The Role of Fiscal Policy in Rebalancing Developing Asia’s Growth

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## Contents

Abstract \hspace{1cm} v

I. Introduction \hspace{1cm} 1

II. Fiscal Policy and Rebalancing: A Conceptual Overview \hspace{1cm} 2

III. Fiscal Policy for Rebalancing in the People’s Republic of China, the Republic of Korea, the Philippines, and Singapore

   A. People’s Republic of China \hspace{1cm} 5
   B. Republic of Korea \hspace{1cm} 8
   C. Philippines \hspace{1cm} 12
   D. Singapore \hspace{1cm} 15

IV. Concluding Observations \hspace{1cm} 19

References \hspace{1cm} 20
Abstract

Rebalancing growth toward domestic demand has emerged as a key postcrisis challenge for sustaining developing Asia’s rapid growth in the medium and long term. The central objective of this paper is to explore the role of fiscal policy in the region’s rebalancing process. What matters most for rebalancing are specific fiscal measures tailored to each country’s unique circumstances. In this context, the paper examines the potential contribution of fiscal policy to rebalancing growth in the People’s Republic of China, the Republic of Korea, the Philippines, and Singapore. As expected, the nature of fiscal measures that can promote rebalancing differs substantially across the four countries and depends on the nature of the rebalancing process in each country.
I. Introduction

Developing Asia grew by 6.6% in 2007 and 5.2% in 2009, and growth is expected to accelerate further to 7.5% in 2010. Although the region’s growth has moderated from the very high levels of the immediate precrisis period—8.0%, 8.9%, and 9.6% in 2005, 2006, and 2007, respectively—the region has weathered the global crisis remarkably well. However, the global crisis has far-reaching medium-term and long-term ramifications for the region’s growth and development. Above all, it is uncertain whether the region can return to the exceptionally rapid growth rates of the immediate preglobal crisis period. This is because such growth was unsustainable in the sense that it was driven by and contributed to global current account imbalances that underlay the global financial crisis. The seemingly infinite appetite of the United States (US) consumer for Asian products contributed substantially to the region’s exceptional export and growth performance of 2003–2007. However, intuitively, a country cannot run sizable current account deficits forever, not even if that country happens to be the world’s biggest economy and the issuer of the world’s dominant reserve currency. More broadly, there are bound to be limits to a situation in which one part of the world chronically oversaves and overlends, while another part chronically overconsumes and overborrows. While the direct and immediate cause of the global financial crisis was market failures in the US housing and financial markets, global imbalances was one of the key underlying imbalances of the crisis.

The strategic implication for developing Asia’s policymakers is that it may be fundamentally in their own enlightened self-interest to rebalance their economies away from overdependence on exports to greater reliance on domestic demand. Temporarily higher growth rates based on unsustainably high export growth is worse for the region than slightly lower growth rates based on a more sustainable, more balanced mix of external and domestic demand. Furthermore, even if the region wanted to revert to its precrisis paradigm of growth based disproportionately on exports, it is unlikely that it could do so. The reason is that the unwinding of the key imbalances that underlay the world economy in the precrisis period is already under way. In particular, US households have begun to deleverage to repair their balance sheets, cutting back on their consumption. The consequent increase in personal saving rate and decline in the current account deficit is a necessary adjustment for global rebalancing but discomforting for Asian exporters. At a broader level, the G3 (the European Union [EU], Japan, and the US) have been hit harder by the global crisis and are saddled with larger structural problems such as high debt levels and impaired financial systems compared to
developing countries. The weakness of the G3 will deprive developing Asia of a traditional engine of growth—robust export growth to the G3—well beyond the crisis.

The central objective of this paper is to explore the role of fiscal policy in developing Asia’s rebalancing process. The paper brings together a key stylized fact of the region’s economic policy environment during the crisis, which is bold and quick implementation of sizable fiscal stimulus packages, against the backdrop of a key medium- and long-term structural challenge facing the region in the postcrisis world: the need for rebalancing toward domestic demand. It is possible to view the stimulus packages themselves as instruments of rebalancing since their purpose is precisely to strengthen domestic demand to offset the slowdown of external demand. However, rebalancing here is merely a byproduct of efforts to shore up aggregate demand in the short run, rather than a deliberate policy effort to strengthen domestic demand in the medium and long run. Beyond the global crisis and the short run, in principle, fiscal policy can promote the rebalancing process. Above all, fiscal policy can help remove the structural impediments and distortions standing in the way of more robust domestic demand on the demand side; and help achieve a more balanced output mix catering to both external and domestic demand on the supply side. For example, lack of adequate social protection may constrain household consumption, while policy distortions that favor manufacturing will stunt the growth of a vibrant services sector. The need for rebalancing differs widely across the region’s countries as does the nature of the rebalancing process. Therefore, rebalancing requires country-specific fiscal measures tailored to each country’s unique circumstances. In this context, the paper examines the potential contribution of fiscal policy to rebalancing growth in the People’s Republic of China (PRC), the Republic of Korea, the Philippines, and Singapore. As expected, the nature of fiscal measures that can promote rebalancing differs substantially across the four countries.

II. Fiscal Policy and Rebalancing: A Conceptual Overview

This section briefly reviews the role of fiscal policy in the rebalancing process at a conceptual level. But first it is worth reviewing the overall policy implications of developing Asia’s need to rebalance its growth, as laid out in detail in ADB (2009). The region’s policymakers have a number of policy options at their disposal for reducing the region’s excessive dependence on exports. Broadly speaking, these policies fall into three different groups. One group of rebalancing policies is designed to boost domestic demand so that domestic consumers and firms can buy more of the output of the domestic economy. A second group of policies are targeted at altering the structure of output so that it is more closely aligned with domestic demand. A third group of policies promotes a better demand–supply balance by influencing both demand and supply. Examples
include financial development and exchange rate policy. None of the above policies can independently bring about a more balanced growth. Nevertheless, the package of policies can collectively make a significant contribution to reducing the region’s excessive dependence on external demand. The optimal policy package will differ across countries since the current account position and its underlying causes differ from country to country.

As noted above, the primary contribution of fiscal policy to the rebalancing process is to help remove the structural impediments and distortions that stand in the way of (i) a better balance between external and domestic demand, and (ii) a better balance between production for both domestic and foreign markets. Put differently, policy can contribute to rebalancing through microeconomic effects that alter the incentives of households and firms. In this context, the composition of public spending matters in the rebalancing process. Specific areas of government expenditures that have received a lot of attention are health, education, pensions, and social protection. The basic idea is that shifting public spending toward those areas will boost household disposable income and encourage them to spend more and save less. In addition, more and better government provision of those services will reduce the risk and uncertainty households face and thus reduce their need to save for precautionary purposes. More government spending on leisure infrastructure can stimulate greater spending on leisure activities.

On the supply side, the removal of taxes and subsidies that favor export production over domestic production will promote a more balanced output structure, as will the removal of fiscal distortions favoring manufacturing over services. There is thus a wide range of fiscal measures that the region’s governments can implement to stimulate domestic consumption, as well as production geared toward domestic consumption, by altering the incentives of firms and households.

The microeconomic effects of fiscal policy depend on the size of the crowding out effects. An increase in government provision of services will not result in a one-to-one increase in the total provision of services. For example, greater government provision of health and education may significantly reduce private consumption of health and education. If the two are perfect substitutes, it is conceivable that households will cut back their spending on health and education by exactly the same amount as the increase in government spending. If, on the other hand, the two are complements, government provision of health and education will encourage households to spend more on those services on their own. At a broader level, government provision of health, education, pensions, and social protection may stimulate private consumption on all goods by reducing the risk and uncertainty facing households. That is, the catalyst for private consumption is more likely to be the overall reduction of risk and uncertainty than complementarity between consumption of public and private services. There are also elements of both substitutability and complementarity between public and private investments. For example, public investment in transportation infrastructure such as highways and ports deprives the private sector of productive investment opportunities but, at the same time, raises the returns to investments for all firms and industries. Whether government
spending crowds in or crowds out public spending at the aggregate level will be ultimately determined by how households and firms respond to higher government spending.

III. Fiscal Policy for Rebalancing in the People’s Republic of China, the Republic of Korea, the Philippines, and Singapore

Although the global crisis exposed the vulnerability of developing Asia as a whole to external trade shocks, the need and scope for medium-term rebalancing differs substantially across the countries of the region. For one, there is a great deal of diversity in the region’s current account positions, with countries such as the PRC running large and persistent surpluses on a sustained basis, while others such as India are running chronic deficits (Figure 1). In fact, it is doubtful whether regional countries such as India and Viet Nam have to rebalance their economies at all since their savings are insufficient to finance their investment needs. For those countries, domestic demand (the sum of domestic consumption and investment) exceeds the output produced by the economy.

Among the surplus economies, the relative size of the surplus varies a lot. Although the PRC has attracted most of the attention, due to the sheer absolute size of its current account and the rapid widening of its surplus since 2003, some small East Asian economies in fact have higher surpluses relative to gross domestic product (GDP), most notably Hong Kong, China; Malaysia; Singapore; and Taipei, China. Higher surpluses do not automatically mean a greater need for rebalancing since the optimal current account position differs from country to country. For example, Singapore’s chronic and large surplus may be structural to a large extent, i.e., high-income city state with an abundance of savings and a lack of productive investment opportunities at home.

In light of the heterogeneous nature of current account positions across the region’s countries, the nature of the rebalancing process will necessarily differ across countries. For example, some countries are already more or less balanced, with domestic demand already contributing heavily to growth, so the need for rebalancing is limited. On the other hand, other countries suffer from much larger imbalances with more serious implications for sustainable growth. In addition to the size of the current account imbalance, its persistence also matters. Countries with more persistent imbalances face a more urgent need to rebalance their economies than countries experiencing temporary imbalances. Furthermore, in some countries the current account surplus may be the result of oversaving or underconsumption, but in others it may reflect underinvestment. The appropriate remedy for rebalancing will differ according to the source of the imbalance. Countries suffering from oversaving will need to create an environment of reduced uncertainty and risk that encourages households to consume more. On the other hand, countries suffering from underinvestment will need to create a better investment climate
that induces firm to invest in future productive capacity. Different Asian economies thus face different challenges in terms of rebalancing their economies, hence it can be reasonably expected that the role of fiscal policy in the rebalancing process will differ across the region.

Figure 1: Average Current Account Balance as a Percentage of GDP, 2000–2008, Selected Developing Asian Countries (percent)

![Graph showing average current account balance as a percentage of GDP for selected Asian countries.]

GDP = gross domestic product; PRC = People’s Republic of China; HKG = Hong Kong, China; IND = India; INO = Indonesia; KOR = Republic of Korea; MAL = Malaysia; PHI = Philippines; SIN = Singapore; TAP = Taipei, China; THA = Thailand; VIE = Viet Nam.

Source: ADB’s Asian Development Outlook database.

A. People’s Republic of China

Among the major Asian economies, the PRC faces the greatest need for rebalancing if it is to sustain its remarkably rapid growth into the postcrisis period. Although many countries in the region contribute to the region’s current account surplus vis-à-vis the rest of the world, the PRC’s large and growing surplus has attracted the bulk of global attention. Partly this is due to the sheer size and very rapid growth of the economy, which means that the absolute size of the surplus may be large even if the relative (to GDP) surplus is not exceptionally large. In fact, the relative surplus has grown rapidly since 2003, tripling from around 3% to more than 9% (Figure 2). The underlying cause of imbalance in the PRC is clear: a saving–investment gap caused primarily by a sharp surge in the saving rate (Figure 3). Although investment rates have also grown over time, saving rates have grown even faster, leading to a large and growing gap.
In principle, the savings–investment gap that underlies a current surplus can reflect either underinvestment, oversaving, or both. The balance of evidence indicates that in the case of the PRC, the surplus is overwhelmingly driven by oversaving. In terms of investment, if anything, the bigger risk for the PRC is overinvestment rather than underinvestment. In terms of saving, the PRC’s saving rate far exceeds the levels predicted by fundamental economic determinants of saving (Figure 4). In particular, the PRC’s saving rate is astonishingly high for its per capita income level. This implies substantial underconsumption, and hence potentially large welfare losses for a country that is still poor. A number of factors account for low consumption levels, including
high precautionary savings, falling wages, poor redistributive mechanisms, shortages of affordable housing, and limited access to financial services. In addition, a significant part of the PRC’s savings are corporate savings, especially savings by state-owned enterprises, rather than household savings.

**Figure 4: The PRC’s Actual Saving Rate and Fitted Value, 1965–2008**

![Graph showing actual saving rate and fitted value](image)


Reallocating public spending from investment to health care, education, pensions, social protection, and social safety nets would mitigate the risk and uncertainty confronting households in the PRC and encourage them to spend more. To some extent, the provision of public goods would substitute for and thus crowd out the consumption of private goods, i.e., public health care for private health care. However, the reduction in the overall risk and uncertainty level that would result from the government taking a more active role in providing social insurance can dampen the need for precautionary saving. Increased social spending is preferable to tax cuts as a means of promoting consumption. Given the small number of income taxpayers in the PRC, tax cuts will only have a limited effect on overall consumption and domestic demand. An important additional mechanism for boosting consumption is to institute corporate governance reforms, in particular dividend policy for state-owned enterprises, which would transfer more of corporate profits to households and thus improve their purchasing power.

Among specific consumption goods, housing deserves particular attention, since it is the major driver of private consumption in the PRC. However, the high cost of borrowing and the short maturity term of mortgages, compounded by escalating real estate prices, have
resulted into a shortage of affordable housing. This weakens consumption and domestic demand. Land supply and its use are major constraints on the development of affordable housing because land in the PRC is owned by the state, and developers purchase land-use rights from local governments on a leasehold basis. Under this framework, local governments have vested interests in keeping prices high as land-related transactions are a major source of their revenue. It is also challenging to attract private developers in the less profitable business of affordable housing due to stringent restrictions on profits. The incentive system is such that developers gravitate toward more profitable larger, less affordable housing.

In this context, fiscal policy can play a key role in both the supply and demand side of housing. A wide range of fiscal subsidies and incentives could be introduced to attract the participation of the private sector in low-income housing. These include capital grants, tax incentives, priority access to land, state guarantees for loans, and public mortgages for developers. Consumers would benefit from tax exemptions, cash subsidies or housing allowances, and capital grants. In addition, the provision of state guarantees and/or public mortgages would help overcome credit rationing, making housing financing available to a larger segment of the population. From the fiscal sustainability point of view, the introduction of a progressive property tax of about 102% of the assessed property value would provide local governments with a stable source of income to offset expected reductions in revenue from land-related transactions stemming from less lucrative housing construction.

Aside from the housing market, supply-side fiscal action can contribute toward rebalancing the PRC’s economy at a more general level. In particular, there is some scope for fiscal policy to encourage a shift away from manufacturing, especially export-oriented manufacturing, toward the services industries that cater primarily to domestic demand. There is ample room for expansion as the sector is relatively small, with services accounting for only 42.9% of GDP and 34.8% of total employment in 2008. The relative underdevelopment of services is a direct consequence of the growth model the PRC has adopted. The model has favored manufacturing, especially export-oriented manufacturing. More specifically, fiscal incentives have channeled investment into the production of goods, while value-added tax and other tax exemptions and rebates benefit exports of goods. Removing such pro-manufacturing and antiservices fiscal discrimination will help promote the emergence of a more vibrant services sector. This, in turn, would reduce the structural mismatch between output and demand.

B. Republic of Korea

The Republic of Korea’s current account position is fundamentally different from that of the PRC, in that the Republic of Korea has not experienced large and persistent surpluses. In fact, its current account position has been more balanced, and has averaged 1.4% during 2000–2008 (Figure 5). However, despite the lack of large external
imbalances, the economy was hit hard by the global financial crisis. The negative impact climaxed during the 4th quarter of 2008, when GDP contracted by 5.6% quarter-on-quarter. The Korean economy has staged a fast and furious recovery since the 2nd half of 2009 but the meltdown highlighted its high degree of vulnerability to external shocks. An important lesson from the Korean experience is that the need for rebalancing is not only limited to countries with large and persistent current account surplus, but also extends to countries with balanced external positions.

**Figure 5: The Republic of Korea’s Current Account Balance as a Percentage of GDP, 2000–2008**


The Republic of Korea’s vulnerability was primarily due to its disproportionate dependence on export-oriented manufacturing. The single most plausible explanation for the collapse in the 4th quarter 2008 is the disproportionate dependence of the Korean economy on exports, or more precisely, trade sectors. This line of explanation is best exemplified by Sommer (2009), who established a strong negative relationship between the portion of high-tech manufacturing industries in GDP (a proxy for export dependence) and the 4th quarter 2008 growth rate, and provided a straightforward but plausible interpretation. Figure 6 reproduces the negative relationship of Sommer except that the high-tech manufacturing industries are substituted by the whole manufacturing sector. It is clear that the Republic of Korea and other Asian countries that relied the most on manufacturing sectors were the most severely hit by the global crisis in 4th quarter 2008.
The definition of rebalancing primarily as a shift of aggregate demand from exports to domestic makes much more sense for the PRC rather than for the Republic of Korea. The underlying logic is to increase domestic demand to offset a potentially long-term decrease in demand from the US. However, the same logic is much less valid for the Republic of Korea, which has a balanced current account. Any large and persistent increase in domestic demand, unless accompanied by a parallel increase in export, implies a large and persistent current account deficit. The aggregate saving rate of the Republic of Korea has also been falling since the Asian crisis, as bank credits became more accessible to consumers (Figure 7). More specifically, the net saving rate of Korean households has declined very rapidly from around 20% before the crisis to around 3% in 2007. In fact, the current saving rate of the Korean household is so low that many economists are worried about its negative implications for financial stability and future growth.
In the Republic of Korea, rebalancing refers primarily to a supply-side shift in the composition of output from manufacturing to services. That is, in order to rebalance its economy, it needs to boost the services sector rather than the manufacturing sector. Though this policy recommendation appears to be similar to the earlier one from the demand side because most services are spent domestically, its implications are totally different. First, it does not have any implication for current account sustainability, while recognizing that the economy relies heavily on manufacturing for exports. Second, while strengthening domestic demand partly involves expansionary macroeconomic policies, boosting the services sector centers on productivity-enhancing microeconomic policies. The country’s productivity growth in the services sector relative to the manufacturing sector was the second lowest among countries of the Organisation for Economic Co-operation and Development (OECD 2004). This was largely attributed to regulations that hampered productivity in the services sector, such as entry and exit barriers, mandatory licensing, and policy discriminations in favor of manufacturing.

The implication for fiscal policy is that pro-manufacturing, antiservices fiscal discrimination, and distortion should be removed. The Republic of Korea has had a tradition of active industrial policy that promoted export-oriented manufacturing as the country’s engine of growth. Such a state-led growth model served the country well as it leveraged its manufacturing-oriented industrialization to transform itself from a typical poor country to one of the world’s 15 biggest economies. However, a legacy of this model seems to be a services sector that is underdeveloped and inefficient relative to the manufacturing sector. To the extent that legacy fiscal incentives favoring manufacturing over services still remain, these should be removed. But much more than that, given the need for rebalancing and the central role of a vibrant services sector in the rebalancing
process, it may be worthwhile to consider more proactive fiscal measures for enhancing productivity in the services sector, such as tax breaks for research and development in services industries, as well as fiscal incentives that boost the services industries in general. Such fiscal measures in support of the services sector will help reverse the negative legacy effects of the Republic of Korea’s past industrial policy on the sector. Those measures should be undertaken with other measures particularly regulatory reform for greater impact, rather than pursued in isolation.

C. Philippines

Unlike the PRC and similar to the Republic of Korea, the Philippines’s current account position is more or less balanced (Figure 8). Consumption already plays a big role in demand and growth, and underconsumption has never been a policy concern. If anything, many economists have voiced concerns that the country may be consuming too much and saving too little. Consumption has been driven to a large extent by remittances from the millions of Filipino overseas workers. One primary channel of transmission that spread the global crisis to the Philippines was remittances, which suffered adversely from the crisis and hence affected consumption. Nevertheless, relative to higher-income Southeast Asian economies like Malaysia and Thailand, as well as the newly industrializing economies, the Philippines was less severely affected by the crisis. To some extent, this reflects the country’s low level of export dependence and its more limited success in export-oriented industrialization relative to its neighbors. But it also reflects the larger role of domestic demand in the Philippines’s growth.

**Figure 8: Philippines’s Current Account Balance as a Percentage of GDP, 2000–2008**

![Bar chart showing Philippines's current account balance from 2000 to 2008.]


If rebalancing is to be defined more broadly as achieving a more dynamic and robust domestic economy, rebalancing in the case of the Philippines would mean strengthening
investment. Healthy domestic demand cannot be sustained by domestic consumption but requires vibrant investment that augments long-run productive capacity. In fact, a relatively low rate of investment is a key reason why the Philippines has underperformed relative to its East and Southeast Asian neighbors in the past. More worrisome, the investment rate has declined even further in recent years (Figure 9). In contrast to the PRC, which suffers from underconsumption, the Philippines suffers from underinvestment. The Philippines’s investment rate has recently fallen below the levels predicted by fundamental economic determinants of investment (Figure 10). The weakness of investment is somewhat puzzling because the Philippines is a capital-deficient, low-income country that, in principle, should offer plenty of investment opportunities with high returns to capital.

**Figure 9: Philippines's Investment Rate, 1965–2008**

![Graph showing the Philippines's investment rate from 1965 to 2008](image)


Much of the puzzle goes away if the Philippines’s chronically poor investment climate is taken into account. The investment climate is a complex and multidimensional metric that encompasses a wide range of factors, including the ease of starting a new business, access to capital, macroeconomic stability, government effectiveness, rule of law, regulatory quality, labor market rigidity, infrastructure, and so forth. Improving the Philippines’s poor overall investment will therefore require a constellation of policies, and fiscal policies cannot do it alone. Nevertheless, there are many ways in which appropriate fiscal measures can help to create a more conducive business for both domestic and foreign investors. In particular, given that poor infrastructure—evident in, for example, erratic energy supply and inadequate water supply—is a major deterrent to private investment in the Philippines, more public spending on infrastructure can help ease infrastructure bottlenecks and attract more investment. However, even though fiscal deficits have been manageable in recent years, averaging around 3% of GDP in 2000–2008, less responsible fiscal policy in the past has left the Philippines with less fiscal space, i.e., the public debt to GDP ratio is higher, compared to most of the other
major economies in the region (Figure 11). Therefore, improving public governance so as to allocate scarce resources more efficiently takes on an added significance if some of those resources are to be used for strengthening the investment climate.

**Figure 10: The Philippines’s Actual Investment Rate and Fitted Value, 1965–2008**

![Graph showing the Philippines's Actual Investment Rate and Fitted Value, 1965–2008](image)

- **Fitted Value**
- **Actual Investment Rate**


**Source:** Park and Shin (2009).

**Figure 11: Average Annual Government Debt-to-GDP Ratios, 2004–2008, Selected Developing Asian Countries**

![Bar chart showing average annual government debt-to-GDP ratios](image)

- **PRC** = People’s Republic of China; **IND** = India; **INO** = Indonesia; **KOR** = Republic of Korea; **MAL** = Malaysia; **PHI** = Philippines; **TAP** = Taipei, China; **THA** = Thailand.

**Source:** CEIC Data Company, Ltd.
D. Singapore

Like the PRC, and unlike the Republic of Korea and the Philippines, Singapore has large and persistent current account surpluses. In fact, while the PRC’s current account surplus is a relatively recent phenomenon that took off only from around 2003, Singapore has experienced a surplus for a much longer period. Singapore has one of the largest relative (to GDP) and most persistent surpluses in the world. Its surplus averaged a staggering 18.4% of GDP during 2000–2008 (Figure 12). Besides differences in relative magnitude and persistence, there are also structural differences between the external surplus of the PRC and Singapore. The PRC’s surplus is abnormal in the sense that it implies a fast growing but still poor country exporting vast amounts of capital to much richer countries. On the other hand, Singapore is a mature high-income country that, economic theory tells us, should be exporting capital. Another structural difference between the PRC and Singapore is that services accounted for 74.4% in 2008 so that the scope for supply-side rebalancing is limited. One way to explain Singapore’s exceptional current account position is that it is an exceptionally productive city-state that sells much of its output abroad given the small size of its domestic market.

Figure 12: Singapore’s Current Account Surplus as a Percentage of GDP, 2000–2008

Source: ADB’s Asian Development Outlook database.

In Singapore, the savings–investment gap underlying the current account surplus is driven by an extraordinarily high saving rate. Although Singapore’s investment rate is itself remarkably high by international standards, especially for a city-state, it has been surpassed by an even higher saving rate. Between 1965 and 2008, the investment rate averaged around 43%, but the saving rate averaged around 49%. On top of that, the savings–investment gap has grown over time; whereas the investment rate has declined since peaking in the early 1980s, the saving rate has risen more or less continuously since 1965 (Figure 13). An important contributor to the high saving rate is a chronically
high fiscal surplus. Singapore’s saving rate exceeds the levels predicted by fundamental economic determinants of saving (Figure 14). The Government of Singapore is one of the few governments in the world that runs a sizable budget surplus year after year. For example, between 2004 and 2008, the fiscal surplus averaged almost 8% of GDP.

**Figure 13: Singapore’s Saving Rate, 1965–2008**

![Graph showing Singapore's saving rate from 1965 to 2008.](source: Park and Shin (2009).)

**Figure 14: Singapore’s Actual Saving Rate and Fitted Value, 1965–2005**

![Graph showing Singapore's actual saving rate and fitted value from 1965 to 2005.](source: Park and Shin (2009).)


For Singapore, the need for rebalancing is driven by rapid population aging due to its low fertility rate (only 1.28 in 2008) and increased longevity. Its population aged above 65 years, as projected by the United Nations, will increase from 0.46 million in 2010 to 1.41 million in 2030, an increase of 207% in just 2 decades. The population of 80+ years will rise even faster from 88,000 in 2010 to 291,000 in 2030. Population aging requires a shift from saving to consumption, since individuals save when they are younger and run down their savings when they are older. Rapid population aging requires that society set aside more resources to the elderly if longevity, inflation, and survivor risks are to be effectively addressed. Rising longevity also increases the demand for health care since older individuals consume more health care. Singaporeans rely on a mandatory savings scheme administered by the Central Provident Fund (CPF) to finance their retirement. The CPF is characterized by a heavy tilt toward individual risk taking and almost complete absence of social risk pooling under which society pools together the risks of all individual members and bears the risks on their behalf. A major problem in terms of financing retirement for the large prospective army of retirees is its low replacement rate, i.e., it fails to provide for adequate old-age income. Estimates suggest that the net real rate of return during 1987–2008 was a meager 1.2%, considerably lower than the growth of real GDP and real wages (Figure 15).

Figure 15: Real Rate of Return on Singapore’s CPF Balances, 1987–2008

A key quasi-fiscal measure widely suggested for improving the ability of CPF to deliver old-age income support is to end the implicit tax on CPF wealth. The real rate of return credited to members has been considerably lower than the investment returns on them, which are in effect invested by the Government of Singapore Investment Corporation, one of the city-state’s two sovereign wealth funds (Asher and Nandy 2009). Ending
the implicit tax will have the significant additional benefit of increasing the share of labor income in GDP, which is relatively low at about 45% of GDP. Indeed one of the structural characteristics of the Singapore economy that militate against a stronger domestic consumption is the low share of labor income in GDP relative to the share of capital (see Figure 16). The second major avenue for fiscal policy to contribute to the rebalancing process is by expanding social sector expenditures. Relative to countries at similar high-income levels, Singapore’s spending on social protection and social safety nets is exceptionally low. In particular, there is a strong case for social pensions that are financed from the budget. This would introduce social risk pooling, rather than relying on the individual risk-bearing CPF Scheme.

Figure 16: Share of Labor and Capital Income in GDP, Singapore, 2003–2008

GDP = gross domestic product.
Note: The total may not add up to 100 because of taxes on production and on imports and statistical discrepancies.
Sources: Calculated from Department of Statistics’ Singapore Yearbook of Statistics and Ministry of Trade & Industry’s Economic Survey of Singapore.

Singapore has ample fiscal space to undertake the fiscal measures required for rebalancing. In this sense, its fiscal policy is uniquely well positioned to contribute to the rebalancing process. Given the persistent budget surpluses, a large stock of accumulated budget surpluses is being controlled by the government. Indeed the Singapore government is an exceptionally wealthy government in light of the vast amounts of assets it controls. Greater outlays for the social sector, in particular outlays toward strengthening old-age economic security, would bring Singapore closer to the industrialized-country norms of social risk pooling. Finally, in the unique case of Singapore where the government contributes substantially to external imbalances through its own large and persistent budget surplus, a smaller surplus would in and of itself directly contribute to the rebalancing process.
IV. Concluding Observations

To some extent, developing Asia's very rapid growth in the immediate precrisis period was driven by rapid growth of exports to the EU and the US. The prospective unwinding of global imbalances, which would entail a reduction of the US current account deficit, means that exports to the US are likely to become less important as a source of growth. Furthermore, the fragility and uncertainty of recovery in the EU and Japan means that exports to industrialized countries as a whole can no longer drive the region’s growth to the same extent that they did in the precrisis period. Therefore, one of the biggest, if not the biggest, strategic challenge facing developing Asia’s economic policymakers in the postcrisis period is the rebalancing of their economies toward a better balance between domestic and external demand, as well as a better balance between export production and domestic production. In principle, fiscal policy can promote rebalancing by helping to remove the structural impediments and distortions that stand in the way of robust domestic demand and a more balanced output mix. The central objective of this paper has been to assess the potential contribution of fiscal policy to the rebalancing process in developing Asia by analyzing country experiences. Two main policy implications emerge from the analysis.

First, the examination of the experiences of four very different countries across the region, the PRC, the Republic of Korea, the Philippines, and Singapore, makes it abundantly clear that there are a wide range of fiscal measures that Asian governments can undertake to promote rebalancing. Some of those fiscal measures are demand-side measures geared toward strengthening domestic consumption and investment. For example, higher spending on health, education, pensions, and social protection will mitigate the need for precautionary savings and encourage households to spend more out of their disposable income. Likewise, more public spending on infrastructure such as ports, roads, and power plants can catalyze private investment. At the same time, there are also a large number of supply-side fiscal measures that can help bring about an output structure that is less dependent on exports and geared more toward domestic demand. In particular, removing fiscal distortions that favor export-oriented manufacturing over domestic demand-oriented services can stimulate a reallocation of resources toward the service sector.

Second, another clear policy implication from country-specific experiences is that the most appropriate and effective fiscal measures for rebalancing will vary widely across countries, and will be determined by the nature of each country’s rebalancing process. Although the global crisis has clearly highlighted the need for the region as a whole to rebalance, the need for rebalancing is greater for some countries than others. More fundamentally, the region’s countries differ a lot with respect to exactly what they need to rebalance their economies. For example, whereas the PRC should use fiscal policy primarily to strengthen domestic demand, especially consumption, the Republic of Korea should use fiscal policy to promote a better balance between manufacturing and
services. In the Philippines, fiscal policy must tackle the poor investment climate. Finally, in Singapore, the focus of fiscal policies on rebalancing must be to stimulate consumption by addressing the needs of the growing elderly population. In short, the appropriate fiscal policy differs across countries for the simple reason that rebalancing means different things to different countries.

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About the Paper
Donghyun Park explores the role of fiscal policy in rebalancing growth toward domestic demand in developing Asia. In this context, he examines the potential contribution of fiscal policy to rebalancing in the People's Republic of China, the Republic of Korea, the Philippines, and Singapore. He finds that what matters the most for rebalancing are specific fiscal measures tailored to each country’s unique circumstances.

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