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The export trap

Asia's failing export-led growth model

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JAPAN developed rapidly after American gunboats opened it to trade in the late 19th century. Within 40 years, Emperor Meiji led his once-feudal country into the modern world economically (and, alas, militarily). To do so, the state bought Western technology such as factory machines, railroads and telegraph lines. But until the turn of the 20th century it did so by eschewing foreign loans, which were equated with a loss of sovereignty.

How did a poor country like Japan obtain the foreign currency to pay for such products? The answer was exports: first, of light industrial goods such as raw silk and pottery; later, of heavier materials, including steel and chemicals. It was a huge success. In the 1860s Japan's small-scale cotton-textile industry was nearly decimated by European imports. By 1914, however, after buying automated cotton spinners, the country sold half of its yarn production abroad, which accounted for one-quarter of the world's cotton yarn exports.

Bloomberg Static model

Thus the “Asian model” of export-led growth was born. The region was inspired by Japan's lead before the second world war and its economic resurrection afterward. In the 1960s Asia's four “tiger economies” (Singapore, Hong Kong, Taiwan and South Korea) imitated Japan and flourished. South Korea's bureaucrats, for example, protected domestic firms and funneled them cheap loans under the condition that they exported their wares.

China also boomed after opening its economy in 1978. Its “special economic zones” were designed to attract foreign capital—initially from Chinese businessmen in Hong Kong and Taiwan—to build factories for export production. Malaysia, Thailand, Indonesia and later Vietnam all forged similar export-led paths to growth.

The success speaks for itself. Globalisation brought much of Asia out of extreme poverty. The per capita income of people in the tiger economies rivaled those of Europeans. Meanwhile, the countries that resisted the call, such as Myanmar and North Korea, remained poor. Purists argue against such thing as an “Asian model” since the region's development is diverse: Hong Kong enjoyed a raucously free economy; Singapore a tightly controlled one. But all relied, to greater or lesser degrees, on exports.

The West encouraged this. “Special efforts must be made in many countries to turn their manufacturing enterprises away from the relatively small markets associated with import substitution toward the much larger opportunities flowing from export promotion,” instructed the then-president of the World Bank, Robert McNamara, in 1975.

Now, however, Asia's sails have become anchors; the emphasis on exports is amplifying the effects of the downturn. Over the past decade, emerging Asia's exports as a share of its GDP grew from 37% to 47%. There is a wide variance. Singapore's exports hit 186% of GDP in 2007, while Indonesia's were less than 30%.

To be sure, the figures do not tell the whole story. Countries that import many intermediate goods for processing and re-export skew the percentages. Still, it is clear that exports count for a lot. And their importance has increased. Even in Japan, which is less reliant on exports, their influence has grown. Exports as a percent of GDP increased by half during its most recent recovery, from 10% in 2002 to as high as 16% in 2007.

In Vietnam last week, at a government roundtable sponsored by the Economist Intelligence Unit, the country recommitted to an export-led economy. And who can blame them? It works. The model is not inherently flawed, but it is only a part of the answer to establishing a sustainable economy. The problem is that the lucre obtained through exports tempted governments to put off other areas of the economy, such as freeing domestic sectors and encouraging domestic demand.

As long as incomes increased, this was fine; both governments and people were content to ignore things like social services and good governance. The export model helped countries improve their living standards quickly. But what happens next?

And the model is hard to unwind. Doing so would entail diffusing rather than concentrating wealth and political power, which is something that today's elites, the chief beneficiaries of the Asia model, are loath to accept.

After Asia's financial crisis of 1997-98, countries in the region boosted their foreign reserves, which today provides a cushion. China saw its piggybank grow from around $150 billion a decade ago to nearly $2 trillion today. Japan also has the luxury of being rich. Its foreign reserves glisten at around $1 trillion; households sit on some $15 trillion in assets, half held in cash and bank deposits. But Japan, having been the first to develop, is an outlier: it should have developed other sources of growth long ago.

Ultimately, Asian economies themselves were pumped up along with assets like American houses and shares during the credit bubble of the past decade. Now the model is not deflating, but

vanishing: once profligate American consumers are saving instead of spending. Asia needs a new model—but has yet to admit this.