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# The End of Export-led Growth: Implications for Emerging Markets and the Global Economy*

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## 1. Summary

For the past three decades emerging market (EM) economies have relied heavily on export-led growth as a driver of their development. Now, as the global economy struggles to escape the trauma of the Great Recession, many EM economies are hoping for a resumption of that pattern. That hope stands to be disappointed, however, because the conditions that supported export-led growth are exhausted.

The global economy is now characterized by a structural shortage of demand and intense competition between EM economies. In such an environment, export-led growth cannot work for EM economies as a whole. The solution is to shift to domestic demand-led growth but there are major political obstacles that make such a shift unlikely.

## 2. The Current and Future State of the Global Economy

The global economy is still struggling in the wake of the financial crash of 2008 and the Great Recession. The new overarching condition is one of global demand shortage. In the US, early talk of a V- or U-shaped recovery has given way to talk of an L-shaped future, where L stands for long stagnation. The principal problems are a debt-saturated household sector and extreme income inequality. Europe also faces a future of stagnation once the temporary stimulus of the post-crash recovery in international trade fades and permanent fiscal austerity bites. Likewise, Japan is confronted by stagnation because of the strong yen and structurally weak domestic demand conditions that have prevailed for almost twenty years.

One area of strength in the global economy has been EM economies. Given their export-led orientation these economies benefitted significantly from the recovery of trade that began in the second half of 2009. They have also benefitted from the interest rate compression the crisis has produced, with EM economies being re-rated upward, while developed economies have been re-rated downward. Lastly, many EM economies have benefitted from high commodity prices that have bounced back with trade. Commodity prices also now embed a speculative "inflation hedge" component owing to the easy money/low interest rate policies adopted to fight the recession.

The relatively strong conditions in EM economies have encouraged hopes that they can grow rapidly even

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if the developed economies stagnate, and that the EM economies might even act a global locomotive which pulls the developed economies. Were this to happen, it would mark a historic role reversal.

As shown in Table 1, the EM and developing economies (identified as the non-OECD economies) have been steadily increasing their share of global GDP and now constitute approximately 50 percent of global economy.[1] However, despite this increased size there are two fundamental structural reasons why the EM economies will not be able to drive the global economy.

First, they remain heavily dependent on the industrialized economies to provide demand for their exports. This is illustrated in Table 2 which shows the OECD's current account deficit and industrialized Asia's current account surplus.[2] The former's deficit is significantly the result of the latter's surplus.

Second, because of their increased size and continued reliance on exports, the EM economies risk undermining economic recovery in the industrialized economies. Evidence to this effect has emerged in the US, and Table 3 shows how the increased US trade deficit has lowered quarterly GDP growth since the recession ended in June 2009. In effect, the EM economies are locked in a structural trap whereby they depend significantly for growth on the developed economies, but their growth undermines the developed economies.

**Table 1: The changing composition of global GDP based on PPP (billions of current dollars)**

| | 1980 | 1990 | 2000 | 2008 |
|---|---|---|---|---|
| World | $ 12,961b | $ 26,988b | $ 45,205b | $ 77,109b |
| Advanced economies | 7,896 (60.9%) | 16,242 (60.2%) | 26,071 (57.7%) | 37,900 (49.2%) |
| EM & dev. countries | 5,064 (39.1%) | 10,746 (39.8%) | 19,133 (42.3%) | 39,210 (50.8%) |

Source: International Monetary Fund, World Economic Outlook Database, October 2007 and author's calculations.

**Table 2: Current account balances of the OECD and industrialized Asia ($ billions)**

| | 1995 | 2000 | 2005 | 2008 |
|---|---|---|---|---|
| OECD | $ 26 | -340 | -512 | -702 |
| Industrialized Asia | -$ 26 | 68 | 231 | 516 |

Source: OECD Economic Outlook 87 database and author's calculations.

1 Table 1 actually understates the EM and developing economy share of global GDP. That is because the OECD includes South Korea, Mexico and Turkey which have historically all been identified as EM economies.

2 Industrialized Asia consists of the following countries and regions: China, Taiwan, Hong Kong, Malaysia, the Philippines, Singapore, Vietnam, Thailand, India, and Indonesia.

**Table 3: Contribution of US net exports to percentage change in real gross domestic product**

| 2009, Jul.-Sept. | 2009, Oct.-Dec. | 2010, Jan.-Mar. | 2010, Apr.-Jun. | 2010, Jul.-Sept. |
|---|---|---|---|---|
| -1.37 % | 1.90 | -0.31 | -3.50 | -1.76 |

Source: US Bureau of Labor Statistics.

Putting the pieces together, the prognosis is stagnation. The current export success of EM economies is aggravating economic weakness in the developed economies. This weakness in turn stands to undermine the EM economies because of their continued export dependence, and when that happens many of the current strengths of the EM economies will disappear. The post-crash bounce in international trade is likely to prove temporary, while the realization of the prospect of stagnation will take the "inflation premium" out of commodity prices.

Globalization has diversified global economic activity. Consequently, it is no longer possible for a single country or region to act as the lone locomotive of global growth. A diversified global economy requires that all regions have to pull together, and that calls for a new structure in which EM and developed economies pull each other.

### 3. Export-led Growth Revisited

Export-led growth is a critical part of the global economy's problem. The past thirty years have seen the spread of the export-led growth strategy which was pioneered by Germany and Japan in 1950s and 1960s. In the 1970s and 1980s the strategy was adopted by the four East Asian Tigers (South Korea, Taiwan, Hong Kong, and Singapore), and in the late 1980s and 1990s it spread further to Mexico in Central America, and Thailand, Malaysia, and Indonesia in South East Asia. In the 2000s the strategy has been adopted by China.

The export-led growth strategy has not been constant but has evolved to fit changing global circumstances and individual country conditions. This evolution has involved four stages. Stage I was kicked off by Germany and Japan and ran from 1945 to 1970. These countries had their own indigenous industrial base and growth was spurred by an undervalued exchange rate. They also benefitted from post-World War II reconstruction, and from US aid made available after World War II as part of reconstruction and fighting the Cold War.

Stage II involved South Korea, Taiwan, Hong Kong, and Singapore and ran from 1970 to 1985. The four East Asian Tigers also relied on an undervalued exchange rate but they had to engage in more foreign technology acquisition. This was done via strategic planning, and the Tigers also benefitted from the fact that technology was becoming more mobile internationally. Their success encouraged countries such as Indonesia, Malaysia, and Thailand to try to emulate them.

Stage III was launched by Mexico and covers the period 1985 to 2000. It marks a fundamental break with the two earlier stages. Now, instead of developing their own indigenous industrial capacity, countries have aimed to turn themselves into export production platforms for foreign multinationals. This change in strategy was driven by the increased mobility of technology and capital. The key elements of the strategy were integration in the global economy, an undervalued exchange rate, and suppression of wages and social standards. Together, these elements enhance international competitiveness, thereby making a country attractive to multinational corporations (MNCs) as a site for export-oriented foreign direct investment (FDI).

In Mexico the turn to export-led growth began with the trade liberalization of 1986. That established the path to NAFTA which created a North American free trade area in 1994. NAFTA's inauguration was accompanied by the peso crisis of 1994 that resulted in massive devaluation of the peso vis-à-vis the US dollar, thereby undervaluing the Mexican exchange rate and repeating a theme common to all stages of export-led growth.

Stage IV represents the current stage and is exemplified by China's economic growth strategy. In terms of timeline, it can be dated as beginning in 2000 with the US grant of permanent normal trading relations (PNTR) status to China. China's stage IV model involves some

significant adjustments relative to Mexico's stage III model. First, it is characterized by asymmetric global engagement with higher tariffs on imports. Second, China has pursued a managed exchange rate undervaluation maintained with capital controls. Third, unlike Mexico, China has actively sought to build its own indigenous technological base via forced technology sharing, technology copying, and joint ventures in which MNCs may be minority shareholders. The banking and auto industries provide prime examples of this. Furthermore, MNCs have also changed their strategy and are now willing to license and source from foreign producers rather than own facilities. Overall, China has done well under stage IV of export-led growth but other countries (such as Mexico and Indonesia) have seen decreasing and more fleeting benefits. That is because export-led growth always had a zero-sum dimension and that dimension has become increasingly prominent as the export-led strategy has evolved through stages III and IV.

## 4. The End of Export-led Growth

The increasing zero-sum nature of export-led growth, combined with other changes in the global economy, suggests that the possibility of global development via export-led growth is now exhausted.

A first problem for the export-led growth model is that it has relied on robust consumer markets in developed economies to buy exports. For the past twenty-five years consumer spending in developed economies has been artificially strong, fuelled by rising debt and asset price inflation. This artificial strength is captured in Table 4 which shows how consumption spending rose from 64.5 percent of US real GDP in 1980 to 70.3 percent in 2007. This pattern of high and rising consumption and low and falling saving was always destined to prove unsustainable and has now reversed, creating a hole in the logic of the export-led model which is now confronted by demand shortage.

A second problem is that EM economies have become such a large share of the global economy that their exports are undermining the industrialized economies and sabotaging the latter's recovery. As their share of global output increases (see Table 1) EM economies must increase their exports even more to drive their larger economies, but those larger exports have an even more negative effect on developed economies whose share of global output has fallen.

A third problem is that of export crowding out (Palley, 2003; Blecker and Razmi, 2010). Table 5 shows how non-OECD countries, which roughly correspond to EM and developing countries, have increased their share of global trade.[3] The problem now is that as EM economies try to further increase their exports they crowd out the exports of rival EM economies.

A fourth problem is that the export-led strategy is contributing to a declining price of manufactured goods because it has been so widely adopted (Sarkar and

**Table 4: US consumption spending as a percentage of GDP by business cycle peak (billions of chained [2005] dollars and percent)**

| | 1980 | 1981 | 1991 | 2001 | 2007 |
|---|---|---|---|---|---|
| Consumption | $ 3,766 | 3,823 | 5,316 | 7,814 | 9,314 |
| GDP | $ 5,839 | 5,987 | 8,034 | 11,347 | 13,254 |
| Con/GDP (%) | 64.5 % | 63.9 | 66.2 | 68.9 | 70.3 |

Source: Economic Report of the President 2010, Table B-2 and author's calculations.

3 The OECD includes Mexico, South Korea, and Turkey. These countries are EM economies and if they were reclassified as non-OECD, the trade share of non-OECD countries would be even larger.

**Table 5: The changing composition of world trade (%)**

| | | 1995 | 2000 | 2005 | 2008 |
|---|---|---|---|---|---|
| Exports | OECD | 74.9 % | 72.2 | 66.9 | 63.6 |
| | Non-OECD | 25.1 % | 27.8 | 33.1 | 36.4 |
| Imports | OECD | 73.8 % | 75.0 | 71.1 | 66.8 |
| | Non-OECD | 26.2 % | 25.0 | 28.9 | 33.2 |

Source: OECD Economic Outlook 87 database, June 2010.

Singer, 1991; Kaplinsky, 1993; Sapsford and Singer, 1998). In effect, the strategy has created an analogue of the Prebisch (1950)–Singer (1950) declining terms of trade problem that afflicted commodity producing developing countries one hundred years ago. In the earlier era rapid productivity growth in commodity production combined with increased efficiency in commodity use to create adverse demand and supply trends that lowered the relative price of commodities to the detriment of developing countries. A similar pattern is now being repeated in the production of manufacturing goods.

A fifth problem is the increased ability of MNCs to shift production between countries at low cost. This has placed EM economies in competition with each other to attract and retain FDI, creating a disastrous "race to the bottom" in which countries undermine each other through their attempts to gain competitive advantage (Palley, 2004). This race to the bottom operates via wage suppression; suppression of environmental and social standards; shifting of tax burdens onto labor income away from capital income; creation of extra-judicial export processing zones; and competitive devaluations that create financial instability. This destructive competition undermines development and benefits MNCs rather than countries.

A sixth and final problem with export-led growth is its adoption by China which has been siphoning FDI and export demand away from other emerging market economies, thereby undermining their industrialization. This is because China has the advantage of a massive low wage labor force. On top of this, there is the additional attraction of the prospect of producing for China's potentially massive domestic market. In effect, China's entrance on the global stage has introduced intense South–South competition to accompany North–South competition. This explains why the benefits of stage III export-led growth have been so limited and fleeting for countries such as Mexico.

## 5. Beyond Export-led Growth: Domestic Demand-led Growth

The above arguments make a compelling case regarding the exhaustion of export-led growth as a development strategy, which points to the need to shift to a domestic demand-led growth strategy (Palley, 2002, 2006). This does not mean the abandonment of exporting as countries will always need to export to pay for needed imported goods that they do not produce. However, it does mean building up the domestic demand side of the economy and abandoning the strategies aimed at attracting export-oriented FDI.

The elements of a domestic demand-led strategy are clear:

- Establish social safety nets that diminish the need for precautionary saving.
- Raise wages by implementing minimum wages, improved labor protection, and increased collective bargaining via unions.
- Increase public infrastructure investment and address the backlog of public investment opportunities resulting from past neglect.
- Increase the provision of public goods, such as health care and education.

- Rebalance the tax structure by increasing taxes on higher income groups and lowering them on lower income groups.

Side-by-side with instituting a domestic demand-led growth strategy countries must abandon export-led growth which means:

- Ending undervalued exchange rates.
- Ending policies of wage suppression.
- Reversing neglect of environmental and social standards.
- Ending incentives to attract export-oriented FDI.

Although it is clear what policies are needed, there are tremendous political obstacles preventing change. Among EM economies there is an unwillingness to give up a strategy that has worked so well and has not yet been proven to fail. There is also resentment at being asked to change when EM economies still have far lower per capita incomes.

Furthermore, no individual country has an incentive to change for fear of being the only country to do so. Indeed, each individual country has an incentive to cheat and pursue an export-led growth strategy by itself. In effect, there is a global collective action problem blocking a transition from export-led growth to domestic demand-led growth. The only way to get a global shift is through multilateral rules on exchange rates, labor standards, environmental standards, and taxation. However, getting such agreement on such rules appears near impossible.

Finally, it is noteworthy that no country that has industrialized in the modern era through export-led growth has ever abandoned it. Thus, Germany and Japan, which pioneered stage I of export-led growth, remain hooked on it. So too are the East Asian Tigers of stage II, as is Mexico which is the prime example of stage III. China's recalcitrance regarding its undervalued exchange rate shows that it too is unwilling to abandon the strategy.

## 6. Conclusion: A Gloomy Economic Future

The above arguments suggest that the global economy is confronted by a very difficult future. It is trapped in a dysfunctional economic structure that calls for a major recalibration on the part of EM economies. However, that recalibration is unlikely to happen because EM economies mistakenly believe that they can continue to grow by pursuing their existing strategy of export-led growth, and there are also major international political collective action obstacles. This failure to adjust is likely to produce economic stagnation and political backlash in the industrialized countries (particularly the US). That in turn will adversely impact EM economies and contribute to increased international economic tensions.

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