

ECONOMIC WATCH

# Domestic demand not a panacea

BY DEBORAH K. ELMS  
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**I**N SINGAPORE, investors are seizing on any form of "green shoot" to justify a return to economic optimism for the future of the region. This enthusiasm for new economic growth is reflected in rising share prices on various stock markets and a slow increase in the number of homes sold in recent weeks.

One source of optimism is the belief that domestic demand in Asia can make up for falling demand in the United States and Europe. After all, there are billions of potential consumers in China, India and Indonesia alone. Mr Haruhiko Kuroda, president of the Asian Development Bank, made precisely this point in a public lecture in Singapore last week.

While true, the profiles of these Asian consumers differ markedly from that of consumers in the US and Europe. In the short run, stimulating domestic demand

in Asia will not be sufficient for most states to return to high levels of economic growth. Even in the long run (more than five years), the demand patterns will be so different that many current businesses may not survive the transition.

Take a simple example of cashmere sweaters. Rising purchases of luxury products by consumers in the West resulted in greater demand for high-end woollen goods. In the past few years, sweater production has boomed, herds of goats expanded, and more new factories built to accommodate the ever-rising demand.

Today, however, farmers in places like Inner Mongolia are facing a significant economic contraction. Many have been forced to sell, at a loss, their herds for meat rather than continue keeping the animals for wool production. Factories that spin the fibres into yarn have shut down.

Manufacturers prepare sweaters in advance for the cold seasons in the West. Their warehouses are now bulging with merchandise that will not be sold.

Faced with a mountain of sweaters,

the exporters might hope to sell them to consumers in Asia instead. The most likely market, given the weather, is China. But China has not been a target market for large-scale cashmere sweater exports in the past. This means there are no supply chains for delivery of this product from the plains of Inner Mongolia to the shelves in China for consumers.

There are also no contracts with retailers in place. There is nothing like the equivalent of a Wal-Mart with a distribution and retail system so sophisticated that each item sold can result in an automatic order for new replacement stock.

So far, there has been no marketing among possible buyers to convince them to pay premium prices for cashmere over other wool products. Most Chinese consumers will not buy sweaters in sizes larger than S, as the bigger sizes are simply too big. This leaves at least a short-run problem of oversupply of bigger sizes in the warehouse. The styles that appeal to Western consumers may be inappropriate for this new market, leaving sweaters

stagnating on shelves throughout China.

The industry could regroup in the medium term (two to five years). It could painstakingly build the contacts necessary to export and distribute sweaters to potential markets in China. It could put into place a retail distribution system. It could ramp up marketing campaigns.

However, the potential pool of consumers in China is still quite small. For all the impressive growth rates experienced in China in the past three decades, its consumers remain quite poor. The number of possible purchasers of luxury cashmere sweaters may not match the size of consumer pools in Europe or the US in the medium term.

So, at the end of an expensive and difficult process of reorienting the production processes and building logistics and retail distribution networks, the total number of consumers may still not support the number of goat farmers in Inner Mongolia that could survive for a few years while all these new linkages from farm to market are built.

This situation is likely to be repeated in nearly every industry that forms the backbone of economic growth in Asia. Consumers in China, India or Indonesia are unlikely to demand as many large plas-

ma television sets as Western consumers in the next few years. They will also not require as many high-priced automobiles with the latest features or the newest laptops with the thinnest profile.

Even if every consumer with sufficient purchasing power in Asia bought a Pepsi to drink, the total volume of Pepsi sold will not match that sold in the US in a week alone. There are simply not the same numbers of people wealthy enough to afford to buy a Pepsi regularly.

Yes, there will be market opportunities available in domestic markets in Asia. But the mix of products in high demand will be different - particularly with fewer high-value, big-ticket items being sold.

For manufacturers, a shift to cater to domestic demand within Asia will result in significant changes. For many companies, Asian consumers will not provide a panacea for lost markets in the West - and certainly not in the short run. Domestic demand in Asia is less a green

shoot than a tree seedling that will take years to mature. The writer is head of the Temasek Foundation Centre for Trade & Negotiations at the S. Rajaratnam School of International Studies, Nanyang Technological University. She specialises in trade and economics issues.

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