Chapter 1

The Issues of the ASEAN Economy —Rising Debate over the Middle-Income Trap

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Key Points

- There is rising debate over the middle-income trap in the economies of the ASEAN countries. Despite differences among the countries, the economic growth rate has been trending downward since a peak in 2010, which has been a factor giving rise to concerns over the middle-income trap.

- To overcome the middle-income trap, it is essential in terms of industry to increase added value and to shift towards services. To this end, searching for and implementing a development strategy including the introduction of new technologies and new products, the opening up of new markets, and the like is called for.

- The Japanese government should promote cooperation with the ASEAN countries including infrastructure development, the fostering of human resources, and the like, but when doing so, it is necessary to enhance assistance not only in bilateral frameworks, but also in multilateral frameworks such as Japan-ASEAN, RCEP, and the like.

The downward-trending growth rate in the ASEAN countries
(the GDP growth rate trend)

	Actual values						Predicted values					
	2000-2007	2008	2009	2010	2011	2012	2013			2014		
							IMF	WB	ADB	IMF	WB	ADB
Indonesia	5.1	6.0	4.6	6.2	6.5	6.2	5.3	5.6	5.7	5.5	5.3	6.0
Malaysia	5.1	4.8	-1.5	7.2	5.1	5.6	4.7	4.3	4.3	4.9	4.8	5.0
Philippines	5.0	4.2	1.1	7.6	3.6	6.8	6.8	7.0	7.0	6.0	6.7	6.1
Thailand	5.1	2.5	-2.3	7.8	0.1	6.5	3.1	4.0	3.8	5.2	4.5	4.9
Vietnam	7.7	6.3	5.3	6.8	6.0	5.0	5.3	5.3	5.2	5.4	5.4	5.5
S. Korea	4.7	2.3	0.3	6.3	3.7	2.0	2.8		2.8	3.7		3.5
Taiwan	4.2	0.7	-1.8	10.8	4.1	1.3	2.2		2.3	3.8		3.3

Source: Aside from Taiwan, the actual values are from the World Bank, World Development Indicators on line (accessed November 25, 2013), and the Taiwan values are from the Asian Development Bank, Statistical Database System on line (accessed November 25, 2013).
The predicted values by the IMF are from the Regional Economic Outlook Update, October 11, 2013, by the World Bank (WB) are from the East Asia and Pacific Economic Update, October 2013, and by the Asian Development Bank (ADB) are from the Asian Development Outlook 2013 Update, October 2013.

Introduction

As a result of the 1997 Asian Currency Crisis, the Association of Southeast Asian Nations (ASEAN) countries suffered an unprecedentedly severe economic blow, but then achieved a rapid recovery referred to as a V-shaped recovery driven by an expansion in exports. Entering the 21st century, the ASEAN countries also recorded a high level of growth against the backdrop of steady global economic expansion. The global financial crisis triggered by the collapse of the investment bank Lehman Brothers in the US in 2008 had a severe effect not only at the epicenter in the US but also developed countries in Europe, Japan, and the like. The effects of the global financial crisis were comparatively mild in the East Asian countries including the ASEAN countries due to the implementation of an expansionary macro-economic policy as well as a lowered external dependence in terms of finances as a lesson from the Asian Currency Crisis. However, as analyzed in the various chapters of this report, despite achieving middle-income status, the ASEAN middle-income countries have not been able to transition to being high-income countries due to being unable to continue to sustain high levels of growth.

The objective of this study is to elucidate the current situation and issues with respect to economic growth for selected middle-income countries in ASEAN of Malaysia, Thailand, Indonesia, the Philippines, and Vietnam,[1] and to discuss policies for these countries to achieve steady economic growth and to become high-income countries. The issues are apprehended not from a short-term perspective but from a mid- to long-term viewpoint. Based on the analysis results, recommendations are compiled for the Japanese government, the governments of the ASEAN countries, and Japanese businesses.

Below, Section 1 is an overview of the current state of the economies of the ASEAN middle-income countries, and provides foundational information regarding the ASEAN middle-income countries that are treated in each chapter. Section 2 analyzes the significance of the “middle-income trap,” which is the theme of this study, the reasons for falling into the trap, methods for avoiding the traps, the role of regional cooperation for avoiding the trap, and the like based on past studies. Section 3 summarizes each chapter, and Section 4 compiles proposals.

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[1] Aside from the countries discussed in this report, Laos is also classified as a middle-income country by the World Bank among the countries belonging to ASEAN. However, due to a smaller economic scale compared to the other countries, a small importance to Japanese corporations, and the like, it is not treated in this report.

1. The economic situation in the ASEAN middle-income countries

Table 1 indicates the GDP growth rates in recent years as well as GDP growth rate projections for 2013 and 2014 for the middle-income countries of Indonesia, Malaysia, the Philippines, Thailand, and Vietnam as well as South Korea and Taiwan, which overcame the middle-income trap, sustained steady growth, and became high-income countries/regions.

From the start of the 21st century until 2008 when the global financial crisis arose (from 2000 to 2007), Indonesia, Malaysia, the Philippines, and Thailand recorded similar growth rates of around 5% annually. Vietnam had been achieving a higher growth rate of approximately 7.7% annually.

The effects of the 2008 global financial crisis differed for each country. Malaysia and Thailand, which have a high economic dependence on exports, and the Philippines, which has a high dependence on remittances from overseas, experienced a large drop in growth rate due to the Western economic slump. Meanwhile, the decrease in growth rate was not as large in Indonesia and Vietnam, where the dependence on exports to Western countries was not as high. In 2010 there was a rebound from the drop in 2009, and the countries excepting Vietnam recorded a high level of growth exceeding that which preceded the crisis. Despite differences in degree between each country, the economic growth rates from 2011 onwards have been trending downwards from the peak in 2010. This downward trend is thought to be one factor leading to concerns about the middle-income trap.

Table 1: The growth rate in the ASEAN countries, South Korea, and Taiwan

	Actual values						Predicted values					
	2000-2007	2008	2009	2010	2011	2012	2013			2014		
							IMF	WB	ADB	IMF	WB	ADB
Indonesia	5.1	6.0	4.6	6.2	6.5	6.2	5.3	5.6	5.7	5.5	5.3	6.0
Malaysia	5.1	4.8	-1.5	7.2	5.1	5.6	4.7	4.3	4.3	4.9	4.8	5.0
Philippines	5.0	4.2	1.1	7.6	3.6	6.8	6.8	7.0	7.0	6.0	6.7	6.1
Thailand	5.1	2.5	-2.3	7.8	0.1	6.5	3.1	4.0	3.8	5.2	4.5	4.9
Vietnam	7.7	6.3	5.3	6.8	6.0	5.0	5.3	5.3	5.2	5.4	5.4	5.5
S. Korea	4.7	2.3	0.3	6.3	3.7	2.0	2.8		2.8	3.7		3.5
Taiwan	4.2	0.7	-1.8	10.8	4.1	1.3	2.2		2.3	3.8		3.3

Source: Aside from Taiwan, the actual values are from the World Bank, World Development Indicators on line (accessed November 25, 2013), and the Taiwan values are from the Asian Development Bank, Statistical Database System on line (accessed November 25, 2013).
The predicted values by the IMF are from the Regional Economic Outlook Update, October 11, 2013, by the World Bank (WB) are from the East Asia and Pacific Economic Update, October 2013, and by the Asian Development Bank (ADB) are from the Asian Development Outlook 2013 Update, October 2013.

According to the projections by the IMF, the World Bank (WB), and the Asian Development Bank (ADB), all the countries have continued the downward trend in growth rate with respect to the peak growth rate in 2010. With the growth rates as projected, it appears that joining the ranks of the high-income countries will not occur for quite a while for the countries excepting Malaysia which has nearly reached the level of a high-income country (Table 2).

Table 2: Economic indicators for the ASEAN countries

	GDP	Per capita GDP	Population	As a % of GDP:				Internet usage	Power cons.	Higher education enrollment	R&D expenditures	EODB Index
				Investment	Saving	Exports	Inward FDI					
	2012	2012	2012	2012	2012	2012	2012	2012	2011	2009		2012
Indonesia	878.2	3,557	246.9	35.3	33.8	24.3	2.3	15.4	679.7	22.4	0.083	116
Malaysia	303.5	10,381	29.2	25.5	37.4	87.5	4.2	65.8	4,246.5	40.2	0.635	8
Philippines	250.2	2,587	96.7	18.5	15.3	30.8	1.1	36.2	647.0	28.2	0.110	133
Thailand	366.0	5,480	66.8	29.7	30.9	75.0	2.4	26.5	2,316.0	45.7	0.214	18
Vietnam	141.7	1,596	88.8	30.9	30.4	89.8	6.0	39.5	1,073.3	19.7	0.193	98
S. Korea (reference)	1,129.6	22,590	50.0	27.6	30.6	56.5	0.4	84.1	10,162.0	103.9	3.738	6

Note: GDP is in $billions.
Per capita GDP is in $US
Population is in millions
Inward FDI as a % of GDP values for Malaysia and Vietnam are from 2011
Internet usage is users per 100 people.
Power consumption is usage per person (kilowatt-hours)
Higher education enrollment is the gross enrollment ratio
R&D expenditures are as a % of GDP from years as follows: Indonesia (2009), Malaysia (2006), the Philippines (2007), Thailand (2007), Vietnam (2002), and South Korea (2010).
EODB Index is the Ease of Doing Business Index (raking of 189 countries)
Source: World Bank, World Development Indicators on line (accessed November 25, 2013)

Next is an overview of the economies of Indonesia, Malaysia, the Philippines, Thailand, and Vietnam, which are the subjects of this study. There are large disparities between these countries in per capita GDP (US dollars). Malaysia ranks the highest at $13,810, followed by Thailand ($5480), Indonesia ($3557), the Philippines ($2587), and Vietnam ($1596). In terms of economic scale (GDP), Indonesia ranks the highest, followed by Thailand, Malaysia, the Philippines, and Vietnam.

In terms of the investment-to-GDP ratio and the saving-to-GDP ratio, the countries excepting Malaysia have similar values, and there is almost no investment/saving gap. Indonesia has the highest investment-to-GDP ratio of 35%. Vietnam and Thailand also have high values of approximately 30%. Meanwhile, the investment-to-GDP ratio in the Philippines is low at 18.5%, investment being inactive compared to the other countries. Malaysia has the highest saving-to-GDP ratio of 37.4%. Malaysia’s investment-to-GDP ratio of 25.5% is extremely low compared to its saving-to-GDP ratio. Taking into consideration the fact that outward direct investment from Malaysia is rapidly expanding, it can be understood that investment opportunities within Malaysia are limited.

With respect to outward economic relationships (exports and inward direct investment), Malaysia, Thailand, and Vietnam have a high external dependence, while Indonesia and the Philippines have a low external dependence. From the recognition that an expansion in exports and inward direct investment contributes greatly to economic growth through an increase in productivity and an expansion in production and employment, the creation and implementation of policies towards expanding exports and inward direct investment are important in Indonesia and the Philippines. In particular, inviting direct investment of a sort forming a production network has a large effect on economic growth as a result of bringing about an expansion in efficient production and trade.

Internet usage indicates communication infrastructure, and power consumption indicates the infrastructure supporting economic activities, and so these are important indicators for economic growth. Malaysia has the highest value for internet usage, but the other countries are lagging considerably behind. Internet usage in Indonesia is particularly low. Malaysia also stands at a comparatively high level with respect to power consumption, but Indonesia and the Philippines are at an extremely low level. As discussed below, higher education enrollment and research and development expenditures are indicators determining productivity, which plays an important role in avoiding the middle-income trap. Malaysia and Thailand have comparatively high values for higher education enrollment, but the other countries have low values. Also, Malaysia is the only country with a comparatively high value for the R&D-to-GDP ratio, the other countries having extremely low values.

2. Rising concerns regarding the "middle-income trap"

This section analyzes the middle-income trap, which is the theme of this study, from a variety of viewpoints based on prior studies. The objective of the analysis is to provide foundational knowledge regarding the middle-income trap in order to deepen understanding of the analysis in each of Chapters 2 onwards.

2.1 What is the middle-income trap?

Centering around the developing countries of East Asia, many developing countries have overcome the poverty trap, transitioning from low-income countries to middle-income countries. For the record, according to the World Bank definition, middle-income countries are those with a per capita GNI (2012) from US$1035 to US$12,615, within which the lower-middle-income countries are at US$4085 and below, and the upper-middle-income countries are above that value.[2]

In the debates over the middle-income trap thus far, it has been apprehended from two perspectives.[3] One is from per capita income levels, defining being caught in the middle-income trap as the situation of having become a middle-income country, but being unable to grow to a high-income country due to being unable to maintain high levels of growth over the long-term.[4] To express this from a slightly different perspective, countries which have fallen to the middle-income trap are those which cannot compete with low-income countries on cost in industrial production, but conversely cannot compete with high-income countries in innovation requiring high-level human resources. As stated above, since the middle-income countries cover a wide range, the middle-income trap can also be considered to be divided into a lower-middle-income trap and an upper-middle-income trap.[5] The other way to consider the middle-income trap focuses on growth rate, considering being caught in the middle-income trap to be the situation of a stagnating growth rate.

The middle-income trap has been garnering attention in recent years due to declining growth rates in many Asian countries that had been achieving high growth, including China and India. For example, in IMF (2013), OECD (2013), and others, there is a detailed analysis of the middle-income trap in the Asian countries.[6] The middle-income trap has not only garnered attention from international organizations and the governments of various countries, but also has become a notable research theme in the academic world. For example, Eichengreen et al. (2011, 2013) is a detailed analysis of the phenomenon of the middle-income trap, its causes, policies to avoid the trap, and so forth.

In recent years, the middle-income trap is rapidly drawing heightened interest, but it was the World Bank report "An East Asian Renaissance" (2007) that first turned an eye to this phenomenon.[7] This report discusses policies for the East Asian countries that have grown to be middle-income countries to achieve further growth to become high-income countries, but in the discussion, notes that the Latin American countries and the Middle-Eastern countries were not able to maintain high growth despite reaching middle-income status, describing these countries as having fallen into the middle-income trap.

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[2] World Bank, http://data.worldbank.org/about/country-classifications
[3] See Chapter 2 of this report for a more detailed explanation of the middle-income trap.
[4] Kharas and Kohli (2011).
[5] Tran (2013).
[6] Asian Development Bank (2011) briefly explains the problem of the middle-income trap.
[7] Kharas and Gill (2007).

IMF (2013) indicates two intriguing analysis results regarding the middle-income trap apprehended as a decrease in growth rate. One is that among the countries that have fallen into the middle-income trap, the growth rate of total factor productivity (TFP) has a tendency to continue to drop. The growth rate in TFP the portion of the economic (GDP) growth rate that results from an increase in factors that cannot be explained by an increase in production factors such as capital and labor, and indicates an increase in technological progress and/or production efficiency. This analysis result indicates that in order to achieve economic growth, an increase in production factors such as labor and capital play an important role, but an increase in production factors does not have much significance in preventing a sustained decrease in growth rates of the sort observed when caught in the middle-income trap.

The other intriguing analysis result pertains to the frequency of a slowing growth rate, growth rates slowing in the middle-income countries at a frequency approximately 1.5 times higher than that in low-income countries and high-income countries. In other words, this indicates that middle-income countries are more easily ensnared by low growth, and that the phrase "middle-income trap" appropriately reflects the reality. For the record, it has been observed that compared to countries in other regions, the countries of Asia have a lower frequency of a slowing growth rate.

2.2 The causes of falling into the middle-income trap

A cause for falling into the middle-income trap is when even after overcoming the poverty trap and growing from a low-income country to a middle-income country, there is no policy response to new issues as a result of continuing growth strategies implemented during the low-income period.[8]

In many cases, the transition from a low-income country to a middle-income country is achieved by transferring production factors such as labor and capital from low-productivity sectors to high-productivity sectors. For example, economic growth has been realized by moving excess labor from agriculture in rural areas to the urban industrial sector, and shifting from the domestic sector to the export sector. However, since the number of surplus workers declines and wages rise as a result of becoming a middle-income country, previous development strategies relying on low-wage labor lose their efficacy. Also, the shift in industrial structure and the structure of the labor market from being weighted towards industrial production to the service sector is another cause for export-driven strategies that had previously been supported by low-wage labor ceasing to have an effect.

[8] Kharas and Kohli (2011).

In the strategies necessary for shifting from being a middle-income country to a high-income country, promoting an increase in value added and a shift towards services is important with respect to industry. Also, policies necessary for a middle-income country put more emphasis on demand compared to policies adopted by low-income countries. In terms of exports, growth in low-income countries uses low-wage labor to produce and supply existing industrial products at a low cost, but in the successful transition from being a middle-income country to a high-income country, the introduction of new technologies and new products as well as the opening up of new markets become important. In that, it is necessary to understand the taste of consumers, and to realize an increase in product quality. If these developmental strategies cannot be developed and implemented, a country will fall into the middle-income trap.

IMF (2013) uses statistics to perform an interesting analysis of the factors behind slowing growth. The analysis had 138 countries as subjects during the period from 1955 to 2010, and brought to light the fact that a deterioration of fundamental indicators is an important factor in slowing growth. The fundamental indicators include healthy economic institutions (rule of law, limited government intervention, appropriate regulations on goods, labor, and capital markets, and the others), favorable demographics (population bonus), favorable trade structure (diversified export product structure, participation in regional integration, proximity to large markets), and so on. Further noted is the fact that while dramatic inflows of capital and a rapid rise in investment enable high growth, the risk of destroying high growth is included. There is also a search for the causes of falling into the middle-income trap from an analysis narrowed down to the middle-income countries among the 138 subject countries. From the analysis, government intervention and regulation are considered the primary factors behind a decrease in economic growth in middle-income countries. IMF (2013) asserts that government intervention and regulation suppress technological innovation and the development of the private sector, which plays an important role in economic growth. Also, it is noted that undeveloped infrastructure for transportation, communication, and others is a factor which dulls economic growth.

Eichengreen et al. (2013) analyzes the growth rate of 146 countries during the period from 1957 to 2010, and performs a quantitative analysis with the objective of elucidating the factors bringing about low growth (the state of having fallen into the middle-income trap). Their analysis indicates that countries having high-level human resources and that are active in high-tech exports have a higher likelihood of being able to avoid the middle-income trap, whereas financial crises, unstable political environments, closed economies, low growth in the global economy, and so forth like facilitate being caught in the middle-income trap. They conclude that to avoid the middle-income trap, the enhancement and development of educational institutions is particularly important.

2.3 Methods for avoiding the middle-income trap

The previous section clarified the causes for being caught in the middle-income trap. Although it is clear that the method for avoiding middle-income trap is to appropriately handle those causes, this section uses that as a stepping-off point to once again discuss avoidance methods while touching on specific countermeasures. Important suggestions for tactics for avoiding the middle-income trap are obtained from the experience of Japan and the NIEs, which overcame or avoided the middle-income trap. Below, the research of Kharas and Kohli (2011), which discusses this problem from the broad vantage point of the transformation of economic structures, is introduced followed by a discussion of more specific measures.

Kharas and Kohli (2011) assert that to avoid the middle-income trap, it is important to achieve the three transformations below. First is the transformation from diversification to specialization in industry. By specializing in a specific industrial field, it is possible to gain profit from economies of scale and to overcome the high costs resulting from increased wages.[9] Also, industrial specialization enables innovation and the development of new products. As a result, corporations and industries that are competitive in the global market rise up, and the economic growth of the country in question is also promoted. Also, the agglomeration of corporations and industries, which is a geographic specialization, concentrates human resources and information promoting research and development as well as technological innovation, greatly contributing to economic growth. Specialization in production transfers production factors such as labor and capital from low-productivity sectors to high-productivity sectors, realizing economic growth.

In order to promote industrial specialization, it is necessary for governments to deal with rigid obstacles of the sort that hinder competition, such as vested interests and inappropriate regulations. For example, state-owned enterprises respond slowly to market trends, and so it is difficult for them to achieve efficient production. In these cases, the privatization of state-owned enterprises is necessary. However, for the people who would be harmed by the regulatory reforms and liberalization necessary for handling such rigid obstacles, governments must develop a safety net that mitigates such harm.

The second transformation is that from growth based on production factor inputs to growth

[9] Kharas and Gill (2007) also discusses the importance of obtaining profit through economies of scale in order to avoid the middle-income trap.

based on productivity increases. With respect to productivity, a rise in total factor productivity as discussed earlier is particularly important. In response to the report released by the World Bank (1993) titled “The East Asian Miracle” regarding the limits of growth based on production factor inputs, Krugman (1994) garnered attention through a rebuttal saying that East Asian growth is not due to an increase in productivity as noted in the report by the World Bank, but rather is economic growth realized through the use of labor and capital on a large scale, and so growth would be expected to eventually slow as the expansion of labor and capital would not continue forever.[10] Although the validity of Krugman’s assertions regarding the factors bringing about economic growth in the Eastern Asian countries continues to be debated to this day, the importance of increases in total factor productivity in realizing sustained economic growth has become a common awareness among many economists.

Research and development, technological innovation, the promotion of competition, and others play important roles in increasing total factor productivity. High-level human resources such as scientists and researchers are indispensable for research and development and technological innovation, and high-level human resources can be appropriated through domestic cultivation as well as through invitations from abroad. Establishing and expanding institutions of higher learning is necessary for domestic cultivation. Education brings about tremendous benefits not only to those who receive that education but also to society, and so government engagement and assistance is necessary. Also, if it is recognized that the establishment and expansion of institutions of higher learning are not realized over the short term, governments must promote the enhancement of institutions of higher learning in a sustained manner from a long-term perspective.

The third transformation is the shift from centralized institutions to decentralized institutions. This shift occurs in a variety of forms, and in terms of the government, includes delegating authority from the central government to the regional governments, and even within the central government, shifting from the situation of authority being concentrated in fewer hands, for example the president, to the situation of authority being distributed among various ministries and agencies. In lockstep with the transition from being a low-income country to being a middle-income country, the economic system becomes complex, and governance by a centralized government becomes difficult. Here, a decentralized government that can effectively respond to various problems becomes necessary. However, as authority becomes decentralized, effective governance becomes difficult due to it becoming easier to be

[10] The grounds for the arguments of Krugman (1994) lie in Young (1994) instead of being the result of his own corroborating analysis.

influenced by stakeholders. Effective governance must be realized through overcoming these sorts of issues. Additionally, in policymaking and policy management, the flexibility to alter those policies is necessary when problems arise.[11]

The above was a discussion of the three transformations necessary for avoiding the middle-income trap as emphasized by Kharas and Kohli (2011). Next is an introduction to a number of interesting studies regarding concrete policies for avoiding the middle-income trap. In this introduction, an attempt is made to avoid overlaps with the arguments of Kharas and Kohli (2011) as much as possible.

World Bank (2007) notes the importance of production networks that sustain an inter-process division of labor for effecting an increase in industrial efficiency. Production networks enable efficient production by enabling vertical specialization and economies of scale. In the building and smooth operation of production networks, it is necessary to furnish an open and stable business environment that can draw in direct investment from foreign companies that establish such networks. It is particularly important to develop infrastructure (transportation and communication services) such that component trade within production networks can occur smoothly and rapidly. Furthermore, World Bank (2007) explains that a stable and efficient financial sector is important in the efficient operation of production networks. This note is based on the experience of the economies of these countries having incurred a severe blow due to the Asian currency crisis. Specifically, the paper asserts that the development of bond markets promoting a shift from indirect financing to direct financing is necessary. Furthermore, World Bank (2007) considers the realization of a favorable living environment in the cities, where economic activities are concentrated, the rectification of income disparities, the eradication of corruption, and the like to be important in achieving sustained economic growth.

OECD (2013) analyzes the middle-income trap problem with respect to China, India, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam. This report issues the same basic prescription for avoiding the middle-income trap as Kharas and Kohli (2011), but especially emphasizes the role of government. Specifically, it is argued that governments play an important role in building and managing institutions, fostering human resources and innovation, providing a business environment in which corporations can operate easily, the development of the financial sector, particularly the development of a financial sector that provides funds to small and medium-sized enterprises, the development of the service sector, and the promotion

[11] World Bank (1993) emphasizes policy flexibility by the governments of the East Asian countries as an important factor in bringing about the East Asian miracle.

of regional cooperation. Similarly to World Bank (2007), OECD (2013) emphasizes the importance of production networks in the shift of the East Asian countries towards being high-income countries.

The Asian middle-income countries are incorporated into production networks, and have become supply bases fulfilling global demand as the world's factory, but in the future, rising incomes in the Asian countries will likely cause them to become supply bases fulfilling Asian demand within global demand. The Asian middle-income countries currently play a role as a production base for low-added-value goods within production networks, but must change to being production bases for high-value-added goods to become high-income countries. Also, although manufacturing is expected to continue to be an important industry to the Asian middle-income countries in the future, there is a high likelihood that the importance of the service sector will expand alongside the rapid rise in demand for services. The presence of a competitive service sector not only enables the smooth operation of production networks, but also promotes an increase in the value added of manufacturing, and raises the efficiency of the economy as a whole. Entry restrictions due to regulation are severe as a factor obstructing the development of the service sector, and so it is vital for governments to promote deregulation in the service sector.

2.4 Avoiding the middle-income trap through regional cooperation

It has been made clear that in order for the Asian middle-income countries to avoid the middle-income trap and to transition to being high-income countries, it is necessary to overcome a variety of issues. Although a domestic response to these issues is indispensable, efforts as part of cooperation with other countries promote a domestic response, and so are extremely important. For example, among the ASEAN countries, the liberalization of trade in goods resulting from the ASEAN Free Trade Area (AFTA), the liberalization of trade in services resulting from the ASEAN Framework Agreement on Services (AFAS), the participation in liberalization of investment resulting from the ASEAN Comprehensive Investment Agreement (ACIA), and furthermore the various efforts to integrate these aiming towards establishing an ASEAN Economic Community (AEC) by 2015 are effective problem responses necessary to avoid the middle-income trap through building highly transparent, free, and open institutions, developing infrastructure, fostering human resources, and so forth.

The ASEAN countries have established free trade agreements (ASEAN+1 FTAs) with Japan, China, South Korea, India, and Australia/New Zealand. These free-trade agreements not only contribute to the development of institutions for the ASEAN countries, but also promote economic growth through an expansion in exports and an expansion in inward direct investment, contributing to an avoidance of the middle-income trap. Currently, the Regional Comprehensive Economic Partnership (RCEP) is being negotiated by ASEAN and the six countries mentioned above aiming for an agreement by 2015. There is a high likelihood that RCEP will become an agreement including not only liberalization and facilitation of investment and trade in goods and services, but also economic/technological cooperation, competition policy, intellectual property rights, and others. The ASEAN countries should actively engage in proposals and negotiations to cause the contents of RCEP to be a means for avoiding the middle-income trap.

3. Proposals

The ASEAN middle-income countries (Indonesia, Malaysia, the Philippines, Thailand, and Vietnam) have achieved favorable economic growth compared to other developing countries. However, in order to transition from being a middle-income country to a high-income country, it is understood that it is necessary to overcome a variety of difficult issues. Below, the issues for avoiding the middle-income trap are explained, and policy proposals for responding to these issues are first presented for the governments of the ASEAN countries, and next for the Japanese government. Finally, proposals for Japanese corporations are compiled.

Although there are differences in issues among the countries with respect to the economy, developing infrastructure (particularly transportation infrastructure), nurturing human resources, increasing the technological level, and the like are important as issues in common. With respect to these, public good factors are powerful, and so although governments play an important role in realizing them, a response in cooperation/coordination with the private sector rather than a response by the government alone is favorable in terms of efficiency and cost burden.

To achieve economic growth, it is necessary to develop a business environment of a sort that enables free competition between private enterprises, which are the agents of dynamic economic activity. Competition promotes the development of new technologies and new products, and not only increases productivity, but also contributes to economic growth through promoting the efficient use of production factors such as labor and capital. In order to establish business environments in which private enterprises can act freely, it is necessary to provide economic rules such as a competition policy, intellectual property rights, and others, while regulations that obstruct business entry must be abolished. Also, it is important not only to enliven competition within the domestic market, but also to promote competition from foreign businesses through outward market opening.

In grappling with the issues mentioned above, it is effective to take advantage of cooperation with other countries focusing on the ASEAN countries. For example, since it is important for transportation infrastructure not only to be complete within a single country, but also to be linked with other countries, it is favorable for these to be furthered as a joint project of the ASEAN countries like the move towards the establishment of an ASEAN Economic Community (AEC) by all the ASEAN countries. With respect to market opening, the liberalization and facilitation programs for investment and trade in goods and services being carried out leading up to the realization of the AEC should be taken advantage of. For partnering and cooperating with foreign countries, the number one partners should be the other ASEAN countries, but the East Asian countries such as Japan that are currently engaged in the RCEP negotiations should also be targeted.

Political stability is indispensable for the governments of the ASEAN countries to implement these policies in a sustained manner. To realize political stability, situations leading to a loss of social stability, such as income disparity, must be avoided. To this end, it is necessary for policies to be implemented that secure the lifestyles of low-income individuals and the socially weak, and furthermore improve the circumstances in which they are placed by providing employment opportunities.

As a proposal to the Japanese government, bilateral cooperation is effective for developing infrastructure and fostering human resources in the ASEAN countries. With respect to developing infrastructure, the growth strategy of the Abe administration includes the export of infrastructure systems, and so Japan should actively cooperate with the development of infrastructure in ASEAN. Meanwhile, with respect to fostering human resources, nurturing high-level human resources in particular is a pressing issue in ASEAN, and so there must be an expansion in foreign exchange students to Japanese graduate schools. Another idea is the establishment of a graduate school where students from the East Asian countries focused on ASEAN can learn specialized knowledge. Also, the response to the issues faced by the ASEAN countries should be aided not only through bilateral frameworks, but also through multilateral frameworks such as Japan-ASEAN and RCEP.

Finally, with respect to proposals for Japanese businesses, the birthrate in Japan is declining and the population is aging, and so business operations will become difficult if there is a dependence only on Japanese workers. Here, it is possible for talented foreign workers to play an important role in the business operations of companies. In particular, in business operations overseas such as in ASEAN, local workers make large contributions. To recruit and nurture these types of human resources, it is important for corporate advancement policies, benefits, and the like to be attractive. The development of talented human resources by Japanese corporations not only would involve a large benefit to those corporations for the reasons stated above, but also would contribute to economic development in the local countries if those human resources switch their employment to local businesses. The switching of employment by nurtured human resources would constitute damage to the original corporations, but there is the high likelihood that an excellent system for developing human resources would attract talented individuals. In other words, there is a high likelihood that this would benefit the original corporations from a long-term perspective. In either case, improving local reputations through providing an attractive labor environment is effective for business operation.

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