DO BUDGET DEFICITS RAISE CURRENT ACCOUNT DEFICITS? CASES IN ASEAN-5

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ABSTRAK

Tulisan ini bertujuan untuk mengkaji apakah defisit anggaran meningkatkan defisit transaksi berjalan seperti yang diharapkan oleh teori makroekonomi konvensional. Objek dari tulisan ini adalah lima negara pendiri ASEAN (Indonesia, Malaysia, Singapura, Thailand dan Philipina). Terdapat debat mengenai pengaruh defisit anggaran terhadap defisit transaksi berjalan. Pendekatan konvensional menyatakan bahwa defisit anggaran akan meningkatkan defisit transaksi berjalan melalui pengaruh tingkat bunga dan pengaruh output. Pendekatan Ricardian meyakini bahwa defisit anggaran dan defisit transaksi berjalan tidak berhubungan. Selama ini studi-studi empiris menghasilkan kesimpulan yang mendua. Tulisan ini menemukan bahwa pada awal 1980-an defisit transaksi berjalan di ASEAN-5 terutama disebabkan oleh defisit anggaran, sedangkan pada tahun 1990-an defisit transaksi berjalan lebih banyak disebabkan oleh adanya investasi yang berlebihan (overinvestment). Fenomena overinvestment ini disinyalir juga merupakan salah satu sebab timbulnya krisis keuangan di Asia Tenggara.

1. INTRODUCTION

The objective of this paper is to analyze fee relationship of the budget balance and the current account balance in Southeast Asia ASEAN-5: Indonesia, Malaysia, Singapore, Thailand and the Philippines). In most years, Southeast Asian countries have been experiencing current account deficits. Except for Singapore who has insignificant deficits in its current account, the other four countries have reen confronted with the problem of current account deficits. Persistent current account deficit has increased economists' interest in theories and evidence about development policies. These deficits are troublesome since They imply a transfer of wealth to foreigners and possibly a reduction in the future generations' living standards.

The conventional view accepts that the midget deficit is the major cause of current account deficit. If the government can reduce budget deficit, current account deficit will decrease as well. On the other hand, the Ricardian view points out that there is no relationship between budget deficit and current account deficit. The reduction in the budget deficit, therefore, may not solve the current account deficit.

In the case of Southeast Asian economies, it is suspected that in the early 1980s, the budget deficits worsened the current account. Meanwhile, the relationship did not hold in the 1990s. The phenomenon of overinvestment is suspected to be the culprit of the current account deficits in the region. Nevertheless, it does not necessarily follow that the Ricardian hypothesis holds in the region since the hypothesis needs a set of too stringent assumptions to hold especially in developing countries. The excess of investment over saving seems to explain the phenomenon of Southeast Asia's current account deficits in 1990s. To some extent, the gap also seems to help explaining the currencies crisis in the region in 1997.

2. REVIEW OF LITERATURE

This section presents the review of theoretical and empirical evidence on the effect of the government budget balance on current account balance. Generally, there are two theoretical views of the effect of the budget deficit on external balance: the Conventional approach and the Ricardian approach. Meanwhile, empirical evidences dealing with this issue are marked by acrimony and ambiguity.

2.1. Theoretical Literature

The Conventional approach of the impact of the government budget deficit on the current account imbalance argues that government budget deficit forces up current account deficit, whereas the Ricardian approach believes that it does not.. To understand this different views, it is useful to review a conceptual framework to explain how the budget balance may or may not influence the external balance.

2.1.1. Conventional Approach

The national income accounting identity can help us to analyze the relationship of the budget balance and the current account balance. National income, Y, can be

divided into private consumption, C, private saving S, and net taxes collected from households and firms by the government, T:

$$Y=C+S+T \quad (1)$$

On the other hand, the national income of an open economy is the sum of domestic and foreign expenditures on the goods and services, produced by domestic factors of production:

$$Y = C + I + G + (X – W) \quad (2)$$

where I = private investment, G = government expenditures, X = exports, and M = imports.

Combining (1) and (2) yields:

$$(X - M) = S -1 - (G - T) \quad (3)$$

Identity (3) tells us that other things equal, a rise in private saving must increase the current account surplus; a rise in investment or the government budget deficit must lower it (Krugman, 1994). This conclusion follows directly from accounting and does not depend on any behavioural theories. Furthermore, since private saving, investment, current account, and budget balance are jointly determined variables, we cannot fully determine the cause of a current account change by using the identity above alone. Nonetheless, the identity can give us some useful clues.

The conventional approach also elaborates the budget-current account balance relationship in the 1S-LM framework. This approach argues that the channels through which budget balance can influence current account balance are the interest rates and the output effects. The budget deficit raises the interest rates by shifting the IS curve upward. Higher interest rates, related to the foreign rates of interest, cause a demand for domestic assets. Therefore, there will be a capital inflow which induces the rise in domestic assets prices. The increase in domestic foreign exchange value will worsen the current account balance by increasing imports and discouraging exports. Figure 1 illustrates this mechanism.

Besides interest rate effect, output effect can also explain the impact of budget deficit as presented in Figure 2. Suppose the government conducts expansionary fiscal policy. This policy gradually raises the level of domestic output, and as a result, external deficit arises from an increase in the level of demand. Alternatively, the

adjustment may take place via a rise in the domestic price level, contributing to the direct pressure on available resources exerted by an increase in the government demand and expansion in the money supply that resulted from the financing if the increased fiscal deficit. A rising Amnestic price level generates a fall in external competitiveness and a deterioration in the external balance.

Figure 1. Interest Rate Effect

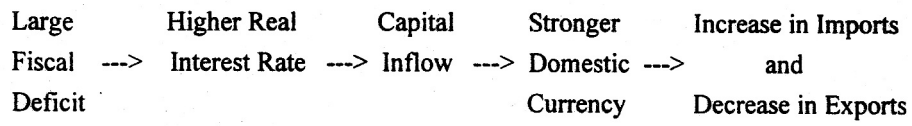
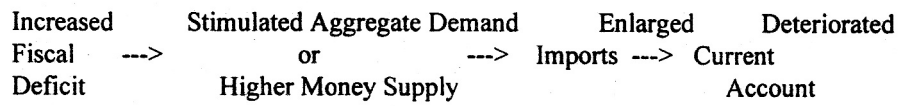


Figure 2. Output Effect



2.1.2. Ricardian Approach

The Ricardian approach asserts that budget deficit or an increase in the government debt is equivalent to a future increase in taxes, and thus is not an addition to the stock of the private wealth. In the Ricardian approach, it is assumed that each generation derives utility not only from its own lifetime consumption but also from that of its off springs. The utility functions of the generations are linked. It implies that current generation will adjust its saving to offset fiscal actions that have effects beyond its own lifetime. It is also assumed that the present value of the government spending equals the present value of taxes. The present value of taxes cannot change unless the government changes the present value of its expenditures. Hence, the intertemporal budget constraint imposes a constraint on the growth of the government debt issued in the current period to finance a deficit which must be matched by an increase in future taxes to serve and repay the debt. The other assumptions underlying the Ricardian hypothesis are non-distortionary taxes, perfect capital markets with no liquidity constraints, and equal planning horizons of public and private sectors.

When taxes are lowered, there will not be a perceived increase in permanent disposable income, because tax cut is not permanent. The issuance of debt would not

add to the stock of the private wealth since the financial value of a bond would be exactly matched by a corresponding liability for the future tax payments. Consequently, the current changes in taxes should not affect current consumption, leading to no impact on the aggregate demand. This is the so-called Ricardian equivalence, i.e. budget deficit and taxation are having equivalent effect on the aggregate demand. The equivalence result can be considered in another way. If the current generations have to increase their consumption when taxes are reduced, the future generations will inherit higher taxes and a smaller capital stock, implying less future consumption. This situation is avoided, however, as long as individuals are fully rational. Under the assumption of perfect capital market, they can borrow and lend and treat the tax cut as temporary and take into account the utility of their heirs. If so, the current generation will save more to increase its bequests so that its offspring can pay the higher future taxes needed to service the debt without having to decrease consumption.

Therefore, the current budget deficit leads to an offsetting increase in desired private saving, and thereby no change in desired national saving. As a result, the interest rates remain unchanged and the capital flow does not occur. Consequently, there would also be no effect on the current account balance (Barro, 1974 and 1989; Bernheim, 1989; Darrat, 1988; Hall and Taylor, 1988).

2.2. Empirical Literature

This section will present previous empirical studies concerning the budget-current account balance relationship in ASEAN-5. The evidences in the region show ambiguity: some are in favour of the Conventional approach, some are the Ricardian approach proponents, and the rest show inconclusive results. Some of the studies which do not reject the Ricardian hypothesis, however, stated that the estimates might be biased because of multicollinearity problems between the explanatory variables. The empirical studies reviewed in this section differ widely' in terms of statistical techniques and structural equations. There are various ways which one can attempt to empirically examine the impact of debt on external balance. It might be recognized that the finding of the high correlation among a set of variables does not establish that

they are causally related. The variable may be functionally related but uncorrelated, and they may be correlated but not causally related.

Do government expenditures crowd out private expenditures? Gupta (1992) attempted to answer that question by examining the data in ASEAN-5 plus India, South Korea, Pakistan and Sri Lanka. The data suggest that government expenditure is a poor substitute for private expenditure. This evidence thus refutes the alleged fears about the massive crowding-out effects in the region. The evidence on the Ricardian equivalence proposition is less clear. The Ricardian proposition is supported in the

case of South Korea, Pakisan, Singapore and Thailand. For the other countries, the outcome is not so clear. For those countries where the Ricardian proposition holds, the problem of raising national saving for accelerated growth is more acute, since contrary to the widespread belief that this could be achieved by reducing the budget deficits, such a policy will achieve nothing of the sort.

In her study on the Philippines, Gochoco (1988) found that during 1981-1986, in the short run, there was a significant crowding out effect of government expenditures on the rates of interest. She suggested that the crowding out effect exist not because of irrationality of individuals but because of fragmented capital market. However, in the long run, there was no crowding out effect. Meanwhile, Manasan (1988) investigated a similar issue in the Philippines during 1975-1984 and found out that crowding out effects exist in 1978, 1980 and 1985.

Saibajai (1993) examined the dynamics of Thailand's budget deficit and current account deficit during 1970-1990. The results of the bivariate and multivariate causality test only partially supported the conventional view that rising fiscal deficit has caused the escalation in the current account deficit. The multivariate causality test further indicated that lagged current account deficit, movements in the exchange rate, money supply along with fiscal deficit seemed to be the key variables causing changes in current account deficit. On the other hand, the current account deterioration also caused lower budget deficit. Officials tended to react to current account deficit by devaluing the baht. The baht devaluation increased exports, resulting in economic boom which generated higher government revenues from taxation on income, profit and exports. Meanwhile, Siwapradit (1988) examined the impacts of

debt-financed budget deficit in Thailand during 1961-1985 and found that 69.8 percent of the public debt was capitalized into private savings and 30.2 percent was passed on to be the burden on future generations. The empirical result also seemed to support Ricardian equivalence theorem. On the other hand, Chantrasmi (1990) found inconclusive result on the Ricardian equivalence tests in Thailand during 1970-1986. Based on permanent disposable income, it was concluded that any crowding-out effect of government deficits on consumption was far from total. She also concluded that we cannot be certain if there was no financial crowding-out as a result of debt financing of the government budget deficit. There was an indication of a crowding-out effect as a result of fiscal deficits financed by commercial banks but the pressure was eased out by foreign funding. Although the crowding-out effect of government deficits on private investment did not show up as measured, data showing the high correlation between government deficits and monetary financing of such deficits suggested that this sort of crowding-out was probably not important.

3. THE BEHAVIOUR OF BUDGET BALANCE AND CURRENT ACCOUNT BALANCE IN ASEAN-5

This section will present the trends of the budget balance and the current account balance in ASEAN-5. It will also explain the determinants of the dynamics of the two. variables. The investment-saving gap calculated as the residual of the national income accounting identity will also be presented.

3.1. Indonesia

Since 1960, Indonesia has been experiencing current account deficits. The only years when the current account recorded surpluses were 1974, 1979, and 1980.. The surpluses were due to oil shock in 1974 and devaluation in 1978. In 1974, the nominal value of net oil exports increased more than fourfold, followed d> a further 90 percent rise from 1978-1981 Hill, 1994; Hill, 1996). During 1982-1986,

Indonesia faced a declining terms of trade due to declines in oil prices. During 1971-1987, Indonesia was dependent on oil exports, therefore, the terms of trade has the fluctuations of oil prices. The government then conducted adjustment programs. Rupiah was devalued in 1983 and 1986. Large capital-intensive projects were rephased. The problems faced were orthodox: reducing the current account deficit

without creating recession. Principal repayments of long-term debt were increased. Trade sector was also liberalized. Manufactures grew rapidly after 1985. As a result, exports of manufactures experienced a boom This boom was also stimulated by 1986 devaluation (Corden, 1996). In the case of Indonesia, devaluations were unique in the sense that they were attempted to promote the nonoil tradable sector and out of concern about the balance of payments (Woo, et.al, 1994). After the 1986 devaluation, the central bank adopted a managed float exchange rate policy which came to a sudden end in August 1997 when the central bank let the exchange rate to freely float due to the currencies crisis in Southeast Asia.

Since 1967, under the New Order regime, Indonesia has been applying the 'balanced' budget rule. In economic sense, it is not a 'balanced' budget. The budget is 'balanced' since the foreign borrowing used to balance the budget is counted as 'revenue'. Therefore, if the foreign borrowing is excluded, the budget would be in deficits in most years, except in 1984, 1990-1, and 1993. The balanced budget rule was instituted as a political tactic to guard against a recurrence of excessive inflation in 1960s. Due to the rule, fiscal policy impact has been less flexible. The government has seldom been utilizing fiscal fine-tuning as economic policy. Nevertheless, Boediono (1990) stated that the rule has delivered good outcomes in terms of macro-economic stability. In addition, the government was able to sterilize some of the windfall oil revenues in the 1970s and later to stimulate the economy in the mid 1980s through monetary sector. In 1990 and 1991 the government established fiscal reserves of Rp 2 trillion and Rp 1.5 trillion which exhibits that there is more flexibility in the system than is commonly believed (Hill, 1996; Woo et.al, 1994).

Table 1. Current Account Balance, Budget Balance, and Investment-Saving Gap: Indonesia, 1972-1993

Year	Current Account (%ofGDP)	Government Budget (%ofGDP)	Investment-Saving (%ofGDP)
1972	-3.2999	-0.2347	3.0652
1973	-3.0999	-0.3009	2.7990
1974	2.0000	-0.2863	-2.2863
1975	-3.5000	-0.7640	2.7360
1976	-2.2999	-1.0582	1.2417
1977	-0.2000	-0.5507	-0.3507

1978	-2.5999	--0.9808	1.6191
1979	1.7000	-0.9361	-2.6361
1980	3.5999	-1.2510	-4.8509
1981	-0.8999	-1.2385	-0.3386
1982	-5.8000	-1.2630	4.5370
1983	-7.5000	-1.8134	5.6866
1984	-2.2000	1.1125	3.3125
1985	-2.2000	-0.8428	1.3572
1986	-5.0999	-3.0428	2.0571
1987	-3.0000	-0.8308	2.1692
1988	-1.7999	-3.3227	-1.5228
1989	-1.3999	-2.3704	-0.9705
1990	-3.0999	0.5256	3.6255
1991	-3.7999	0.6062	4.4061
1992	-2.4000	-0.6354	1.7646
1993	-1.6000	1.1002	2.7102

Source: The World Bank, World Tables, 1995
International Monetary Fund, International Financial Statistics Yearbook 1995

3.2. Malaysia

The Malaysian budget and current account balances have been up and down. In 1970s the exports growth was highly correlated with the GDP growth. Yet, at the end of 1970s there was a sharp deterioration in the terms of rade. Therefore, sizable current account deficits emerged. From 1981 to 1986 Malaysia experienced massive both government budget and current account deficits. The crisis was mainly due to a public spending boom. During iat period, due to the world recession, the terms of trade plunged by 24 percentage points and the rate of growth declined. The declining terms of trade dampened private investment. To protect the economy, the government accelerated public investment and expenditure program. This fiscal expansion which led to a construction boom was a major factor enhancing the economy in the face of the world recession. There have been two motives for this spending boom. The first was the necessity for a heavy industrialization push and the second was countercyclical motive. As a result of the declining terms of trade and the public spending boom, in 1982, the budget deficit achieved its peak to 20 percent of GDP and the current account deficit to 13.5 percent (see Table 2). The real growth was sustained but at the cost of soaring current account deficit. Thus, the current account deficits in sarly 1980s were caused by fiscal deficits. To rtduce the current account

deficit and the irowing foreign debt, at the end of 1982 the government conducted fiscal austerity by scaling down public spending and conducted a policy shift to favor the private sector. As a result, the budget deficit declined gradually from 1982. The construction boom ended in 1985. The terms of trade improved in 1984, but deteriorated again in 1985 and 1986 due to the collapse of the prices of all major export commodities. Terms of trade movements reflected the dynamics of the Malaysian economy. Nevertheless, the revival of the economy was rapid. The current account recorded a surplus of 7.8 percent of GDP in 1987 and budget deficit was down to 0.34 percent of GDP in 1988. The budget recorded small surpluses in 1992 and 1993. Increased external demand for Malaysia's manufactures and the better prices for Malaysia's primary exports explained the economic recovery. By 1988, Malaysian economy grew at 9 percent. The economy moved into its next high growth accompanied by high private investment and capital inflow. In 1991-1993, the current account again experienced deficits. These deficits were mainly due to private investment boom. Saving and investment influence the fiscal and current account balances. From 1976 to 1980, national saving were in excess of investment, therefore there were current account surpluses and capital outflows. During 1981-1988, the excess of private savings over private investment was absorbed by the budget deficit. In 1989, private investment started rising and was high in 1991 and 1992, well ahead of private savings which included compulsory savings through the Central Provident Fund (Ariff, 1991; Corden, 1996).

Table 2. Current Account Balance, Budget Balance, and Investment-Saving Gap: Malaysia, 1972-1993

Year	Current Account (%ofGDP)	Government Budget (%ofGDP)	Investment-Saving (%ofGDP)
1972	-4.8000	-5.6094	-0.8094
1973	1.1000	-4.0421	-5.1421
1974	-5.5999	-4.2881	1.3118
1975	-5.3000	-6.1830	-0.8330
1976	5.0000	-5.9941	-10.9941
1977	3.0999	-6.7759	-9.8758
1978	0.5000	-6.2187	-6.7187
1979	4.1999	-3.3818	-7.5817
1980	-1.2999	-7.1554	-5.8555
1981	-10.0000	-18.0076	-8.0076
1982	-13.5000	-20.0278	-6.5278

1983	-11.6999	-12.6647	-0.9648
1984	-5.0000	-8.9330	-3.9330
1985	-2.0999	-3.4575	-1.3576
1986	-0.6000	-11.3836	-10.7836
1987	7.8000	-8.6785	-16.4785
1988	5.0000	-0.3439	-5.3439
1989	0.4000	-0.6408	-1.0408
1990	-2.2999	-1.9004	0.3995
1991	-8.8999	-0.3626	8.5373
1992	-2.7999	1.1121	3.9120
1993	-3.2999	2.6637	5.9636

Source: The World Bank, World Tables, 1995
International Monetary Fund, International Financial Statistics Yearbook 1995

3.3. Thailand

Since 1970, Thailand has been experiencing current account deficits, except in 1986 when the oil prices dropped. In 1972-1974, Thailand experienced an export commodity boom. As a result, exports surged. Yet, this event was followed by oil price increases in 1974. Since Thailand is an oil importer, the rise in oil prices worsen its current account. In the late 1970s Thailand experienced public and private spending boom. At that time, the

overvalued dollar had worked to increase the balance of payments deficit. In 1982, the budget deficit reached its peak at 5.6 percent of GDP while the current account deficit peaked to 7.7 percent of GDP in 1981. These enlarged deficits led to a reconsideration of exchange rate policy. In May and July 1981, November 1984, and December 1985, the government devalued the baht in order to reduce the current account deficits. In addition, fiscal contraction took place gradually on the revenue and expenditure side. By 1987 the adjustment was complete. Cuts in public investment expenditure were a major source of mis adjustment. The fiscal deficit was only 2.2 percent in 1987 and was transformed to a surplus of 0.7 percent in 1988. There were significant increases in tax revenues due to higher rates and increased tax collection efforts. The adjustment was also helped by the 1984 devaluation. In 1986 there were foreign investment boom which explained the emerged large fiscal surplus. Simultaneously, Thailand was experiencing an export boom, concentrated in manufactures (Warr, 1994; Corden, 1996).

Table 3. Current Account Balance, Budget Balance, and Investment-Saving Gap: Thailand, 1972-1993

Year	Current Account (VoofGDP)	Government Budget (%ofGDP)	Investment-Saving (%ofGDP)
1972	-1.0000	-1.4452	-0.4452
1973	-0.6999	-1.3013	-0.6014
1974	-0.8000	0.4407	1.2407
1975	-4.4000	-1.0521	3.3479
1976	-2.7000	-2.1366	0.5634
1977	-5.5999	-1.8473	3.7526
1978	-4.9000	-2.2641	2.6359
1979	-7.8000	-2.4843	•5.3157
1980	-6.8000	-3.7276	3.0724
1981	-7.6999	-2.7913	4.9086
1982	-3.0000	-5.5677	-2.5677
1983	-7.5000	-3.5877	3.9123
1984	-5.3000	-3.1430	2.1570
1985	-4.3000	-4.9319	-0.6319
1986	0.2000	-4.0397	-4.2397
1987	-1.0000	-2.22%	-1.2296
1988	-3.0000	0.7227	3.7227
1989	-3.7000	3.3135	7.0135
1990	-8.6999	5.3829	14.0828
1991	-7.8000	5.9383	13.7383
1992	-5.6999	3.7375	9.4374
1993	-5.5999	2.8666	8.4665

Source: The World Bank, World Tables, 1995
International Monetary Fund, International Financial Statistics Yearbook 1995

3.4. Singapore

Until 1984, Singapore has always experienced small current account deficits. Singapore has extremely high private savings, over 40 percent of GNP which includes compulsory savings through the Central Provident Fund (CPF). The Monetary Authority of Singapore has invested the national savings abroad. On the other hand, Singapore has also been the recipient of huge foreign private investment. Private capital inflow, especially by transnational corporations has outweighed the capi-

tal outflow, therefore, there has usually been a net capital inflow financing a current account deficit. Like Malaysia, Singapore experienced a recession in 1985. The 'high-wage' policy conducted in 1981-1985 was one of the causes of the

recession. Competitiveness declined as a result of the sharp rise in wage costs. The policy also created a pressure for importing foreign low-skilled labour. This policy was considered as one economic policy mistake. A sharp decline in public investment, owing to the completion of some major public projects,

Table 4. Current Account Balance, Budget Balance, and Investment-Saving Gap: Singapore, 1972-1993

Year	Current Account (%ofGDP)	Government Budget (% of GDP)	Investment-Saving (%ofGDP)
1972	-0.9143	0.7074	1.6217
1973	-0.7593	-0.0705	0.6888
1974	-1.2980	L0842	2.3822
1975	-0.7697	0.6405	1.4102
1976	-0.6863	0.1531	0.8394
1977	-0.3165	0.7518	1.0683
1978	-0.4131	0.6164	1.0295
1979	-0.6142	1.8082	2.4224
1980	-1.1508	1.8953	3.0461
1981	-0.9688	0.6848	1.6536
1982	-0.8226	3.3030	4.1256
1983	-0.3614	1.8384	2.1998
1984	-0.2154	4.2175	4.4329
1985	-0.0022	2.1338	2.1360
1986	0.1787	1.4414	1.2627
1987	-0.0733	-2.7341	-2.6608
1988	0.3659	7.3558	6.9899
1989	1.0172	11.3804	10.3632
1990	0.6513	12.7825	12.1312
1991	1.0841	10.7544	9.6703
1992	0.9718	15.9809	15.0091
1993	0.4693	0.0000	-0.4693

Source: The World Bank, World Tables, 1995
International Monetary Fund, International Financial Statistics Yearbook 1995

was also the cause of the recession. In 1985, rivate investment declined sharply due to the in external demand. To restore Singapore's competitiveness and to stimulate do-| mestic demand, wage restraint was introduced. The compulsory employers' contribution to CPF was reduced from 25 percent of wages to 10 percent. Corporate taxes were reduced and depreciation was accelerated. The government also conducts fiscal expansion by reducing income taxes and expanding development expenditures. In 1986, exports increased because of the cost reduction and the ifcpreciation. In

1987, domestic demand, especially investment, recovered. Indeed, policy responses to the mistake of high wage policy were sound and rapid. Moreover, it should be noted that the contribution to the Central Provident Fund was changed for counter-cyclical purposes. Through borrowing from itfee CPF at below-market interest rates, the government obtained a cheap, non-inflationary source of finance the infrastructure and public goods procurement. The government also invested a high proportion of public savings aaroad. Thus, Singapore exchanged an out-Sow of national savings for an inflow of private foreign capital. In the case of Singapore high savings largely relied on the public sector but high investment came mainly from lime private sector. (Corden, 1996). Most of the nine, saving exceeds investment. In 1992, the lctcess of investment over saving reached aoout 15 percent of GDP, although in 1993 this figure dropped sharply into only 0.47 percent. There was a phenomenon of booming investment in early 1990s.

3.5. The Philippines

The Philippines is the only country in ASEAN-5 which experienced balance of payment crisis. Its economic performance is more similar to that of Latin America than to its neighbouring countries. In 1979, the government of the Philippines conducted a countercyclical policy. Investment was increased through an increased in foreign borrowing. Therefore, the increase in budget deficit was financed by foreign debt which led to a foreign debt crisis in 1983-1987. The budget deficit in turn was translated into current account deficit. The current account deficit peaked to 9.1 percent of GDP in 1982-1983. The government tried to reduce the current account deficit by devaluing peso in June 1983. Furthermore, the government turned into IMF and renegotiate its adjustment program. In October 1983, the goverment conducted another devaluation. In 1984, the Philippines conducted classic IMF adjustment measures, i.e. reducing reserve money, conducting floating exchange rate, increasing Treasury Bill rate and strengthen the tax base. Although the tax revenues have not reached planned levels, the administration has been characterized by relatively prudent fiscal policy. It can be viewed as a modest poljcy response to the fiscal crisis in the early 1990s which arose from huge public indebtedness which needs 30-40 percent of total government outlays to service. Except in 1973 and 1986, the Phi-

lippines has always been experiencing current account deficits. The persistent deficits is a reflection of low aggregate domestic savings. Total savings as a proportion of GNP declined from 28 percent in the late 1970s to 17 percent in the 1990s. The figure in 1990s was much lower than the typical saving rate of 35 percent or higher in neighbouring Southeast Asian economies. The excess of investment over saving reached almost 4 percent of GDP in 1993. Because foreign savings cannot be relied upon to always accommodate the large gap between current domestic savings and the needed investment levels, the domestic saving rate needs to increase (Bautista and Lamberte, 1996).

Table 5. Current Account Balance, Budget Balance, and Investment-Saving Gap: Philippines, 1972-1993

Year	Current Account (%ofGDP)	Government Budget (%ofGDP)	Investment-Saving (%ofGDP)
1972	-1.2999	-0.2591	1.0408
1973	3,2999	-0.1823	-3.4822
1974	-2.5999	0.0931	2.6930
1975	-7.1999	-0.2698	6.9301
1976	-7.1999	-0.4289	6.7710
1977	-4.4000	-0.4850	3.9150
1978	-5.4000	-0.3568	5.0432
1979	-5.9000	-0.0543	5.8457
1980	-6.3000	-0.5012	5.7988
1981	-6.3000	-1.7402	4.5598
1982	-9.1000	-1.9922	7.1078
1983	-9.1000	-1.0139	8.0861
1984	-5.0000	-1.4588	3.5412
1985	-0.8000	-1.7632	-0.9632
1986	2.5000	-4.6828	-7.1828
1987	-1.8999	-2.4500	-0.5501
1988	-1.7999	-3.1887	-1.3888
1989	-4.3000	-2.5272	1.7728
1990	-6.9000	-4.6784	2.2216
1991	-3.0999	-3.3213	-0.2214
1992	-2.5000	-2.0068	0.4932
1993	-6.5999	-2.6986	3.9013

Source: The World Bank, World Tables, 1995
International Monetary Fund, International Financial Statistics Yearbook 1995

4. CONCLUSIONS

In the early 1980s, the Southeast Asian, economies, except Singapore, experienced current account deficits which were mainly due to budget deficits. But, in 1990s, the

current account deficits experienced by these economies were mainly caused by private investment boom. In general, the current account balance is mainly determined by the movements in the terms of trade, while the dynamics in the budget balance is determined independently. Therefore, the behaviour of current account balance could not be predicted by only examining the behaviour of budget balance since there exists another magnitude which influences the relationship of the two variables, i.e. the investment-saving gap. In general, Southeast Asian economies experience a phenomenon of overinvestment. Therefore, national savings should be enhanced, especially in the cases of Indonesia, Thailand and the Philippines, in order to meet the need of the booming investment.

In addition, although the data shows that there is no necessary relationship between budget balance and current account balance, it does not necessarily >mean that the Southeast Asian economies are Ricardian. Ricardian paradigm needs a set of rigid assumptions to hold. Violations of one or more of the assumptions underlying the Ricardian proposition could lead to deviations from the equivalence. It seems that the assumptions are more likely to be violated rather than upheld in developing countries. For example, in most Southeast Asian economies, capital markets are far from perfect, with severe liquidity constraints. The approach of this paper is not to verify these assumptions, rather it overviews briefly at the relationship of the budget-current account balance directly. The data shows that the current account balance is mainly determined by the movements of the terms of trade, while the government budget is independently determined. The theoretical framework gives us some useful clues, but in the real world, the stories do not necessarily follow.

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