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Growth and Stability in Advanced Middle Income Countries

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**ADB Insight Thursday
July 13, 2017
Manila**



The Asia Foundation

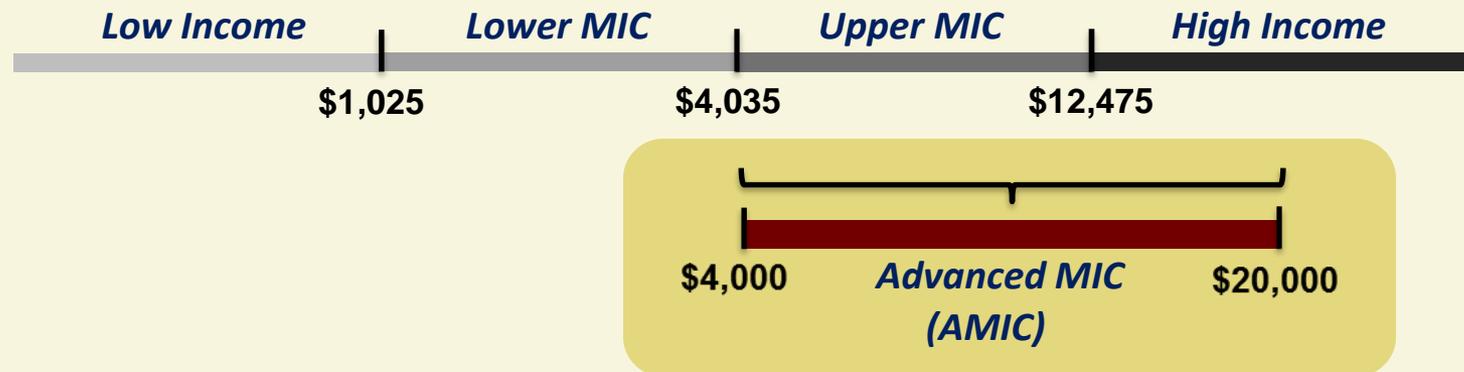
This Session

- ❖ **Definitions and Context**
- ❖ **Core Challenge: Economic Upgrading**
- ❖ **Underlying Challenge: Political Management**
- ❖ **Addressing the Challenges Ahead**

Definition and Context

- ❖ Roughly \$4,000-\$20,000 GNI per capita

IBRD categories



- ❖ Not focusing on:
 - China (scale)
 - High NR export dependent
 - Small island states

Rising Wave of AMICs in Asia

Countries Ranked by GNI per Capita

<u>Lower Income</u>		<u>LMIC - near AMIC</u>		<u>Developed</u>	
Afghanistan	630	Indonesia	3440	Taiwan	20925
Nepal	730	Philippines	3540	Greece	21090
		Sri Lanka	3800	Korea	27440
		Mongolia	3830	Spain	28520
				Brunei	36710
<u>Lower MIC</u>		<u>Advanced MIC</u>		Japan	36680
Cambodia	1070	Thailand	5620	UK	43340
Bangladesh	1190	Maldives	6670	Singapore	52090
Myanmar	1280	China	7820	USA	54960
Pakistan	1440	Brazil	9850	Australia	60070
India	1590	Turkey	9950		
Laos	1730	Malaysia	10570		
Timor Leste	1920	Chile	14060		
Vietnam	1980				

- Asian countries
- Non-Asian

IMF Data, 2015

What Makes AMICs Different from LMICs?

- ❖ Poverty much reduced, social indicators strong, large middle class, high inequality
- ❖ Economy more advanced - integrated into regional/global markets, higher credit rating better
- ❖ More urbanized, more educated
- ❖ Greater in-country capacity to address their own problems
- ❖ Greater national confidence - more skeptical of donor prescriptions
- ❖ Most traditional forms international aid end
- ❖ Greater ability to engage with and shape external environments



Core Challenge: Sustaining Economic Growth

- ❖ Core problem: comparative advantage based on cheap labor fades
- ❖ AMICs cannot compete with low-cost LMICs, but have trouble moving to a high productivity, innovation based economy
- ❖ Achieving higher productivity requires *economic upgrading*
- ❖ Breadth, scale, and technical complexity of the reform agenda is immense
- ❖ Growth slowdown... **Middle Income Trap**
- ❖ Increasingly researched – ADB engaged

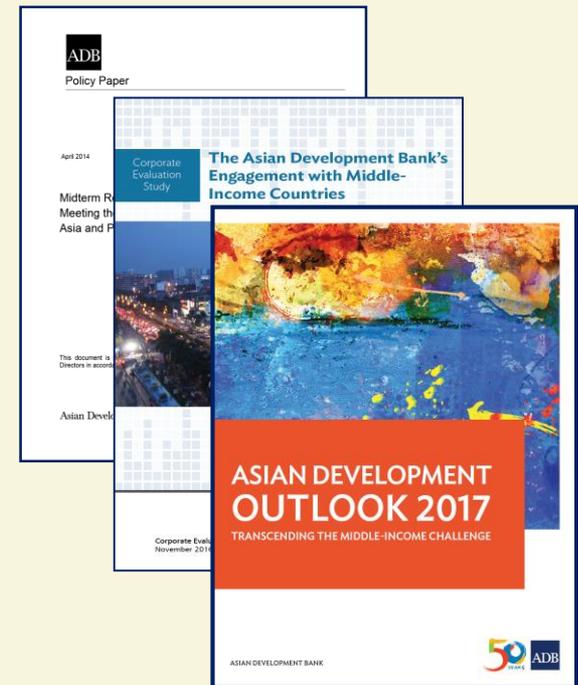
Asian Economic Outlook 2017

ADB's Engagement with MICs - 2016

Approach to UMICs: Refined Framework - 2015

Clients-Contributors-Collaborators - 2015

Mid-term Review of Strategy 2020 - 2014

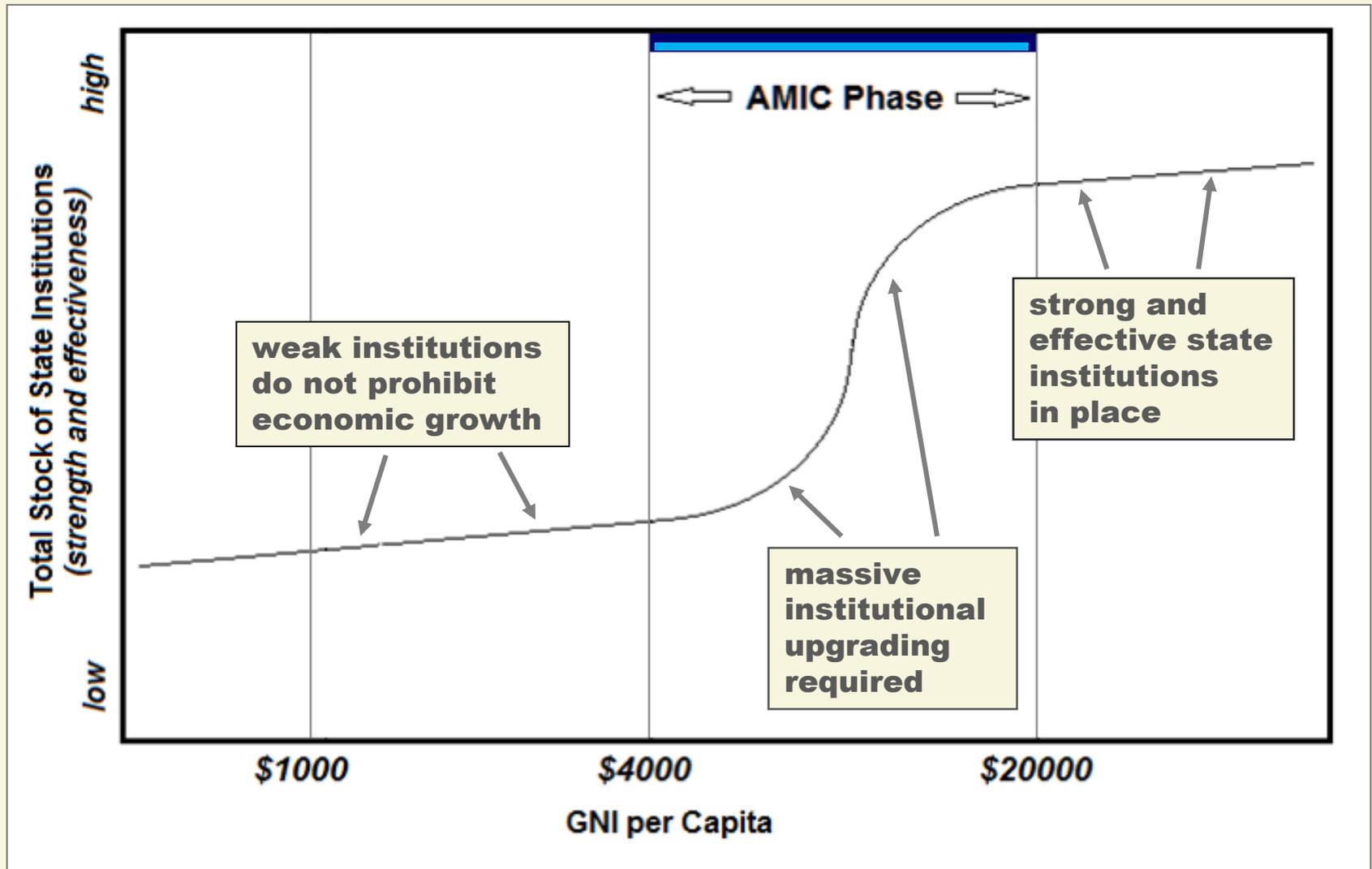


Economic Upgrading: What Does it Take?

Major improvements across a very broad front including...

- Macroeconomic stability: **debt/GDP; monetary policy; financial stability**
- Access to skilled workers: **education; immigration; labor reform**
- Access to ideas & technology: **IPR; FDI; “national innovation system”**
- Spurring entrepreneurship: **deregulation, SME growth, incentives**
- Economic diversification: **products and sectors**
- Financial markets reform: **banking and capital markets**
- Stable and predictable government: **efficient and effective *public administration*; efficient and fair *legal system***
- Improved physical infrastructure: **IT, energy, water, transportation**
- Adequate security: **conflict management; crime**
- Enhanced resilience: **disaster management; global econ shocks**
- Urban development: **growth, dynamism, and innovation is in cities**
- State revenues must increase: **tax reform; PFM; counter-corruption**

Thought Exercise: S-Curve in State Institutional Development



Underlying Challenge: Political Management

- ❖ Why is it so difficult for AMICs to make progress on upgrading?
 - (1) institutional reform is technically complex
 - (2) avoidance: **natural resource exports, remittances, import of cheap labor**
 - (3) upgrading reform is potentially politically risky 
- ❖ Reform creates winners and losers – every advance can be a struggle – good outcomes are technically sound/politically possible
 - ➔ Skilled **Political management** is therefore essential
 - building reform coalitions
 - effective use incentives and sanctions
 - responding to populist mobilizations
 - ensuring benefits/losses are shared
 - ...all easier said than actually done



Policy Management and Stability

- ❖ Economic policy disputes tend to be drawn into broader currents of political conflict...delaying and watering down reform
- ❖ In AMICs, diversity of fault lines complicates political management

- Large *middle class* with high expectations and growing demands
- *Educated youth* with middle class hopes – goods jobs and voice
- Intensifying conflict between *central and peripheral* regions
- Real or perceived rise in *inequality* and *politicization of inequality*
- Lingering ethnic, sectarian, and/or subnational *conflicts*
- Powerful *entrenched elites* ally with aggrieved constituencies

➔ **ICT and social media** vastly increases the leverage of *all* groups

Broader Stability Challenge

- ❖ Poor political management may lead to stalling of reforms in AMICs, but also to increased instability
- ❖ Firm level perspective: both negatively impact willingness of the private sector is to make costly investments in industrial upgrading
- ❖ In AMICs, periods of political instability, social unrest, and occasional violence tend to be the norm.



Democracy and Political Management

- ❖ Most Asian AMICs will enter this phase as electoral democracies

Does democracy make political management of reform easier?

...depends on formal and informal policy making and implementing institutions and the capacity of leadership

- ❖ But there are built-in challenges for early democratizing AMICs:

- overcoming resistance from powerful oligarchic factions
- short -term constituent demands drive policy
- technocratic bodies uninsulated from partisan politics
- frequent elections make long-term agendas difficult

➔ Implication for us: In the AMIC transitions ahead in Asia, the most difficult challenges are likely to be related to political management

...and globally there few successful examples to learn from

Addressing the Challenges Ahead

- ❖ **Need for greater awareness of the ways in which a country's political institutions and political dynamics affect policy outcomes.**
- ❖ **Greater awareness within the ADB of the political management implications of policy prescriptions—technically sound solutions may sometimes be politically impossible and even counterproductive.**
- ❖ **Could lending and other support be structured in ways specifically designed to encourage emergence of sustainable political consensus on key upgrading reforms among powerful stakeholders.**
- ❖ **Testing the potential for sequencing upgrading reforms in ways that could create support among emerging pro-reform constituencies—educated youth, SME entrepreneurs, professional associations, etc.**
- ❖ **Greater investment in accelerating urban development, recognizing again that effective political management may be the key to success.**

Addressing the Challenges Ahead

- ❖ **Deeper exploration of the potential for regional cooperation and integration efforts to strengthen domestic support for in key reforms.**
- ❖ **Research on political management of economic upgrading in democratic states. Is there something to be learned from Finland, Ireland, or Israel? From Latin America? From Turkey?**
- ❖ **Explore regional/global dialogue among early democratizing AMICs—if political management of transitions now occurs primarily under conditions of democracy, then knowledge about how best to do this is only emerging now.**
- ❖ **Explore new partnerships between the AMIC governments, non-state actors, implementing partners, and the ADB to experiment with ways to strengthen political management of AMIC transitions.**

MANY THANKS



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