Title: Comment on "The Direct Substitution between Government and Private Consumption in East Asia"

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URL: http://www.nber.org/chapters/c0370
difficult to hold in some countries in East Asia. The validity of this optimality assumption itself is, therefore, a very important issue to be tested in these countries.

My third comment has to do with a liquidity constraint. This paper assumes that all private agents do not face a liquidity constraint so that the level of their consumptions depends only on the relative price of government consumption with respect to private consumption. With regard to East Asian countries, however, it is worth investigating the possibility that a sizable fraction of consumers are subject to liquidity constraints. When a part of private agents is subject to a binding liquidity constraint, their consumption can be assumed to depend on current or transitory disposable income.

In concluding, this paper gives us important insights on the substitutability issue for East Asian countries. I would appreciate Professor Kwan’s paper to work in this interesting area of research.

References


Comment

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The paper empirically verifies the extent of direct substitution between government and private consumption in nine East Asian countries. A pos-

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itive sign of the elasticity of substitution indicates substitutability between government and private consumption, thereby making fiscal policy relatively ineffective. The reverse holds true when a negative sign of elasticity of substitution obtains.

The author finds that there is substantial substitutability for the nine East Asian countries as a whole using pooled data. However, looking at individual countries, he finds varying results: Thailand and Malaysia show substantial substitutability between government and private consumption; Singapore and Indonesia show complementarity; the North East Asian economies including Hong Kong show moderate elasticity of substitution; and the Philippines show statistically insignificant elasticity of substitution.

The questions are:

1. Why are the results so different, especially in the case of Southeast Asia where cases of substitutability and complementarity between government and private consumption exist?
2. While the author mentions the contrasting result between Indonesia and Thailand, what about similarity in results for Singapore and Indonesia?

Let me offer some factors that could help explain some of the results.

For Thailand, the government had been running government surpluses except in the years after the 1997 financial crisis.

For Indonesia, the result may have been driven by the large government subsidies.

For Singapore, the public sector is quite large and the retirement fund has been an important source of funds until recently when the Singapore government encouraged large state-owned enterprises to issue bonds to develop the bond market.

The Philippine case is quite interesting because the analyses show statistically insignificant results. There are three factors that may help explain those results. First, growth in private consumption has been relatively stable over the years despite swings in the economy. A large part of it could have been fueled by remittances that in recent years have reached about U.S. $8 billion dollars, which could easily be about a quarter of gross merchandise exports. Second, government debt service has been very high, accounting for 20 percent of total government expenditure. Moreover, there are rigidities in government expenditure. Roughly 70 percent of annual government budget is earmarked for personal services, thus leaving only about 10 percent for capital expenditures. Third, national government expenditure does not include expenditures undertaken by large state-owned corporations.