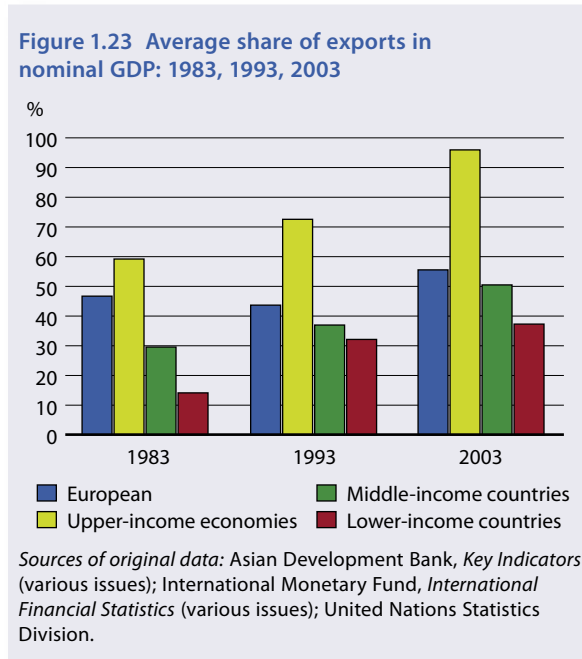
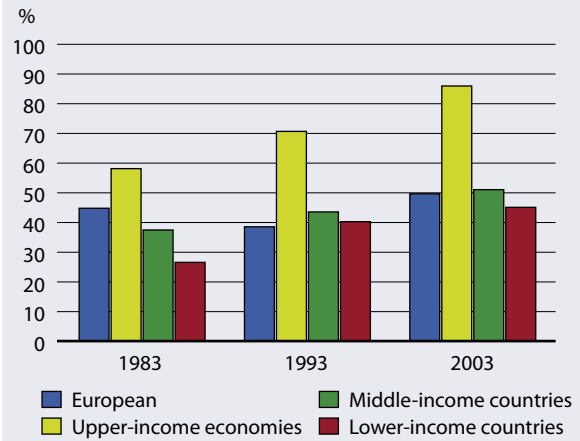


Figure 1.24 Average share of imports in nominal GDP: 1983, 1993, 2003



different (Figure 1.24). The European countries had higher import shares than the MA and LA countries in 1983, but in 1993 both the MA and LA countries had exceeded the import share of the European countries. In 2003, the MA countries' import share still exceeded that of the European countries, but the share of the LA countries fell again below that of the European countries. The UA economies again have had the highest share of imports since 1983, and their import share is also growing the fastest.

Figure 1.25 indicates that net exports (exports less imports) as a share of GDP are positive and growing for the European and UA economies. On the other hand, net exports are negative for both the MA and LA countries in three periods analyzed. But the net export position of the MA countries had clearly improved in 2003 (almost zero on average). The LA countries still had large negative net exports in 2003, of around 8% of GDP on average.

It must be stressed that the UA economies improved their net export share considerably between 1993 and 2003. In 2003, it was almost twice as large as the net export share of the European countries.

Domestic demand—defined as consumption (private and government) plus GDCF—and net exports sum to GDP. Thus, Figure 1.25 also

indicates that the share of domestic demand has been decreasing significantly in the European, UA, and MA economies.

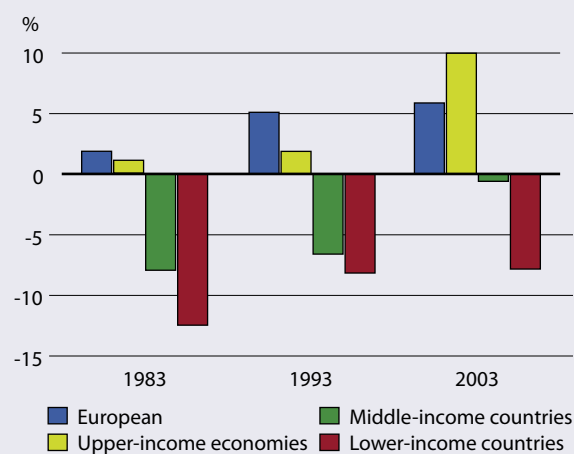
The above analysis shows that the UA and MA economies—where most of the emerging markets in the Asia-Pacific region are categorized—on average improved their net export position between 1993 and 2003, and that the UA and MA economies' share of domestic demand also declined. The UA economies even outperformed the European countries in terms of exports and net export shares.

The decreasing share of the domestic demand components in the UA and MA economies is borne out in Figures 1.26 and 1.27, which graph the average shares of consumption (private plus government) and GDCF (or gross domestic investments), respectively, in GDP.

Figure 1.26 indicates that consumption shares fell in all groups of countries between 1983 and 2003. It is clear that, although the MA and LA countries have higher consumption shares than the European and UA economies, the shares are decreasing more quickly over time in the first two groups of countries. The UA economies have the smallest share of consumption, even lower than that of the European countries.

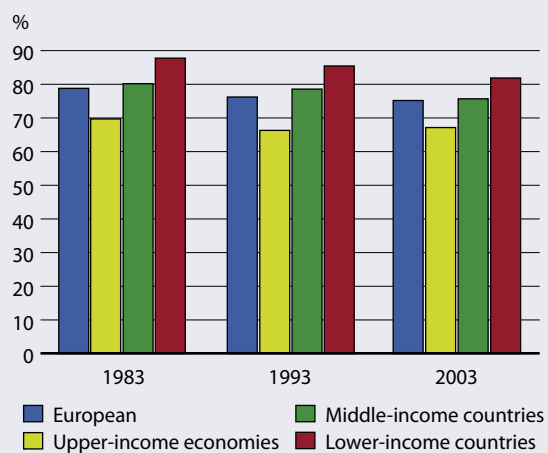
For GDCF, Figure 1.27 shows that all of the

Figure 1.25 Average share of net exports in nominal GDP: 1983, 1993, 2003



Sources of original data: Asian Development Bank, *Key Indicators* (various issues); International Monetary Fund, *International Financial Statistics* (various issues); United Nations Statistics Division.

Figure 1.26 Average share of consumption in nominal GDP: 1983, 1993, 2003



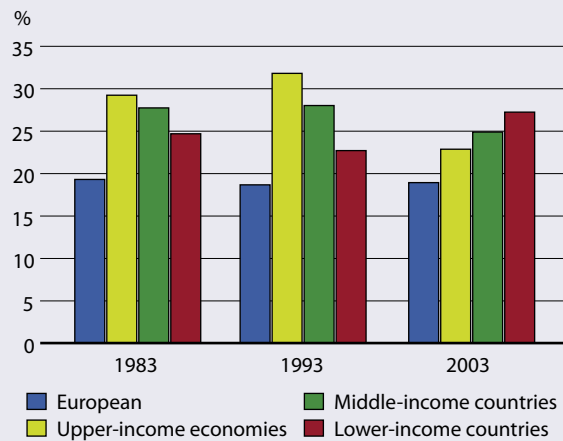
Sources of original data: Asian Development Bank, *Key Indicators* (various issues); International Monetary Fund, *International Financial Statistics* (various issues); United Nations Statistics Division.

categories of Asian countries have had, since the early 1980s, higher shares of investment to GDP than the European countries. The latter have very stable gross investment shares of between 18% and 19% of GDP. The UA economies had the highest investment share in 1983 and 1993. But this share, as well as that of the MA countries, fell during the 1993–2003 decade, with the UA economies' investment share losing almost 10 percentage points. The LA countries, on the other hand, increased their investment share in this decade.

Thus, on average, there is no indication that strong domestic demand-led growth or consumption-led growth has been taking place in the developing countries of Asia-Pacific during the last decade. The shares of consumption and GDCF declined during the last decade in the UA and MA economies (i.e., the share of domestic demand declined, which means that the net exports share improved). The LA countries' consumption share also fell, but their GDCF share increased. This is a positive indication that the lower-income countries, which are capital scarce, are accumulating capital at a faster rate than the other groups.

The outstanding performance of the UA economies in terms of exports and net exports reinforces the general perception that these four

Figure 1.27 Average share of gross domestic capital formation in nominal GDP: 1983, 1993, 2003



Sources of original data: Asian Development Bank, *Key Indicators* (various issues); International Monetary Fund, *International Financial Statistics* (various issues); United Nations Statistics Division.

economies are some of the strongest export performers in the world.

What is worrisome is the very large negative net exports still plaguing the low-income Asia-Pacific developing economies. This is discussed further in the following section.

Summary and conclusions

In brief, the main conclusions of the growth-accounting and stance analyses are as follows:

(i) There is no evidence that the 1993–2003 decade was marked by domestic demand-led growth at the expense of net exports. On the contrary, the countries hit by the Asian financial crisis, such as Korea and Thailand, lessened domestic demand expansion and strengthened net export growth. Domestic demand and net exports have been growing in countries not hit by the crisis, such as the PRC and India.

(ii) In general, the Asia-Pacific countries were able to reduce their trade deficits during the 1993–2003 decade, so that the share of net exports increased vis-à-vis that of domestic demand.

(iii) There is no evidence that the export-led strategy contributed to the Asian crisis. On the contrary, the export-led strategy, as defined in this discussion, was not implemented during

the period right before the crisis. This period was marked more by overexpansion in domestic demand, and deterioration of net exports.

(iv) Periods when domestic demand was highly expansionary at the same time that net exports deteriorated signaled an ensuing crisis. The periods when the countries analyzed performed the best were those when both domestic demand and net exports exhibited impressive growth. This corresponds to what was defined above as domestic demand-led growth weakly speaking.

Two more conclusions, of a normative nature, may be added.

(v) There should be no conflict between growth in exports and in domestic demand: successful and sustained growth requires growth in both domestic demand and net exports.

The demand-side growth-accounting exercise and the decomposition analysis of stances from the private, government, and trade sectors provide some useful lessons for appraising the discussion of domestic demand-led versus export-led growth.

Growth of successful countries such as the PRC, and to a lesser extent India, is based on a combination of both domestic demand components—especially GDCF—and exports. It is clear that developing countries should have adequate investment levels in order to grow and develop. There also has to be appropriate growth in consumption so that the population's welfare improves. These can be achieved at the same time that the country succeeds in developing and improving its export sector. In fact, in terms of technology deepening and “learning by doing,” growth in both sectors will be complementary and mutually reinforcing.

It is when one strategy is overemphasized at the expense of the other that the growth strategy becomes unstable. Clearly, the growth strategies of Korea, Philippines, and Thailand in the 1990s (before the Asian crisis) overemphasized expansionary tendencies in domestic private sector demand at the expense of net exports. This is reflected in the frequently discussed roots of the Asian crisis: currency overvaluation as well as overlending or overborrowing—spurred by inflows of short-term speculative capital—that

brought high growth to the domestic and nontradable sectors, and deterioration in the net export positions.

Conversely, the harsh adjustments undertaken by the three countries during and after the Asian crisis saw recessions and a collapse of gross investment as net export positions improved. There are prominent economists (e.g., Stiglitz 2002) who believe that the adjustments and policies imposed on the Asian countries hit by the crisis were overly harsh, especially on domestic demand, and contractionary. Whatever side one takes, it is clear that the sacrificed growth and resulting decline in the growth of productive capacity in the crisis-affected countries constitute a harmful consequence of the strategy that they followed (currency overvaluation, overlending, and overborrowing), which reversed the healthy balance and the desirable progression that both domestic demand (and the capital goods sector) and the tradable sectors achieved during the second half of the 1980s.

(vi) Countries with high trade deficits, mostly low-income countries, will benefit from a more open international trading system, and from promotion of their exports through price and non-price competitiveness.

Now, finally, is addressed the question posed by Palley (2002), Blecker (2002, 2003), and those who contend that not all developing countries can achieve successful export-led growth, inasmuch as positive net exports and trade surpluses correspond to trade deficits in other countries, and as the markets of the weaker countries (mostly in industrial countries) are gobbled up by the richer, high-performance countries.

It must be pointed out that Figure 1.25 shows that even if the LA countries had high negative net exports in 2003, this position had not, on average, deteriorated from that in 1993, despite the high export growth of countries such as the PRC, India, and other large countries that strengthened their export sectors in the 1990s. This is one encouraging sign, at least in the Asia-Pacific region. It must be added, however, that the net export position of many countries may not have deteriorated very much due to the very large and growing trade deficits of the US. Expected

adjustments, especially through the depreciating US dollar, may correct this situation in the medium term.

There are some other encouraging signs. The fast growth and expansion of the PRC has quickly opened up a potentially large export market for other developing economies. This will benefit many Asian economies, and has already benefited Korea; Malaysia; Taipei, China; and Thailand. The task now is to extend the benefits to the middle- and low-income countries in Asia-Pacific. India is another country that has been growing fast in the last decade. Its opening up to the world trade market has also opened a large export market.

The conclusion is that, for an export-led development strategy to cover as many countries as possible, a more balanced and equitable growth in exports and imports across the world is required.¹² This in turn requires the following two main “pushes”:

- all countries, including richer and trade-surplus nations, must open up their markets to poorer countries; and
- the poorer and latecomer countries need to make extra efforts both to promote their export sector via price and non-price competition, and to develop the necessary technological, physical, and human infrastructure to be competitive.

The first obviously requires the cooperation and participation of rich and trade-surplus countries so that developing countries can access the large world markets and reduce their trade deficits with the surplus countries. Trade liberalization of poor and trade-deficit countries alone (without the opening of the markets of the first group of countries) will obviously lead to perverse results. The second requires twin growth in the domestic demand and tradable sectors inasmuch as a high level of this infrastructure building will be part of domestic demand.

A more balanced and equitable international arrangement in world trade should therefore lead to smaller trade surpluses and smaller trade deficits across countries in the world, since more developing countries will be able to share in the benefits of international trade.

Endnotes

- ¹ See, for example, Patrick Smith. 2002. "From Exports to Domestic Demand-Led Growth: A New Model of Economic Growth?" *International Herald Tribune*. 8 November; and articles in *The Economist* (5–11 February 2005), "Heading back" (p. 9) and "Thaksin's way" (pp. 22–24).
- ² In fact, this is part of a very ambitious agenda (stimulus package) laid out by the prime minister, which includes lowering the cost of medical care; debt relief and microcredits for farmers; and the "local enterprise initiative" e.g., the encouragement of the production of wine out of exotic fruits.
- ³ What the literature discusses is the import-substitution strategy, often presented as the "opposite" of the export-led growth strategy (Felipe 2003).
- ⁴ The term "Washington consensus" was coined by Williamson (1990). In its original formulation, the idea encompassed fiscal discipline, reorientation of public expenditures, tax reform, interest rate liberalization, unified and competitive exchange rates, trade liberalization, openness to FDI, privatization, deregulation, and securing of property rights.
- ⁵ Palley certainly acknowledges that developing countries need to export. What he argues is that "the global trading system must be made the servant of domestic development, and domestic development must not be forgone for the sake of international competitive advantage" (Palley 2002, p. 4). For him, domestic demand growth rests on four pillars: improved income distribution, good governance, financial stability, and a fairly priced supply of development finance. The policies needed to put these pillars in place are labor and democratic rights; financial reform; and a combination of debt relief, increased foreign aid, and increased development assistance through the expansion of special drawing rights.
- ⁶ Another important point is that domestic demand is made up of consumption and investments. Growth dominated by consumption may have a very different impact and implications from growth led by investments. This topic is not tackled in this discussion.
- ⁷ Actually, the PRC's net exports turned positive in 1990. The negative net exports position in 1993 was an aberration, since it was the only year in the 1990s when the country registered a trade deficit.
- ⁸ In fact, Thailand's net exports improved in the second half of the 1980s, as will be shown in the next section, but deteriorated again in the 1990s.
- ⁹ It must be added that high GDCF growth also provides a strong force in expanding aggregate demand in the PRC, despite a nonexpansionary private sector stance.
- ¹⁰ Available: <http://www.worldbank.org/data/countrydata/countrydata.html>.
- ¹¹ The four UA economies are Hong Kong, China; Korea; Malaysia; and Taipei, China (Singapore was not included since it did not have separate data for exports and imports in the national income accounts). MA countries comprise People's Republic of China, Fiji Islands, Kazakhstan, Philippines, Sri Lanka, Thailand, and Vanuatu (Maldives was not included because it was such an outlier in some of the indicators that it distorted the averages). LA countries are Azerbaijan, Bangladesh, Bhutan, Cambodia, India, Indonesia, Kyrgyz Republic, Lao People's Democratic Republic (Lao PDR), Mongolia, Nepal, Pakistan, Papua New Guinea, Tajikistan, and Viet Nam. The World Bank categorizes the countries according to 2002 gross national income (GNI) per capita using the *World Bank Atlas* method. LA countries have GNI per capita of \$735 or less; MA countries have GNI per capita of \$736–2,935; and UA economies have more than \$2,935 GNI per capita. All the selected European countries fall into the World Bank's category of high-income countries, with \$9,076 GNI per capita or more. For the following countries, 2002 data were used due to lack of 2003 data: Bhutan, Fiji Islands, India, Lao PDR, Papua New Guinea, Tajikistan, and Vanuatu. Sources of data were ADB *Key Indicators*, IMF *International Financial Statistics*, United Nations Statistics Division, and World Bank country profiles.
- ¹² The breakdown of trade talks in Cancun, Mexico at the end of 2003 also points to the strong need to push for trade reforms in industrial countries to allow more agriculture, industry, and services sector imports from the developing world.

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