The effect of systemic vulnerabilities on the Middle-Income Trap

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Key takeaways from Dr. Akira Suehiro regarding "Developmental States" & Introduction to "Systemic Vulnerability"

"Society must have the social capability to absorb modern technology"

"Developmental States" consists of 3 components

1. Strong public sector
2. Talented and proficient firm
3. High skilled labor

Act as the main players in terms of driving effective industrial policy and economic growth

Systemic Vulnerability

A key string that pressures the East Asia countries to **develop themselves economically** at a fast pace

Key components of Systemic Vulnerability

1 **Broad coalition**

2 **External threats**

3 **Resource constraint**

By Richard Doner, Bryan Ritchie, and Dan Slater

Source: Expert's takeaways; Research Paper by Dr. Akira Suehiro

Introduction: Case Example:

Correlation of Coalitional Structure and Systemic Vulnerability by country

Case 1: South Korea, Taiwan, Singapore

1) After WWII	2) Reforms	3) Maturation of institutions
Fear/ Discontent No major export commodities "Wealth-sharing" mechanism	Needs for: • Effective development plannings • Export promotion • Industrial deepening	Boosting productivity Export sophisticated products

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Meet challenges of Systemic Vulnerability

Stimulate strong capacity for strong economic development and promote linkage with public-private sectors

Case 2: Thailand, Indonesia, Malaysia

- Never experienced the levels of Systemic Vulnerabilities
- Absence of external threats
- Rarity of revenue shortfalls
- More resources endowment than east asia countries

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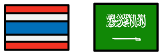
No incentives to promote development

Source: gsdrc.org; the101.world

Case Example:

Correlation of Coalitional Structure & Systemic Vulnerability by country

	Low External Threats		High External Threats	
	More Fragmented	**More Homogeneous**	**More Fragmented**	**More Homogeneous**
Fewer resource endowments	Broad with participation in ruling party and competition among elite groups 	Broad, but with limited participation among members of ruling party/ group 	Narrow with participation within parties/groups 	Broad with wide participation across groups and classes 
More resource endowments	Narrow with high participation within competing political and economic parties/groups 	Narrow with low participation primarily from ruling elites 	Broader but participation is limited to consultation and then only within ruling groups/party 	Narrow with little participation outside of ruling group/party 

Source: EE482 Lecture Notes

Issues & Challenges:

Comparison on feudalism between Thailand and South Korea

Thai Sakdina | **Chaebol**

Designed to favors the **vested interest group.** Hence, reflects the system of **social hierarchy**

Thai feudalism negatively impact the economy

Narrow Coalition

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Failure in policy reforms

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Failure of the country's industrial policy

- Promote inequality
- Resulted in a rise in poverty rate
- Declining the level of competitiveness

- FDI and/or foreign demand was not the main focus on the process of policy reforms
- Fail to drive technological growth and value creation to domestic players

Fail to escape Middle-Income Trap

Chaebol brought the "economic miracle" to South Korea

Narrow Coalition

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Success in policy reforms

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Success in market reforms

- Promote inequality
- Resulted in a rise in poverty rate
- Declining the level of competitiveness

- Reformulation of the Antitrust Laws
- Market decentralization
- Put the main focus on attracting FDI inflows and enhance competition in the market

- Able to drive technological transfer add value creation to domestic players
- Able to escape Middle-Income Trap

Source: nytimes.com; thai-blogs.com

Issues & Challenges (Professor Daron Acemoglu):

The adaptation of technologies and innovation technologies are the key success to world technology frontier.

1 Focus on borrow technology from abroad and rely mostly on vested interest group

2 Moving to digitalization and innovation

Stage 1: Investment-based strategy

- Borrow innovation & Adopt technology
- Vested interest group lead the market
- Large-average investment, but little selections

SWITCH!

Middle-Income Trap

Stage 2: Innovation-based strategy

- Promoting competition
- Encourage more entry to the market
- Less investment, better selections of managers

Distance from world technology frontier

By innovating itself and promoting competition, Thailand will be able to sustainably move toward modernization and transition to a high-income economy

Source: Expert's takeaways; nber.org

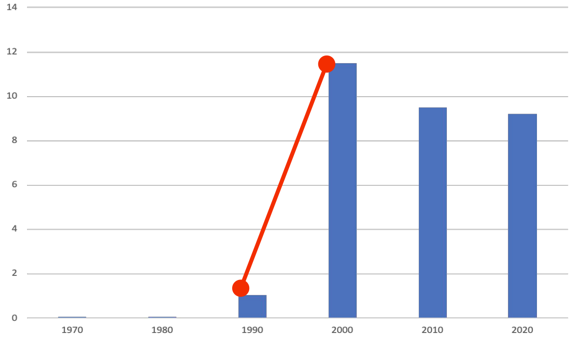
Solutions:

Get to know how South Korea develop effective industrial policies and its successful market reform

How did South Korea successfully develop its economy in a fast-pace?

1) Offers incentives in favor to foreign companies

With the purpose of driving the development of new regional market and high-end sectors



South Korea's FDI inflows rises sharply by $US 10.46 billion during 1990-2000

2) Enhance competition

Aims at removing obstacles to economic activities and encourage total productivity

- Barrier to market entry
- Encourage SMEs and small businesses

3) Apply the Export-related Industrial Policy

By launching developing industries called "Heavy and Chemical Industrialisation", South Korea successfully sustained its growth in export throughout 1970s

4) High-quality bureaucracy

By focusing on organisational reform, improvement in incentive systems, and sending its bureaucrats for extra training

5) Rapid expansion of higher education

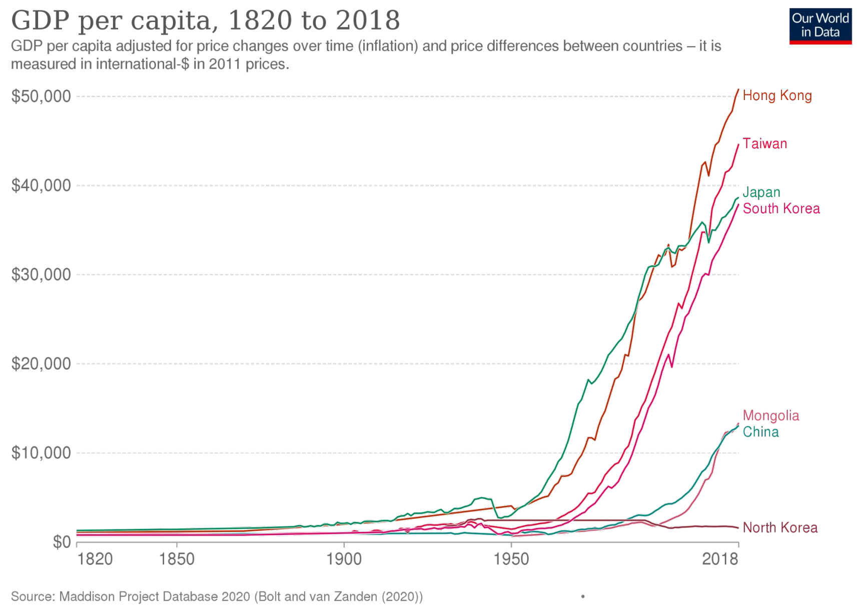
Resulted in a positive impact shown by an increase in supply of skilled worker

Altogether, South Korea can effectively pick up and implement the capabilities needed for effective industrial policy

Source: Macrotrends.net; fdiintelligence.com; EE482 Lecture Notes

Solutions:

Explore the industrial policies implemented in East Asia Countries



Industrial policy implemented in East Asia

1) Coordination of complementary investments
2) Coordination of competing investment through entry regulation
3) Policies ensuring stable economies
4) Regulation on technology imports
5) Regulation on FDI
6) Mandatory worker training for firms above a certain size
7) State acting as a venture capitalist incubating high-tech firms
8) Export promotion
9) Government allocation of foreign exchange

Source: Wikipedia.org; EE482 Lecture Notes

Recommendations:

Suggestions on factors preventing Thailand to escape the Middle-Income Trap

Concern: Limitation of input-driven growth > Middle-Income Trap

Factors Thailand and/or other emerging Asian Economies should be avoid

1) An increase in wage level
    - Resulted in slower growth rates
2) A fall in growth rate of labour productivity
3) Big gap in worker’s productivity between emerging Asian countries and the U.S.
4) Underinvestment in R&D
    - Insufficient development of innovation capabilities
5) Underinvestment in the requisite social capabilities
6) Less contribution to broader coalition

Impact

- Able to compete internationally in standardized
- Able to compete in higher value added activities due to high rate of productivity
- Has the capabilities to run effective innovation policy
- Less inequality and poverty rate
- Effective **export-related industrial policy** is one of the main contributions to economic development, which requires significant industrial policy.

Source: adb.org; EE482 Lecture Notes

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