



**Asia-Pacific  
Economic Cooperation**

---

**2014/SOM3/EC/028**

Agenda Item: 10


## **Avoiding the Middle Income Trap: Opportunities for Action**

Purpose: Information

Submitted by: APEC Secretariat




**Second Economic Committee Plenary Meeting  
Beijing, China  
17-18 August 2014**



Asia-Pacific  
Economic Cooperation

Advancing  
Free Trade for Asia-Pacific  
Prosperity


# Avoiding the Middle Income Trap: Opportunities for Action



Presented by:  
Dr Denis Hew, Director  
APEC Policy Support Unit

Copyright © 2013 APEC Secretariat

## What is the Middle Income Trap?



Asia-Pacific  
Economic Cooperation

- Term used to describe the situation when a middle income economy is unable to graduate into high income status.
  - We have clear definitions of middle income and high income, but none for middle income trap per se.
  - No definition of how long an economy must be in middle income status to be considered in a “trap”.
- However, being in MIT is a concern for middle income economies that are unable to sustain their rapid growth.

## What are the causes of the Middle Income Trap?



- Many theories on why MIT occurs. E.g.:
  - Industries that drove growth in the rapid growth phase start to become globally uncompetitive due to rising wages (Spence 2011).
  - MI economies are squeezed between low-wage, low-income economies and highly innovative high-income economies (Gill and Kharas 2007).
  - Failure to upgrade human capital and too little manufacturing FDI (Ohno 2009).
- Boils down to the challenge of industrial upgrading.
  - Where will future growth come from? How will productivity continue growing?

## Which APEC Economies are Middle Income?

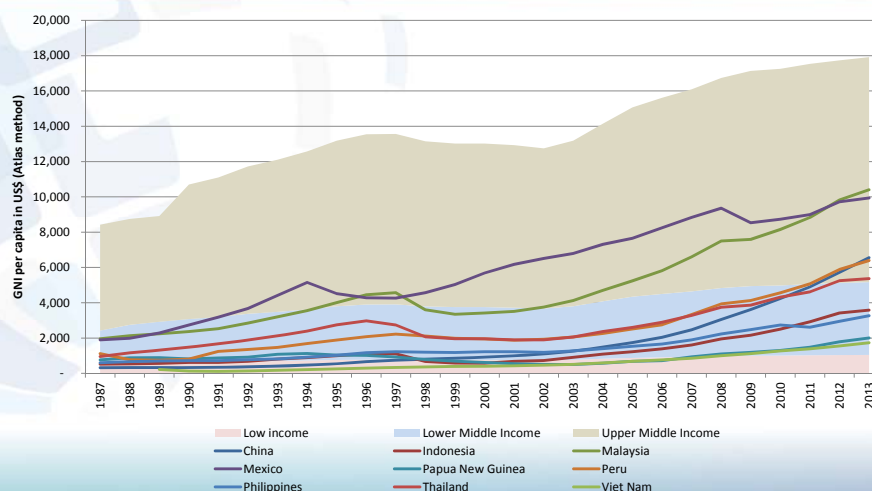


|                     | Per capita GNI<br>in 2013<br>(US\$) | MI<br>status<br>(2013) | Year<br>became<br>LMI | Year<br>became<br>UMI |
|---------------------|-------------------------------------|------------------------|-----------------------|-----------------------|
| China               | 6,560                               | Upper                  | 1998                  | 2010                  |
| Indonesia           | 3,580                               | Lower                  | pre-1987              | ---                   |
| Malaysia            | 10,400                              | Upper                  | pre-1987              | 1992                  |
| Mexico              | 9,940                               | Upper                  | pre-1987              | 1990                  |
| Papua New<br>Guinea | 2,010                               | Lower                  | pre-1987              | ---                   |
| Peru                | 6,390                               | Upper                  | pre-1987              | 2008                  |
| Philippines         | 3,270                               | Lower                  | pre-1987              | ---                   |
| Thailand            | 5,370                               | Upper                  | pre-1987              | 2010                  |
| Viet Nam            | 1,730                               | Lower                  | 2008                  | ---                   |

Source: World Bank data.

- Currently 9 APEC economies are classified by World Bank as MI.
  - 5 UMI and 4 LMI.
- Most have been MI since 1987, when formal income-based classifications began.
- Five APEC economies have transitioned from LMI to UMI.

## Which APEC Economies are Middle Income?



## Which APEC Economies graduated into High Income?



|                   | Year became UMI | Year became High Income | No. of years in UMI | Average growth rate (GDP p.c.) |
|-------------------|-----------------|-------------------------|---------------------|--------------------------------|
| Hong Kong, China  | 1976            | 1983                    | 7                   | 5.9                            |
| Japan             | 1968            | 1977                    | 9                   | 4.7                            |
| Republic of Korea | 1988            | 1995                    | 7                   | 6.5                            |
| Singapore         | 1978            | 1988                    | 10                  | 5.1                            |
| Chinese Taipei    | 1986            | 1993                    | 7                   | 6.9                            |

Source: Felipe et al. 2012

- Five APEC economies have transitioned from UMI to high income post-1950.
- All were able to make the transition in one decade or less.
- But Asia is an exception. In other regions it takes more than a decade.
  - E.g., Argentina (40 years); Greece (28 years); Israel and Spain (17 years)
  - Median is 14 years.

## How did they avoid the middle income trap?



- Agenor et al. (2012): Experience of “Asian Tigers”
  - Success in developing advanced infrastructure networks, improving competitiveness and role as regional hubs
    - ICT and high-speed communications networks
    - Physical infrastructure
  - Able to push technological frontier from imitation to innovation
    - Aided by strong intellectual property rights protection
    - High human capital investment and R&D spending
  - Have flexible labour markets and open economic policies
    - Enabled reallocation of labour across sectors and encouraged competition
- Felipe et al. (2012): Economies that were able to transition from MI to high income status had “more diversified, sophisticated, and non-standard export baskets” than those that did not.
  - I.e., production of goods and services higher up the value chain

## What do middle income economies need to do?



- Basically need to promote structural transformation and move up the value chain, but...
  - Each economy has different contexts and starting points
  - LMI: low-cost advantage still presents (limited) opportunities for growth, but institutional, infrastructure, and human capital deficiencies can constrain growth
  - UMI: can no longer rely on the low-cost advantage and need to develop a high-value innovative economy; need to upgrade institutions, infrastructure, and skills
- But most recommendations converge on five main action areas...

## What do middle income economies need to do?



- Encourage industrial upgrading
  - Reduce three key barriers to development: lack of efficient infrastructure, heavy tax burdens, and rigid labour regulations
  - Financial market reform could also help this process to provide funding for investments as well as infrastructure development
- Develop human capital and innovative capacity
  - Need to ensure continued labour productivity growth
  - What education? Depends on level of economic development and technological adaptation
  - Need to be forward-looking: train for tomorrow's needs today
  - Promote and incentivise innovative activities

## What do middle income economies need to do?



- Continue with efforts in opening up markets and liberalising trade and investment
  - Provides markets with adequate signals on where best to allocate resources
  - Promotes competition and innovation
- Improve macroeconomic policies
  - To avoid macroeconomic imbalances that can constrain growth
  - E.g., fiscal and monetary policies, taxation, inflation management, and macroprudential regulation
- Improve institutions and property rights protection
  - Strengthen rule of law, transparency, and accountability
  - Improve public and private institutions (e.g., civil service, self-regulation) as well as competition policy
  - Provides policy space for productive and innovative activities

# What can APEC do?



- Most prescriptions to avoid MIT involve structural reforms
  - Economic Committee can play a key role in coordinating initiatives and ensuring regional cooperation in addressing MIT
  - Working Groups can be instrumental in promoting cooperation in various areas (e.g., HRDWG on education and scientific exchange)
  - ANSSR could incorporate MIT in structural reform agenda post-2015
- Regional cooperation on infrastructure development and connectivity
  - MYPIDI and APEC Connectivity Blueprint are steps in the right direction
- FMP: promote financial market openness and sound macroprudential regulation in the region
- CTI: continue efforts on promoting trade and investment liberalisation in the APEC region

Thank you



## Policy Support Unit

APEC Secretariat

35 Heng Mui Keng Terrace

Singapore 119616

Telephone: (65) 6891 9600

Fax: (65) 6891 9690

Email: [info@apec.org](mailto:info@apec.org)

APEC Website - [www.apec.org](http://www.apec.org)