

THE MIDDLE INCOME TRAP

East Asian Economies

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What is Middle Income Trap?

Section I

- How to balance the politics of further economic growth and the politics of redistribution
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- Indermit Gill and Homi Kharase An East Asian Renaissance: Ideas for Economic Growth World Bank 2007
 - Asian Development Bank “Competitiveness in Developing Asia” Asian Development Outlook 2003
 - ADB “The Rise of Asian Middle Class” Key Indicators 2010

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World Bank 2008

Thailand faces “ a real challenges of sustaining its growth and transforming into a higher income country...” With more intense global competition, Thailand needs to improve its productivity and competitiveness “ if it ...is....to avoid being struck in a middle income trap in which many Latin America sic countries have been in for several decades”

Dual Tracks in Economic Policy

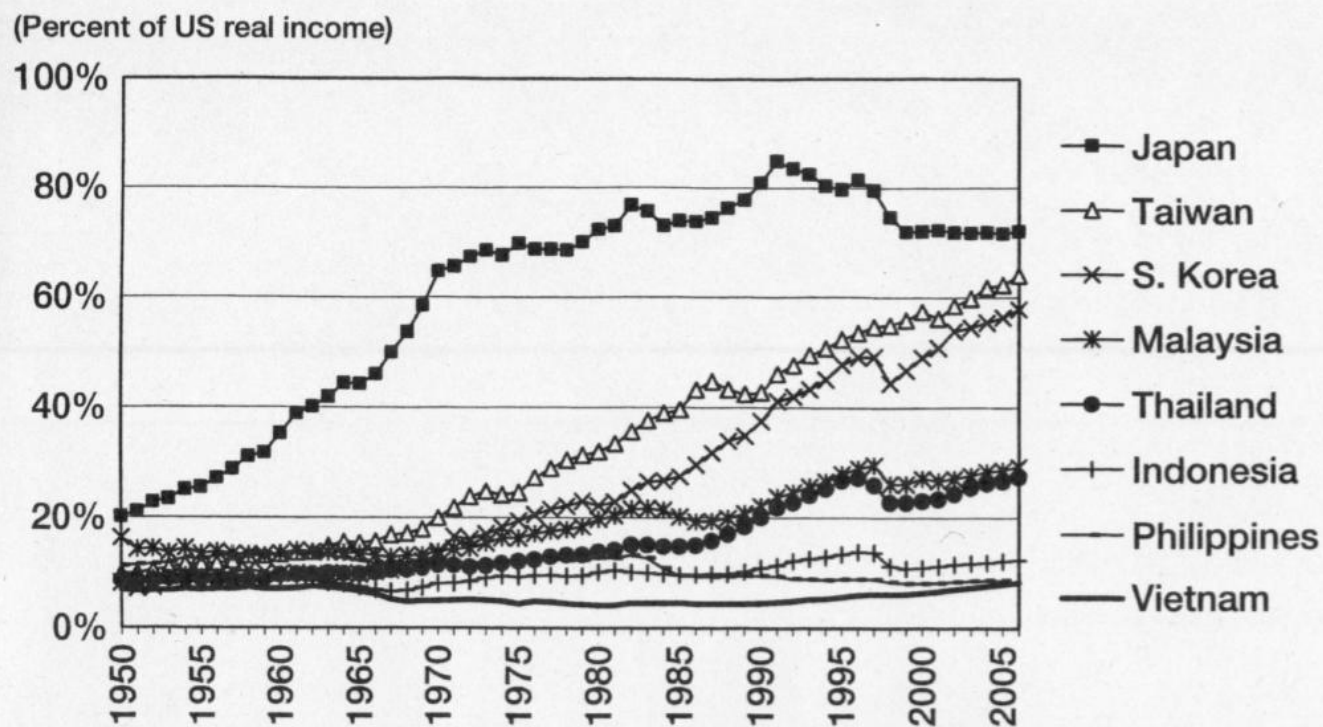
Policy of Economic Growth

from the stage of labor-intensive industrialization
towards the next stage of capital and technology
intensive industrialization

Policy of Redistribution

emergence of the urban middle class
emergence of dual structure in labor market
widening income gap between the urban and rural
households

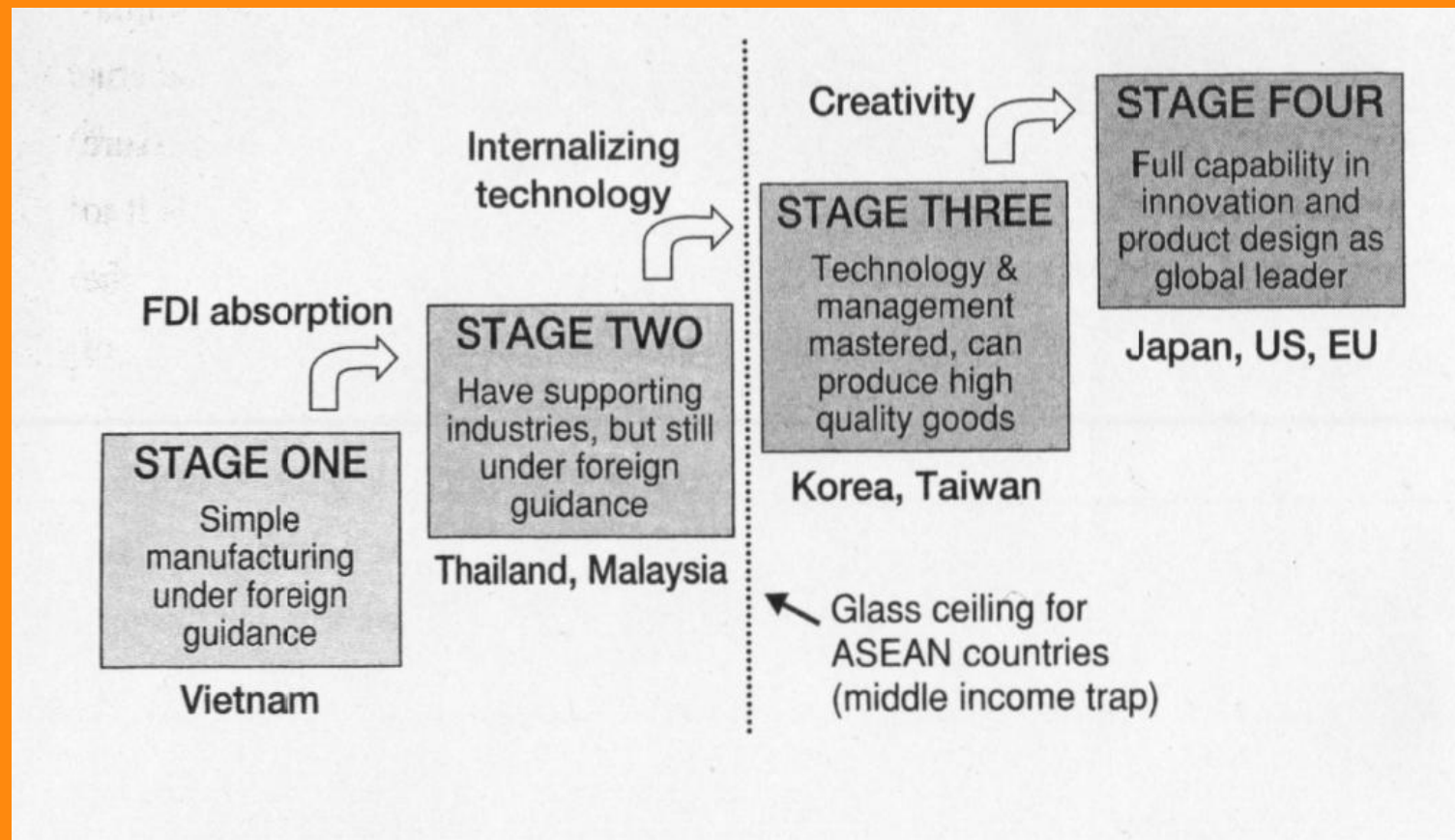
Different Speed of Catching Up



Sources: Angus Maddison, *The World Economy: A Millennium Perspective*, OECD Development Centre, 2001; the Central Bank of the Republic of China; and IMF *International Financial Statistics* (for updating 1998-2006).

Note: Per capita real income relative to US as measured by the 1990 international Geary-Khamis dollars.

Breaking the “Glass Ceiling” in Manufacturing



My Analytical Angle of discussing MIT

The core of my argument today is that MIT is an inevitable phenomenon experienced by the developing countries who has fully utilized the advantages of the later-comers, discussed by Alexander Gershenkron

Gershenkron, Alexander, Economic Backwardness in Historical Perspective, Harvard University Press 1962

Almost all the developing countries who have succeeded catching-up have been in the MIT after the initial phase of catching-up process.

First Phase of Catching-up Process

- Japanese Type
 - introduction of advanced technology
 - through “ borrowing from the advanced countries”
 - since pre-war period to post-war high growth period
- Southeast Asian Type
 - active introduction of FDI
 - capital, technology and export-markets



Phase Transition as Path of Punctuated Equilibrium

Phase

decades under which one form of political and economic institution continued to prevail

Transition of Phase

from the old type of institution towards the new one

Transition is not an easy path. It includes big conflicts between the old and the new interest groups.

Murakami's Developmentalism as an Integrated System

Industrial Policy

Industrial policy attempts to realize the advantages of decreasing cost. Its objective is to maintain competition appropriate for industries faced with decreasing cost.

Without such a policy, these industries would be able to realize their latent potential for growth.

Policies fundamentally necessary

- Designation of priority industries
- Industry-specific indicative planning
- Policies to promote technological progress
- Regulation of Excessive Price-cutting Competition

Supplementary Policies Redistribution

The Achilles heel of any effort to take off into industrialization is the outbreak of social discontent caused by distributive inequality. According to the classical argument, labor was supposed to move from old industries to new industries in search of higher wages, and the disparities were supposed to disappear. At least for the developing countries, however, the inadequacy of such

an argument has now widely recognized, Beginning with Arthur Lewis's model of the unlimited supply of labor , countless theories of economic development have appeared, but all of these recognize that a certain amount of surplus labor will remain in agriculture or in the informal sector in the cities, and in this sense the theories of economic development are in fact a partial critique of the neoclassical school.

This supplementary policy will be a policy of distributive equality, in the broad sense, but there is more than one way to achieve this equality. Inheriting the tradition of J.S.Mill, the neoclassical school has emphasized that distributive policy should take a form that has no connection to production activity or to price formation—in other words, some kind of lump sum subsidy.

This is because it is believed that redistribution linked to prices and output [for example, the Japanese system of price supports for rice] distorts the working of the market and makes resource allocation inefficient. On the other hand, income supplements that are not tied to production—unlike wages—do not increase the desire to work.

A second means of achieving distributive equality: An anticlassical redistribution corresponding to changes in prices and outputs

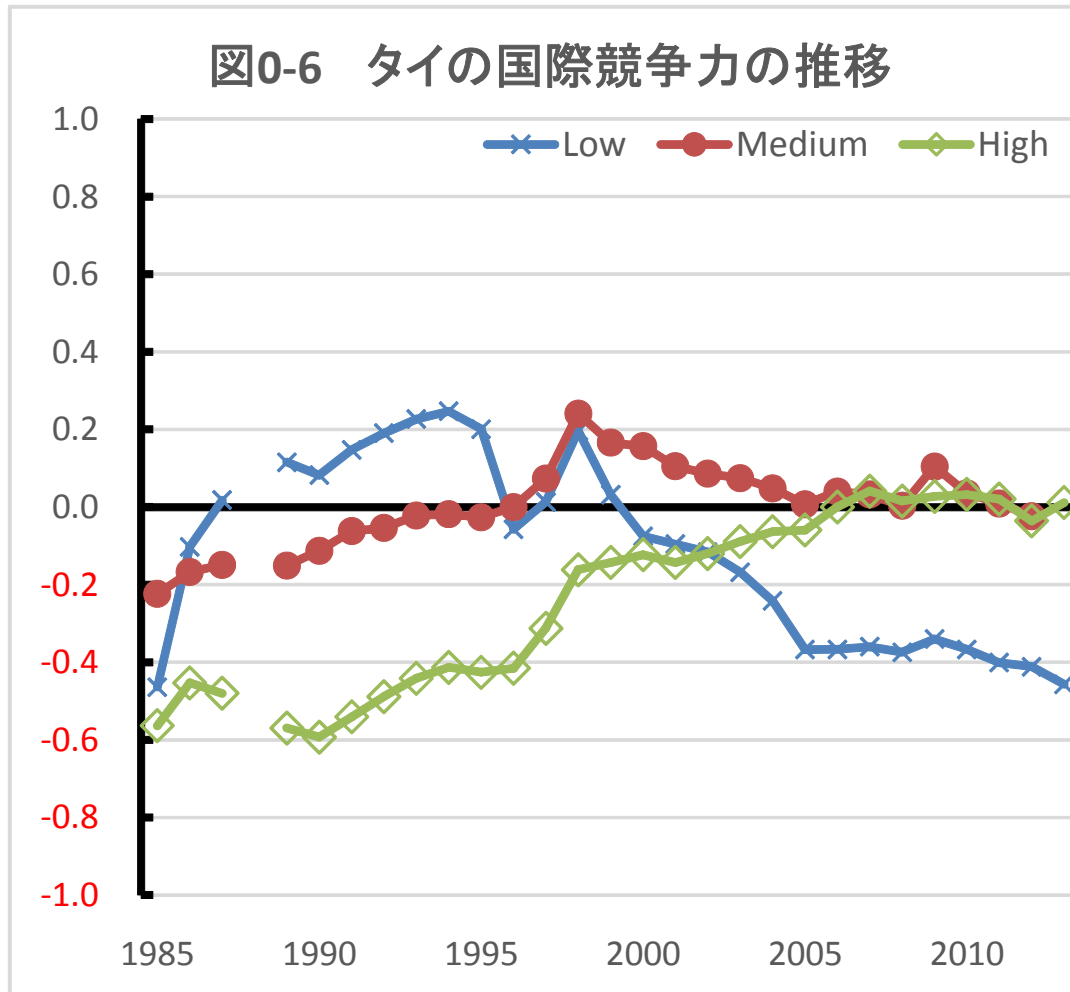
The problem with the anticlassical distributive policy, as with industrial policy, is the difficulty of bringing it to an end. “sun set” rule

Case of Thailand

Section II

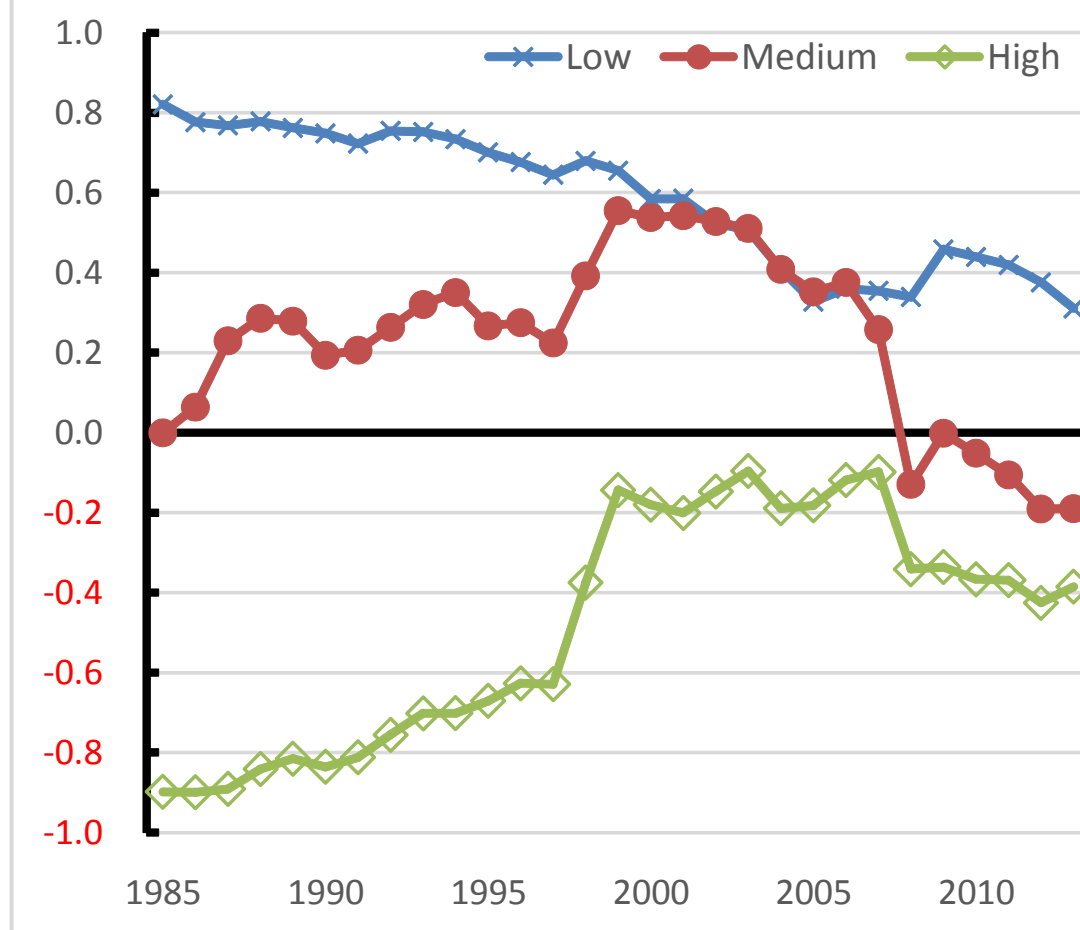
- Thailand has become a mainland Southeast Asian hub for the multinational manufacturing. The government needs to invest in infrastructure and human resources as a host for multinationals. It also needs to encourage competition and assist domestic companies to enhance their capabilities and become more productive. And given the fact that at the bottom of the political stalemate-and the disorder-in the 2000s-lies the deepening division between the elite and urban middle classes on the one hand and the rural poor on the other, state power has to be reorganized to address the question of social safety nets and income redistribution and to expand its social base.

図0-6 タイの国際競争力の推移



注と資料：図0-5と同じ。

図0-7 インドネシアの国際競争力



注と資料：図0-5と同じ。

Policy of Economic Growth

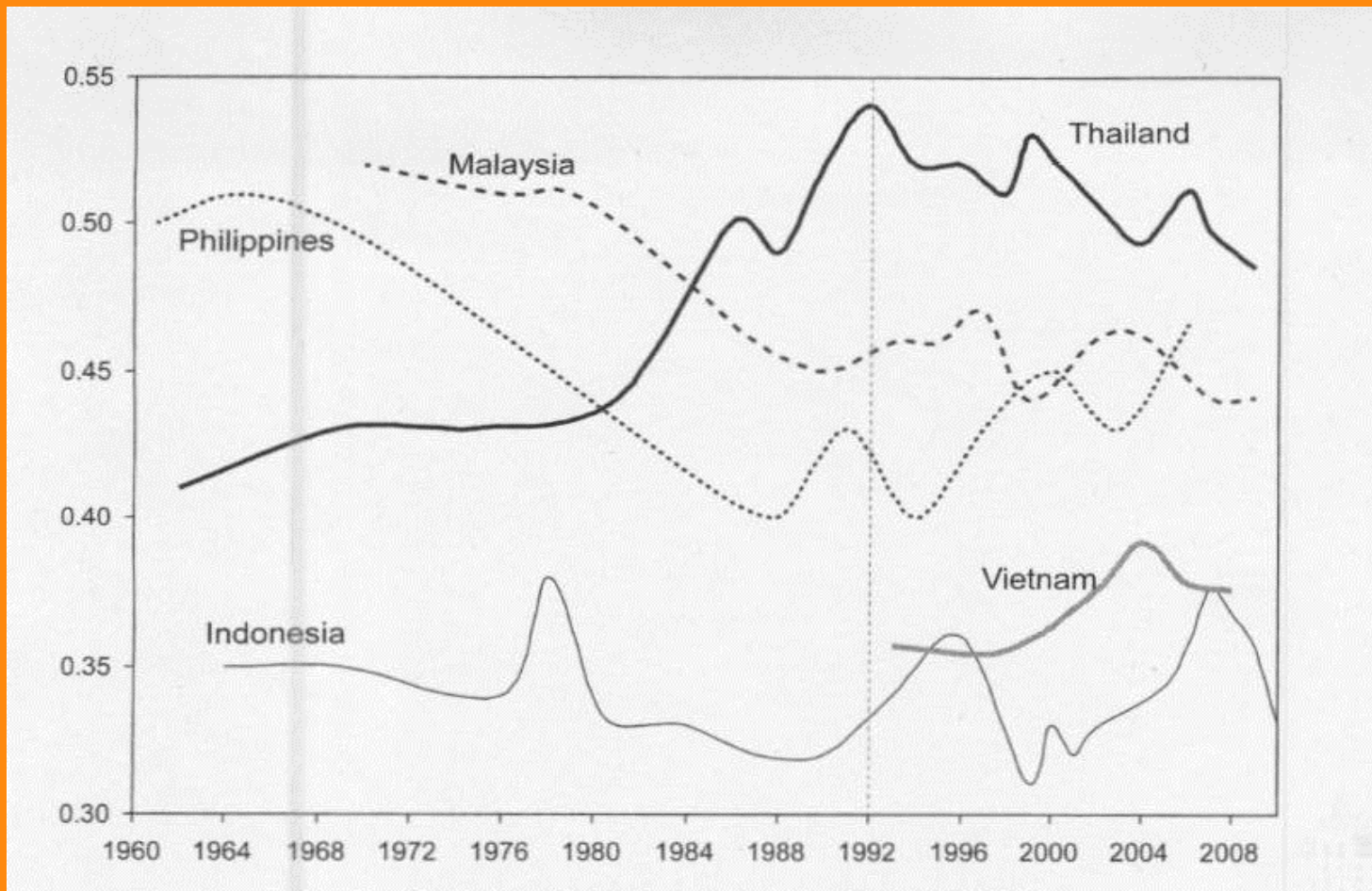
Auto Industry

Thai Auto Industry Research Institute
established in 1994

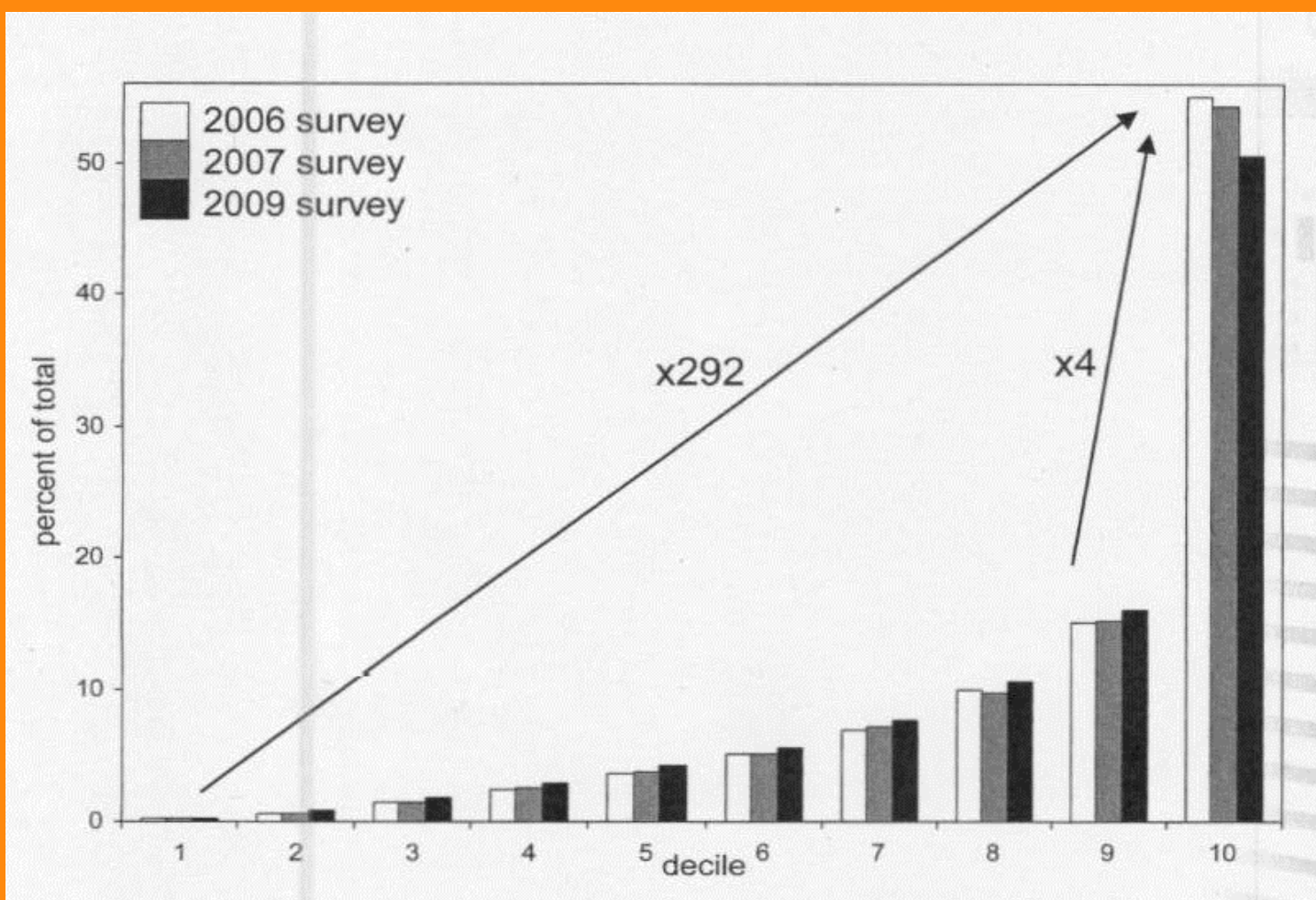
Sugar Industry

Richard F. Doner The Politics of Uneven Development:
Thailand's Economic Growth in Comparative Perspective
Cambridge University Press 2009

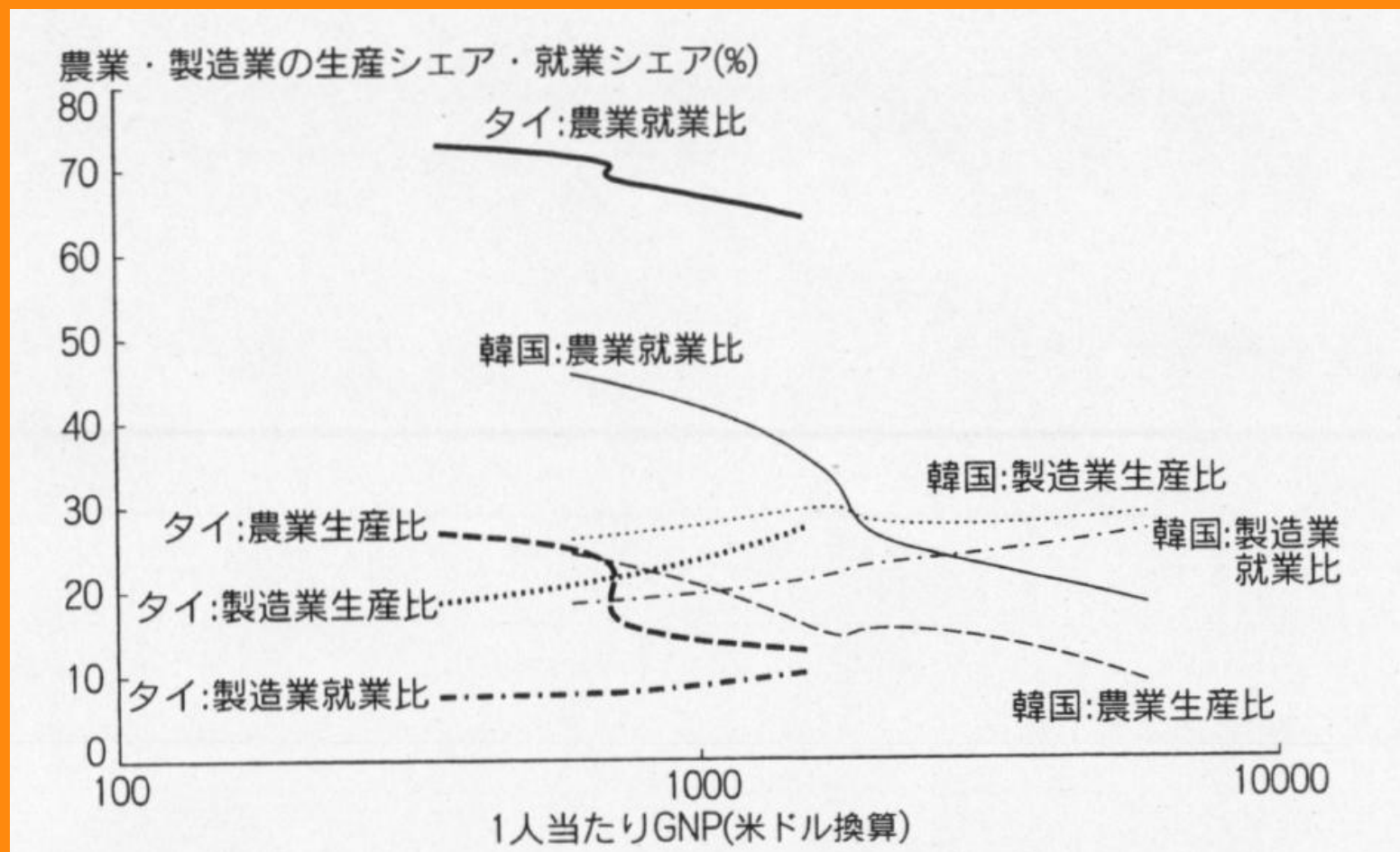
Gini index of Southeast Asian Countries (1960-2010)



Thailand(1): household wealth by wealth deciles



Thailand(2): Trend of Productive and Employment Structure (1975-1990)



Relative Labor Productivity

Sectoral share of GDP

$$Y_a/Y \quad Y_i/Y$$

Sectoral share of Labor

$$L_a/L \quad L_i/L$$

$$Y_a/Y \div L_a/L = Y_a/L_a \div Y/L$$

$$Y_i/Y \div L_i/L = Y_i/L_i \div Y/L$$

Policy of Redistribution: Rice Policy

“ Rice Premium”

In 1955 the multiple exchange rate system was itself abolished and a unitary exchange rate adopted. At the same time, the government established the “ rice premium” system , under which rice exporters were required to pay a specific tax for each ton of rice exported.

Thailand NRA


rice

sugar

- 1970-74 -29.5 12.6
- 1975-79 -27.7 -3.2
- 1980-84 -17.3 12.7
- 1985-89 -14.3 36.8
- 1990-94 -15.5 34.0
- 1995-99 -10.2 22.4
- 2000-04 -6.8 12.6
- 2005 -1.2 32.9

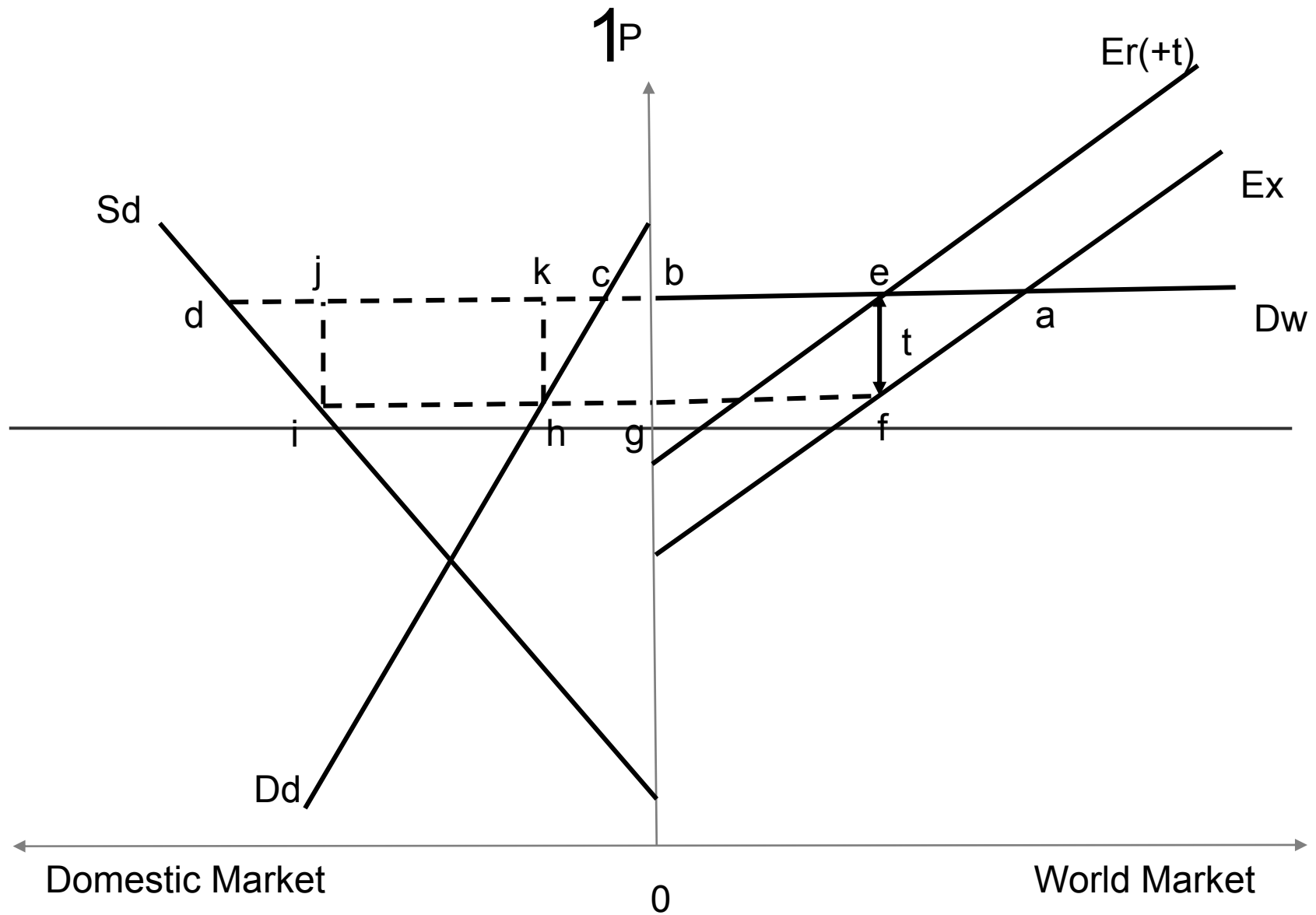
Rice

- Since the end of World War II, Thailand taxed its exports of rice. There were four individual instruments of export taxation, each with different legal foundations, each generating revenues that went to different destinations within the government. Their combined effect was a rate of export taxation of around 40% from the late 1950s to the early 1970s. The rate

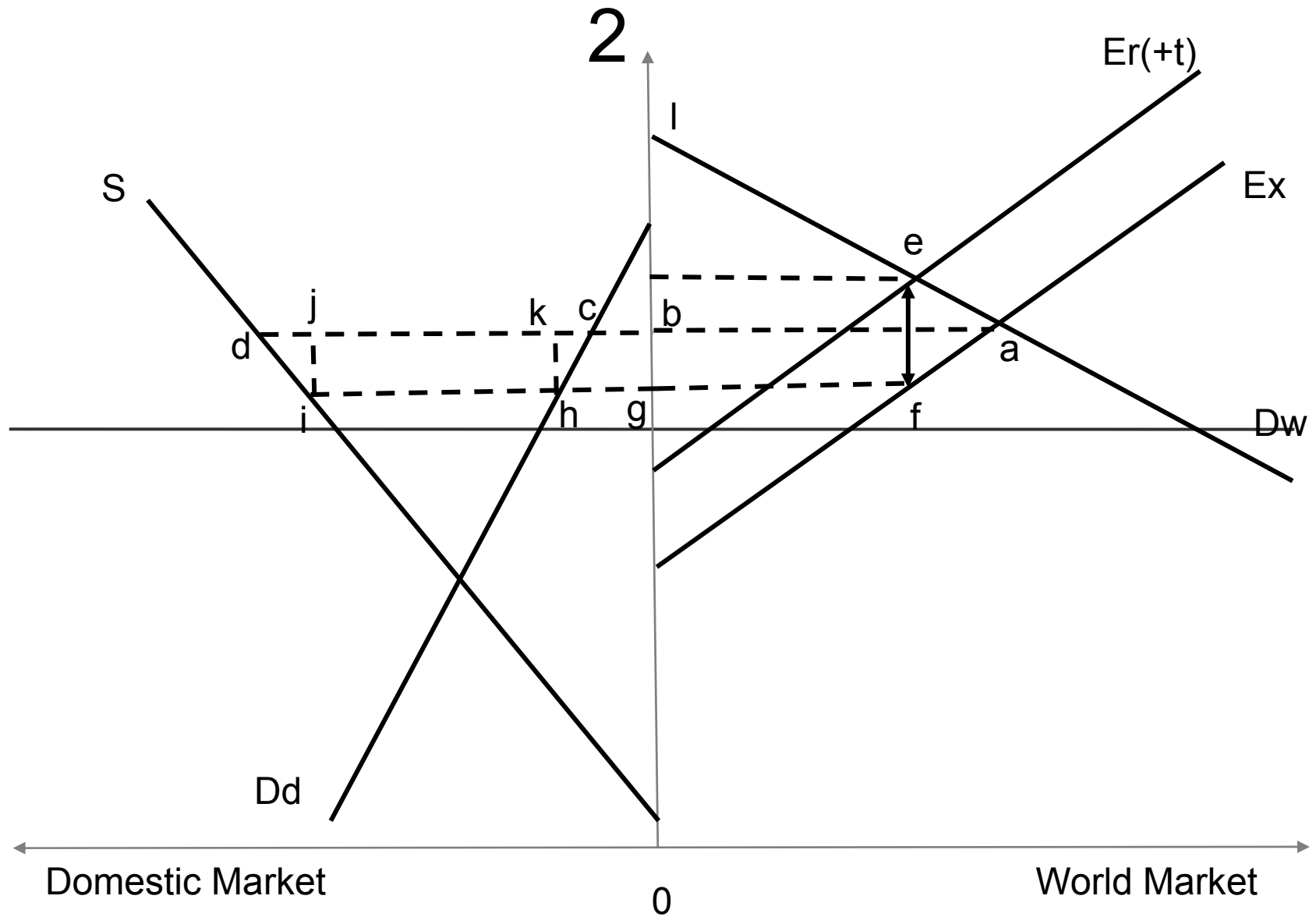



increased to around 60% during the commodity price boom 1972-74, but subsequently diminished quickly to about 20%. There was a further peak of about 40%, at the time of the second OPEC oil price shock in 19789-80, and then a steady decline until all forms of tax were suspended in 1986. Rice exports have remained untaxed since then.

Rice Premium : Thailand



Rice Premium : Thailand



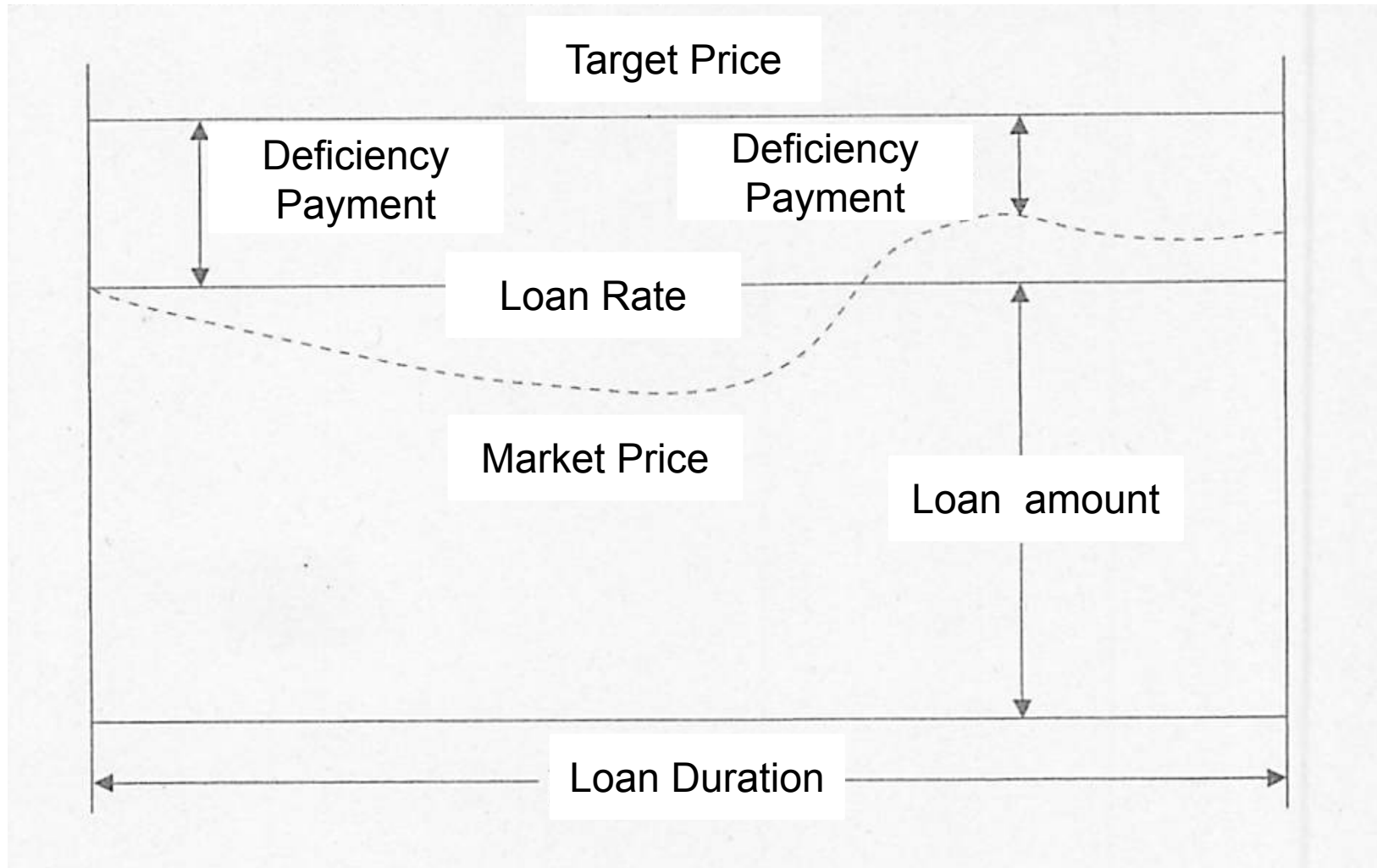
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- Since the economic crisis of 1997-98 and especially during the government of Prime Minister Thaksin Shinawatra, a wide range of income support program, cash grants to villagers and subsidized credit schemes was introduced.
 - Yingluck government moved toward more populist policy packages, including the paddy-pledging scheme, farm debt moratorium, rebates and tax cuts.



Paddy pledging program

- Started in 1981
- Very similar scheme of supporting the sale price of paddy for the rice farmers
- Bank for Agriculture and Agricultural Cooperatives BAAC

Deficiency Payment and Loan Rate: USA



Japan in the 1920-30s

Section III

Politics of Economic Growth

from the stage of labor-intensive industrialization towards the next stage of capital and technology intensive industrialization

Akamatsu's Flying-geese Hypothesis

from the third stage to the fourth stage

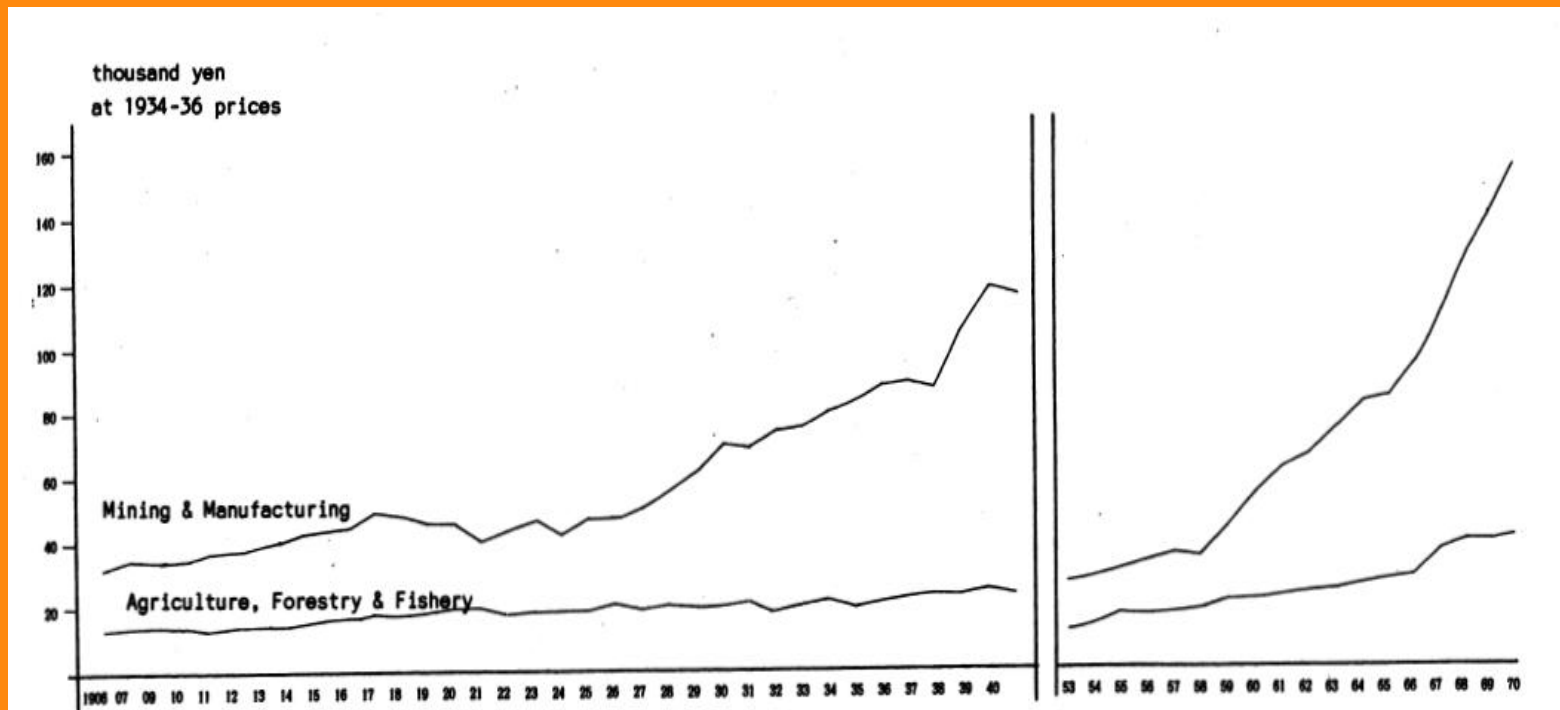
Politics of Redistribution

the emergence of the urban middle class

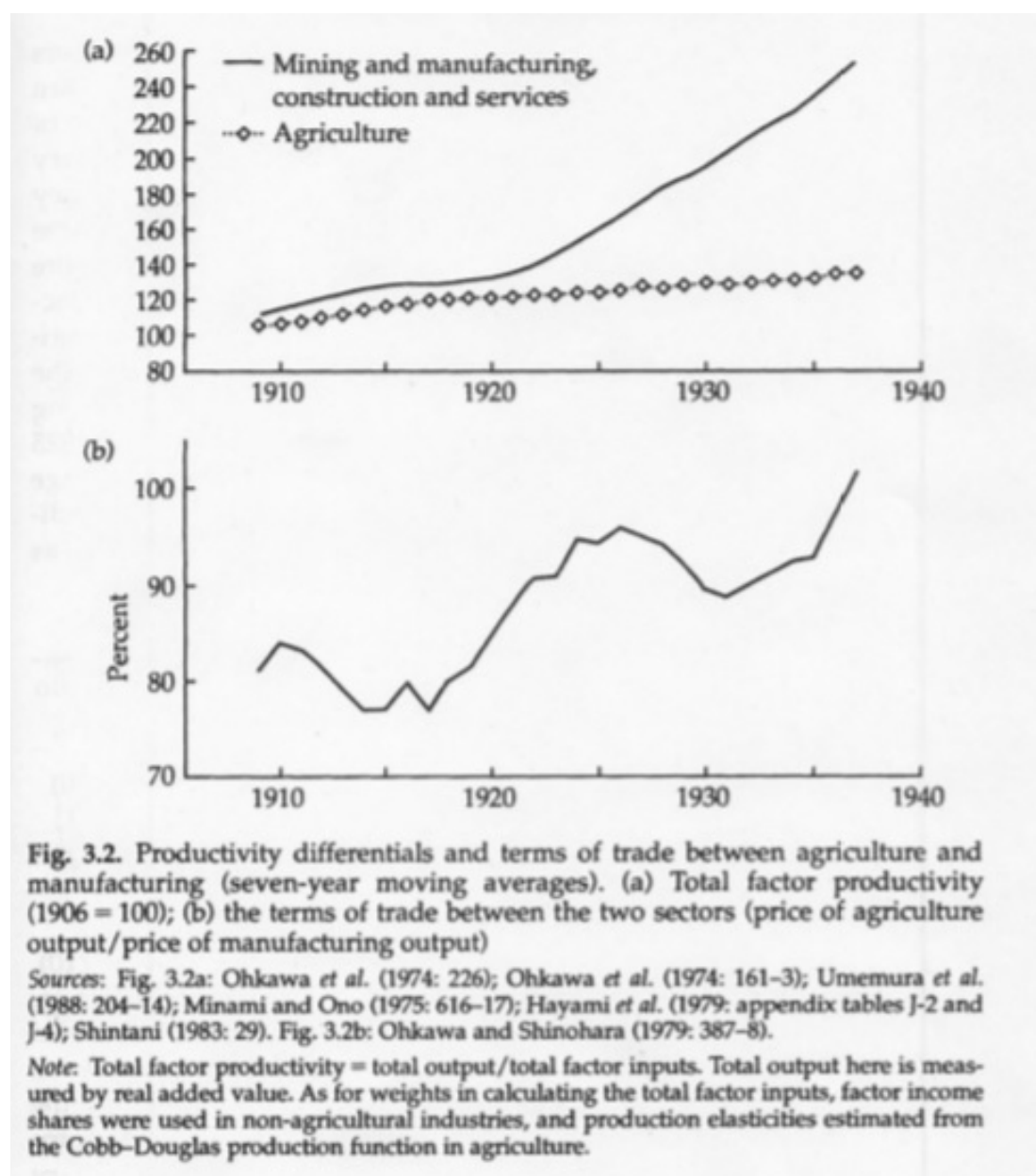
widening income gaps amongst the rich and poor families

and also between the urban and rural households

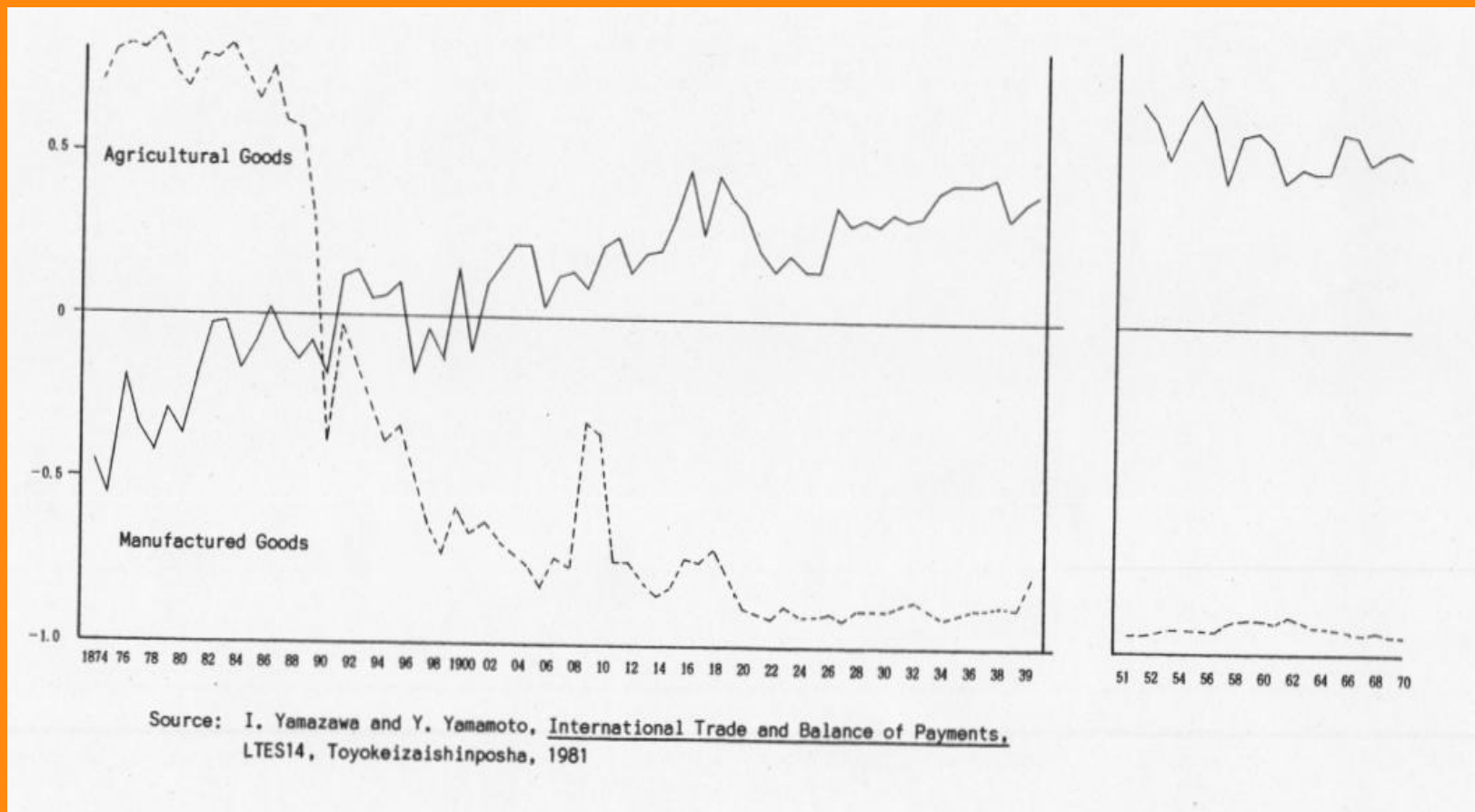
Labour Productivities in Japan



Source: Value added and labor force from K. Ohkawa and M. Shinohara,
Patterns of Japanese Economic Development, Yale University Press, 1979



Net Export Ratio: Agricultural Goods and Manufactured Goods



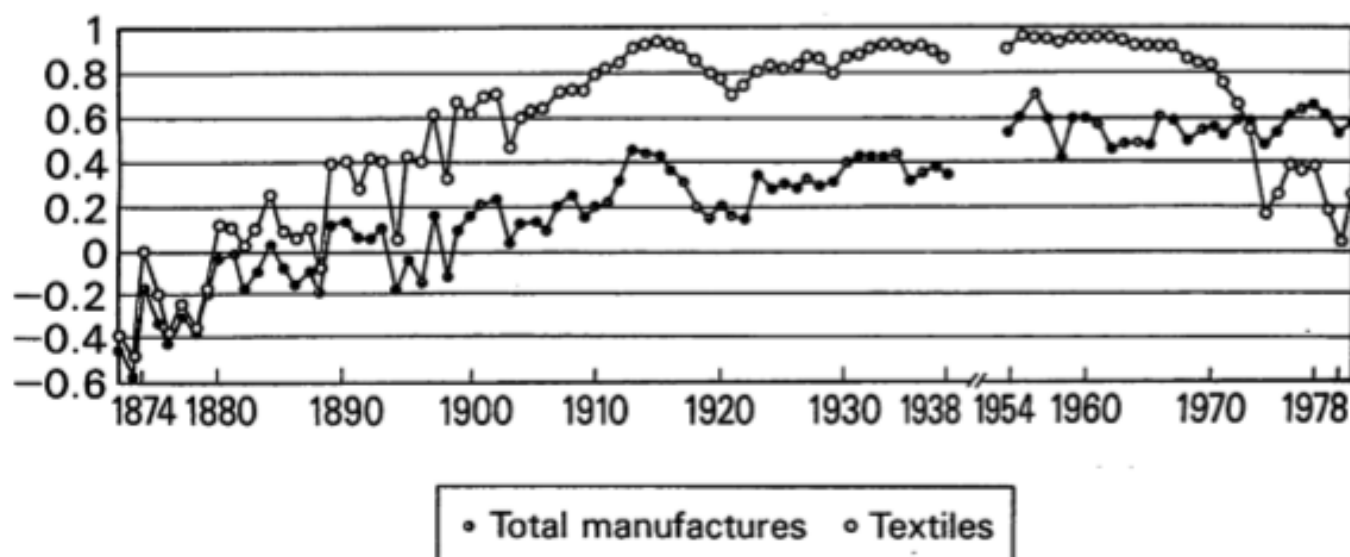


Figure 8.1

NER of Manufactured Total and Textiles: Japan, 1874–1978

Sources: Ohkawa and Shinohara, eds., *Patterns of Japanese Economic Development*, Tables A26 (pp. 315–318), A27 (pp. 319–322); Ippei Yamazawa, *Japanese Economic Development and International Trade*, Appendix Tables 1–1 and 1–2 (pp. 240–243).

Note: Five-year averages.

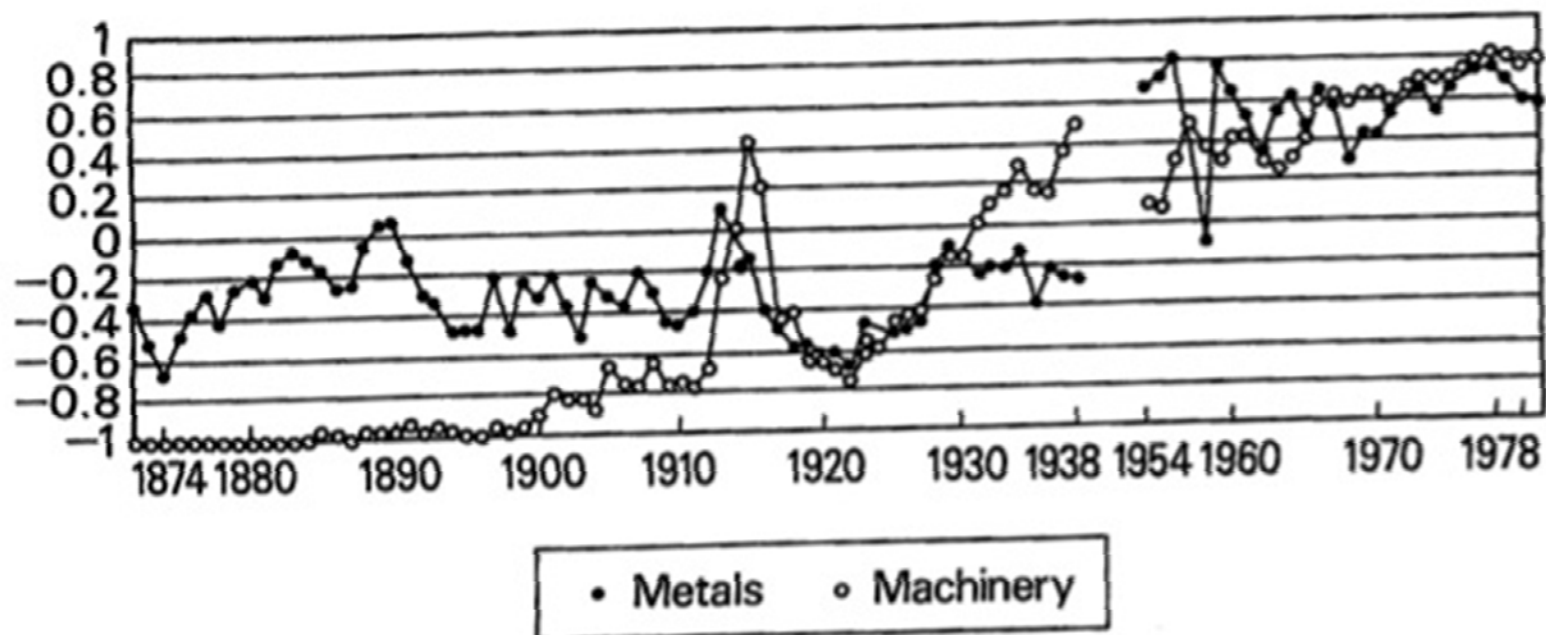


Figure 8.2
NER of Metals and Machinery: Japan, 1874–1978
Source: The same as for Figure 8.1.

Data regarding the inequality

Gini coefficients

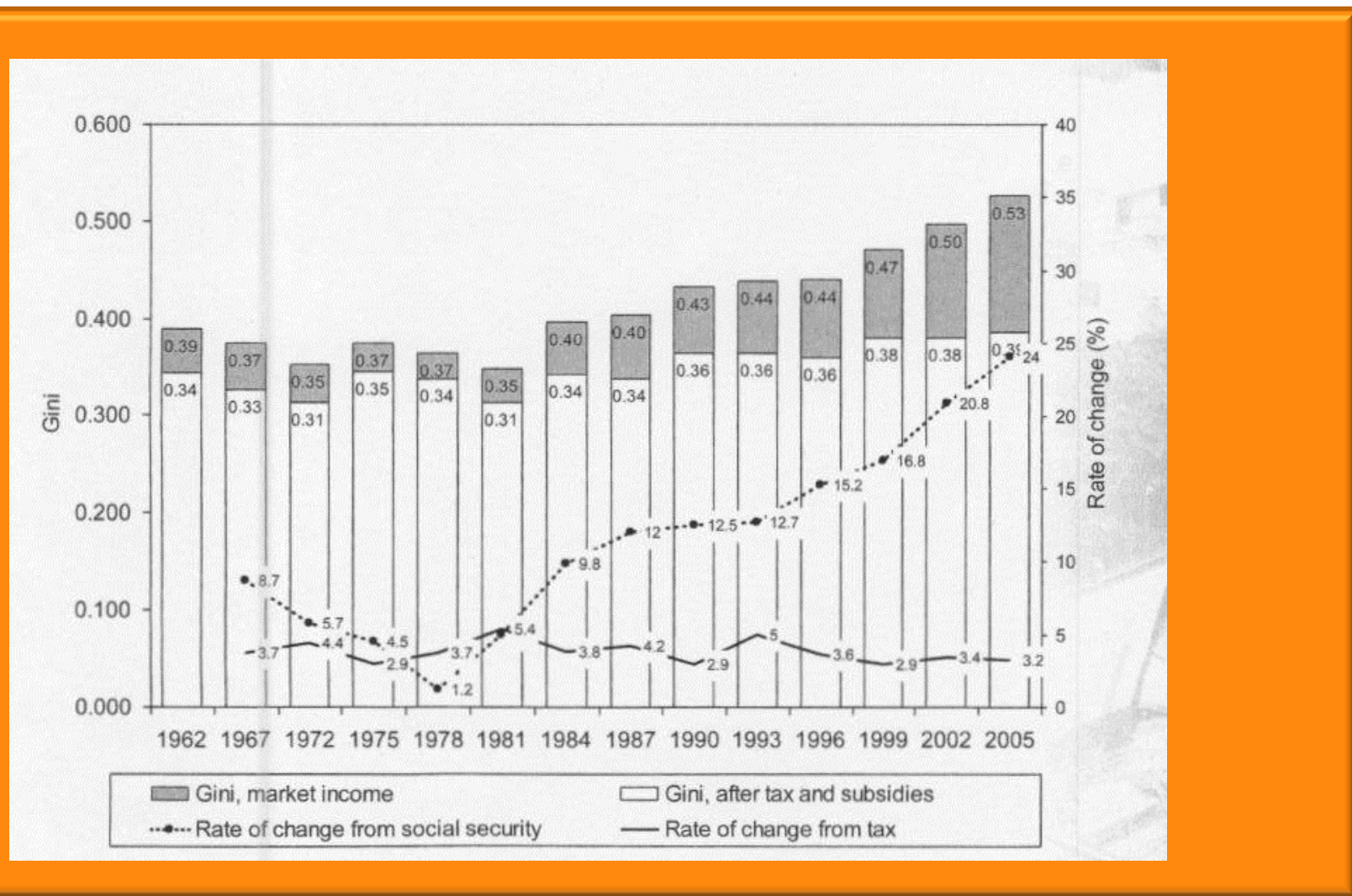
1910	0.357
1920	0.417
1930	0.431
1940	0.467

Wage-differentials between the agricultural and industrial sectors

no significant differential in 1920

Ration W_i/W_a increased to around 2.5

Japan: Trends in Gini Index (1962-2005)



Policies adopted by the Government

Industrialization

machinery industry , chemical industry
metal-processing industry

Agricultural protection policy

Public investment to the infrastructure in the less-developed areas , especially in the Tohoku-region

Industrial Policy: Policy of Enhancing Productivity

1931 Major Industrial Control Law

Article 1 of this law provided that when more than half the members of an industry formed a cartel, it had to be registered with the minister having jurisdiction over the industry. Article 2 allowed the minister to order business that were not members of the cartel to conform with cartel decisions if the minister deemed it necessary to protect reasonable profits in the industry and to ensure the sound development of the national economy.

Forced Cartel

Heavy Industries and “Rationalization”

In the 1920s, a shift toward heavy industry-chemical and machinery industries- and greater industrial productivity was progressing apace, although not in a fashion that was immediately obvious to the casual observer.

On the surface, the structure of Japanese industry did not appear to change a great deal, but it is worth noting that within the companies efforts to upgrade operations were becoming more sophisticated, laying the groundwork for the 1930s.

The 1920s were a time of productivity campaigns in the United States and Germany. This meant eliminating waste and raising workers' productivity. Many companies made efforts to streamline their operations in a time of recession out of fear that if they did not completely rationalize their operations they would not be able to stay alive in a competitive society.

Major Causes of Industrialization in these decades

Two major reasons lay in the background to this growth of production and export. One was that the cumulative technological experience and rationalization efforts since the 1920s had finally borne fruit, and new demand was being developed within Japan. Importance of domestic market.

The second was that a result of lower exchange rates , the prices of imported products had risen , making it easier for companies to beat the competition.

Establishment of Agricultural Protection Policy

- During the inter-war stagnation phase, the basic emphasis of agricultural policy clearly changed from keeping rice price low to raising rice price. In terms of the World Bank's definition, it can be said that the basic stance from the policy of developing countries to that of developed countries. Such a change materialized through positive rent-seeking activities by farmers in the process of decision making on economic policy.

During this period, there existed the worsening tendency of the conditions of agricultural trade because of increasing import of rice. At the same time, there emerged a widening gap of labor-productivity between agriculture and non-agriculture, as already mentioned. These two trends resulted in widening income gap between farmers and urban workers. In order to narrow such a widening income gap, farmers activated in collaboration with landlords a political movement pressuring the Government into raising price of rice. This was the reason why the basic stance of agricultural policy changed during this inter-war stagnation phase.

- In the 1920s competition from colonial rice depressed rice price and agricultural income. Based upon strong pressures from the Imperial Agricultural Society, the Government adopted BEIKOKU HO (The Rice Law) in 1921. This law gave the Government the power to adjust rice supply in the market by managing purchase, sale, and storage, by changing import duty, and by restricting imports from foreign countries.

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- In 1933, because of surplus of rice, the Rice Law was replaced by BEIKOKU TOSEI HO (The Rice Control Law) which authorized the Government to buy and sell unlimited quantities of rice at the floor and ceiling prices. Subsequently, as the war progressed, the Government strengthened direct control of rice distribution , and in 1939 BEIKOKU HAIKYU HO (The Rice Distribution Act) was adopted. The number of food items added to the list of direct control and rationing increased, and finally in 1942 SHOKURYO KANRI HO (The Food Control Act) was proclaimed.

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