

Stuck in the Middle?

*Is there a middle income trap
and can it be overcome?*

Professor Richard Vietor
Harvard Business School

Universiti Teknologi Malaysia
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What do I mean by “stuck in the middle?”

In *Competitive Strategy*, published 25 years ago, my colleague Mike Porter built his framework for business strategy around three generic approaches:

- **Overall cost leadership**
 - Scale, cost-reduction from experience, overhead control
- **Differentiation**
 - Something unique (brand, high-quality, dealer network, durability, design)
- **Focus**
 - On a buyer group, segment of product line or geographic market

He warned firms against being “stuck in the middle”

Firms without such a clear strategy would

- *Lack adequate market share;*
- *Lack adequate capital investment*
- *Lack adequate R&D or the knowledge necessary for differentiation;*
- *Lack resolve to play low-cost game;*
- *Lack the necessary organizational focus*

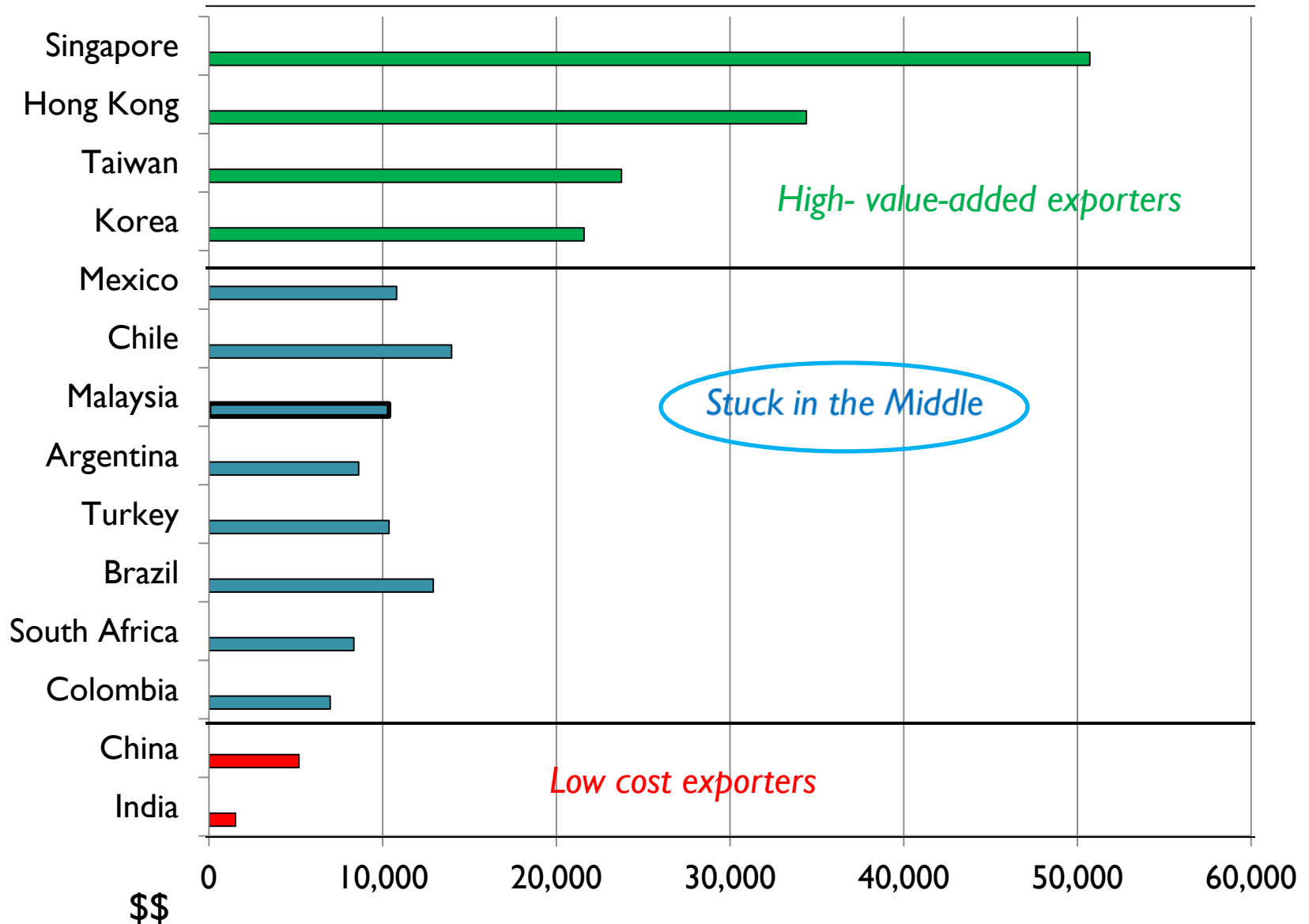
Thus, to survive and prosper, a firm stuck in the middle must...

- *Reduce costs (to achieve cost leadership)*
- *Re-orient products to particular target markets (i.e., a certain product type, focused on particular customers, or particular regions; or*
- *Achieve uniqueness in quality, brand, style, etc.*

I believe

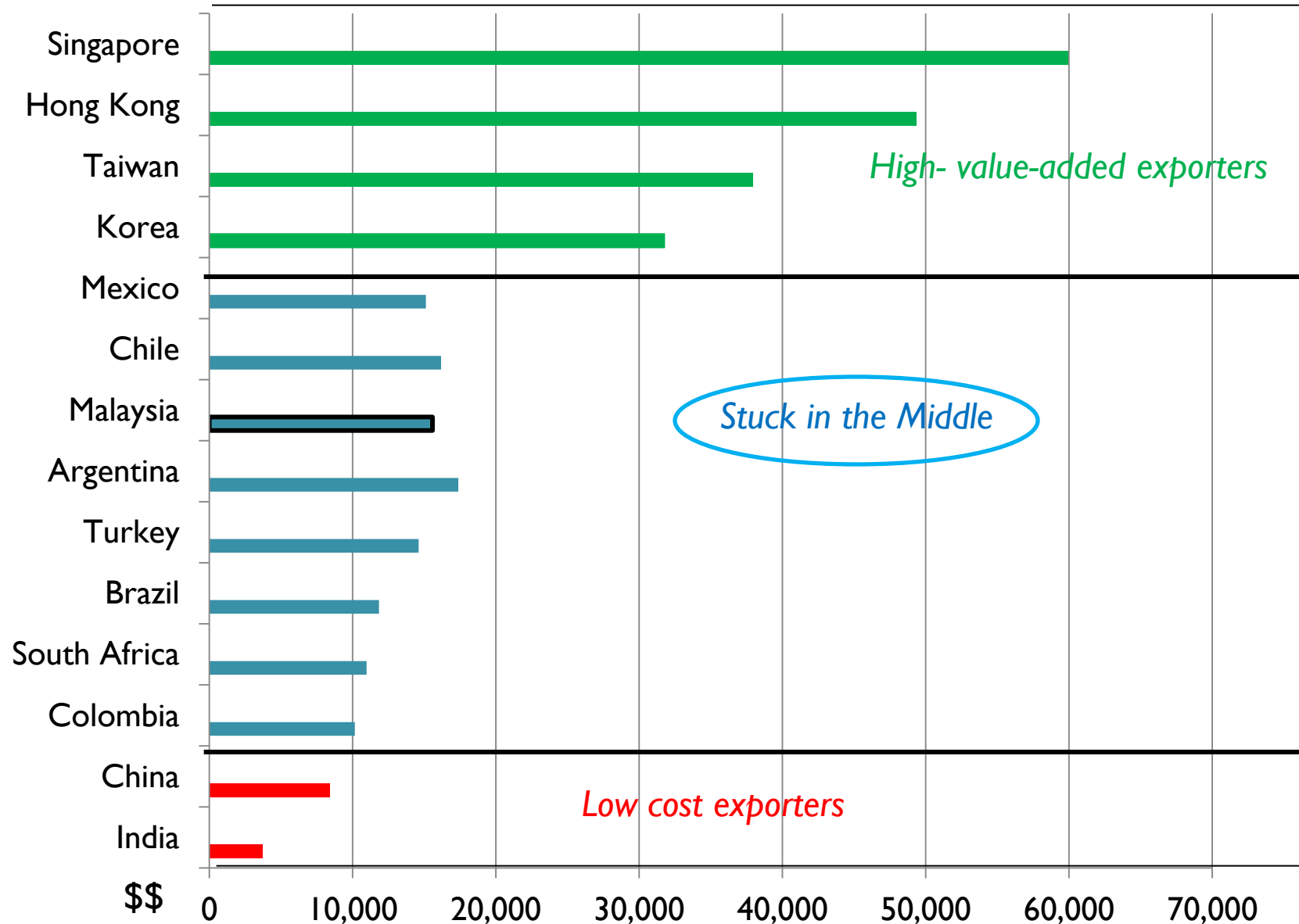
it is the same with countries...

Gross Domestic Product per Capita for Exporting Countries (in nominal U.S. Dollars)



Source: IMF Database, 2011

Gross Domestic Product per Capita (PPP) for Exporting Countries (in U.S. Dollars)



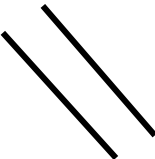
Source: IMF Database, 2011

Trajectories of Development

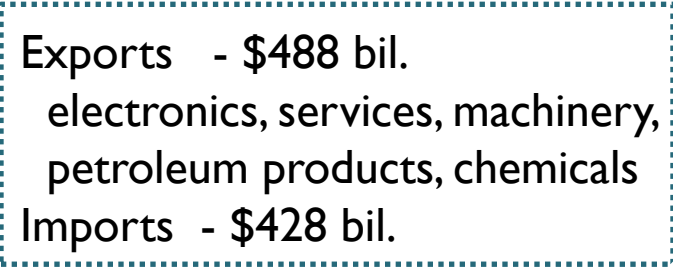
- **Low-cost Giants**
 - China - goods
 - India - services
- **High-end, high-value added Exporters**
 - Singapore
 - Japan
- **Stuck in the Middle – commodities/assembly**
 - Mexico
 - Brazil
 - South Africa
 - Turkey
 - Malaysia
 - Chile
 - Colombia
 - Argentina

Singapore's Strategy:

1. *create jobs and housing*
2. *encourage foreign direct investment*
3. *free trade*
4. *force savings*
5. *build infrastructure*
6. *make "doing business" easy*
7. *discourage corruption*
8. *fiscal and monetary stability*
9. *low taxes*
10. *build around "clusters"*
11. *move up value-added*
12. *enhance education*



GDP growth 9.7%/yr.(\$\$) 50 yrs.
Inflation 2%
Savings rate 46% (2010)
Productivity growth (10.7%) 2010
Fiscal Balance 3.2% surplus
Current Account Bal. +18%/GDP
Exch Rate up 3.2 -> 1.26 S\$/US\$



Exports - \$488 bil.
electronics, services, machinery,
petroleum products, chemicals
Imports - \$428 bil.

China's Strategy: "Get Rich is Glorious"

1. One-child policy
2. Household Responsibility System
3. Town and Village Enterprises – low-end manufacturing
4. Special Economic Zones – FDI and exports
5. Management Responsibility System (SOEs)
6. Price decontrol
7. Tax Reform ('94)
8. Currency Reform ('94)
9. Joining WTO (2001)

2001-2010

GDP growth 10%/year
Consumption 36%; Savings 52%
Trade surplus \$360 bil. Cur Acct. \$426
Fx reserves \$3.5 trillion
productivity 8.5%/yr. ULC -2.5% /yr.
balance budget
low inflation 1% -> 6% -> 3%
Y/\$ 8.3 -> 6.2 per \$\$

GDP growth 9.5%/year
Investment 34%; Savings 37%
Exports 5% -> 18%
Y/\$ 5.7 -> 8.3 per \$\$
BOT +19 bil., CA +7 bil.
inflation 2.4% -> 5%

NEW STRATEGY

New strategy: *Balanced Growth*

- *Stimulus (\$586 billion, from strong base)*
- *Encourage domestic demand*
- *Increase domestic consumption*
- *Reduce savings*
- *Modernize agriculture*
- *Domestic innovation*
- *Energy efficiency*
- *FDI in West*
- *Improve services*
- *Better income distribution*
- *Rebuild social institutions (health care, pensions, hukou)*

Let's examine four of the countries
“in the middle”

- Mexico
- South Africa
- Turkey
- Malaysia

Mexico: Crisis of Confidence

107 million people, three regions, three cultures, democracy resources (oil and agriculture),, and 1760 mile border with the USA

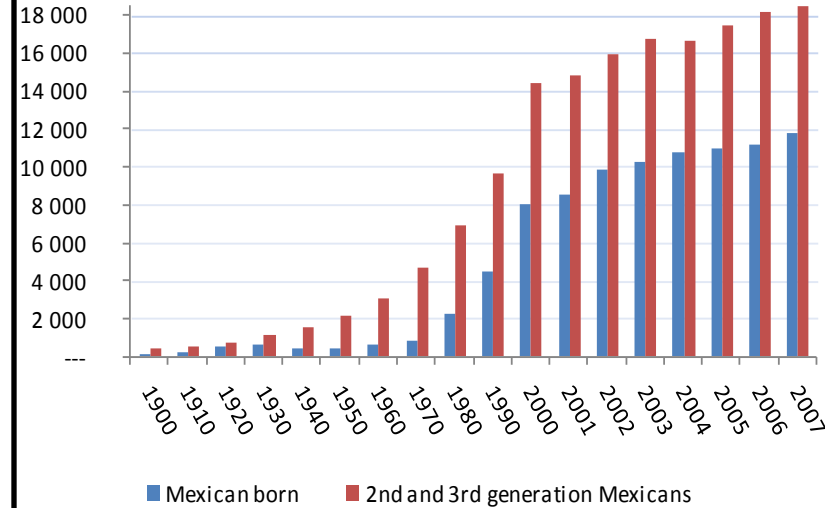
Development strategies:

- '50s - '70s import substitution
- '76- '90s resource-led (oil) growth
- '82- '94 adjustment to debt; liberalization
- '94 - '06 export-led growth (NAFTA)
- '06 – present – structural adjustment, (drugs, crime, corruption, income distribution, China in the WTO)



GDP per capita (ppp) - \$15,121
 GDP growth since 2001 - 1.4%/year
 Consumption 80% GDP
 Investment 21%
 X-I -2%
 inflation 5%
 exchange rate 9.4 -> 13.6 -> 12.9 P/\$
 labor productivity 0.3%/year
 total factor productivity -0.5%
 U.L.C. 1.9\$ - 1.8\$

Mexican Immigration to the United States (in thousands)



Main Trading Partners of the United States
(share of United States Imports, Excluding Oil)

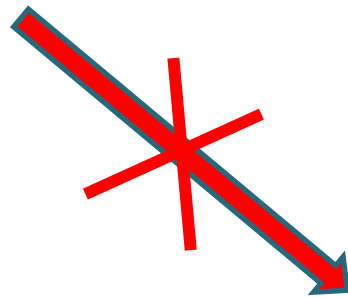
Country	1994	1997	2000	2005	2009
Canada	19.5	19.5	18.9	17.3	14.4
China	6.3	7.8	9.2	16.8	19.1
Mexico	7.0	9.4	10.8	9.6	11.3
Japan	18.9	14.8	12.9	9.2	6.1
Germany	5.0	5.3	5.2	5.6	4.6

Mexico's Most and Least Dynamic Export Industries, 1997–2005

Product/Industry	Share of U.S. imports		Change in market share for	
	1997	2005	Mexico	China
Most Dynamic Export Industries				
Meals and flour	2.0	27.5	25.5	-0.4
Road motor vehicles	4.2	21.9	17.7	0.0
Old clothing and other old textile articles: rags	17.2	32.7	15.5	1.1
Live animals chiefly for food	11.0	26.2	15.2	0.0
Zinc	9.3	23.8	14.5	0.0
Milk and cream	2.3	11.6	9.3	0.1
Ingots and other primary forms, of iron or steel	11.2	20.1	9.0	0.6
Sugar and honey	3.2	11.8	8.6	0.5
Sugar confectionery and preparations, non-chocolate	16.7	25.1	8.4	5.9
Iron or steel wire (excluding wire rod), not insulated	4.0	11.8	7.9	10.9
Lorries and special purposes motor vehicles	29.6	37.2	7.6	0.0
Electrical apparatus for making and breaking electrical circuits	20.3	27.4	7.1	7.9
Steam engines, turbines	1.7	8.6	6.9	-0.6
Agricultural machinery (excluding tractors) and parts thereof	2.7	9.6	6.9	5.6
Fruits and nuts, fresh, dried	16.1	22.4	6.3	1.0
Least Dynamic Export Industries				
Cotton	68.5	14.1	-54.3	-1.7
Television receivers	69.3	44.8	-24.5	22
Fuel wood and wood charcoal	40.9	21.6	-19.4	11.8
Lead	23	4.7	-18.3	7.6
Trailers, and other vehicles, not motorized, nes	38.1	20.6	-17.5	31.9
Sulphur and unroasted iron pyrites	42.4	26.8	-15.5	0
Steam boilers and auxiliary plant; and parts thereof, nes	16.4	3	-13.4	3.3
Ores and concentrates of precious metals, waste, scrap	30	17.7	-12.3	0.2
Coffee and coffee substitutes	16.9	6.7	-10.3	0
Furskins, tanned or dressed; pieces of furskin, tanned or dressed	10.3	1	-9.3	3.4
Manufactures of leather or of composition leather, nes; etc.	17.1	8.8	-8.2	30.8
Made-up articles, wholly or chiefly of textile materials, nes	15.4	7.3	-8.1	19.4
Equipment for distribution of electricity	64.3	56.4	-7.8	8
Pesticides, disinfectants	14.7	6.9	-7.8	7.1
Synthetic fibers suitable for spinning	15.2	7.8	-7.4	14.6

Mexican competitiveness

- wages (as Chinese wages rise...)
- exchange rate (as Chinese yuan appreciates...)
- free trade (NAFTA)
- proximity to market (for heavy or bulky freight)
- infrastructural improvements
- oil price sensitivity
- proximity to market (for time-sensitive freight)
- availability of skilled workers
- availability of engineers
- linguistic proximity (Spanish v. Mandarin)



But China has...

- rapidly improving education
- improving command of English
- abundant low-wage labor
- improving rails and ports; larger container ships
- aggressive industrial policy

South Africa: 24% Unemployment?

49 million (6 million whites, 43 million non-whites, Apartheid ended in 1993 – democracy since 1996; mineral resources, modern industry, extraordinary tourism, but crime, AIDs, and corruption

Development Strategies:

- 1948-1993 – Apartheid
- 1996 – 2002 – GEAR (Growth, Employment and Redistribution)
- 2002 – 2008 - ASGISA (Accelerated and Shared Growth Initiative of South Africa)
- 2010 – New Growth Path



GDP per capita (ppp) - \$10,977
Real GDP growth – 3.17%/yr
C/GDP 63%, G/GDP 22%
Savings = 15%; Investment 19%
I>X 4%
Fiscal – near balanced until
financial crisis
Inflation 7%
Current account - \$14 billion
(mostly income & transfers)
Exch rate 10.5 -> 6.7 -> 7.8 R/\$

key strengths

Minerals
Fuels (including coal liquefaction)
Financial Services (big banks)
Information technology
Automobile assembly
Misc. manufacturing
Munitions

key problems

Labor unions (COSATU)
& political parties (ANC)
productivity 2.5%/yr.
wages 8.2%/yr.
ULCs 14.5% -> 5.4%
Education – weak history
BEEs – implementation
Income distribution
GINI .64 -> .72
Dutch disease?

New Growth Path – 5 million jobs by 2020

- Infrastructure
- Agribusiness
- Services
- Green economy
- Light manufacturing
- Minerals beatification
- Hold wages down to inflation
- Tie productivity to labor contracts

Macro-costs

- Fiscal deficits -5.3%GDP -> -3.8% GDP
- Lower i% -> some inflation....

Turkey: Atatürk's Dream Realized?

75 million people, mostly under 24; 99% Muslim, secular democracy, energy poor, big informal economy, tough neighborhood (Iraqi, Syria, Iran, Georgia, Israel)...edge of Europe

Development Strategies:

- state-led development & industrialization
- export-led growth ('83 on)
- open capital markets ('89 on)
- debt crises, structural adjustment
- *applicant to join European Community*



Real GDP growth 5.4%/yr. since 2001
 Consumption (public & private) 88%/GDP
 Savings 12%, Investment 21%
 Current Account balance -10%
 Inflation 10%
 Unemployment 10%
 Exchange rate L/\$



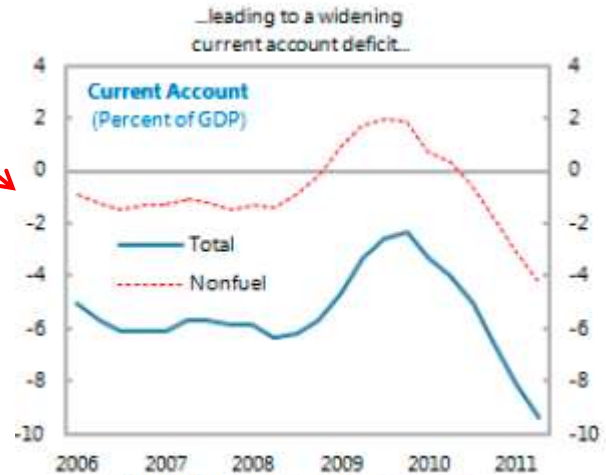
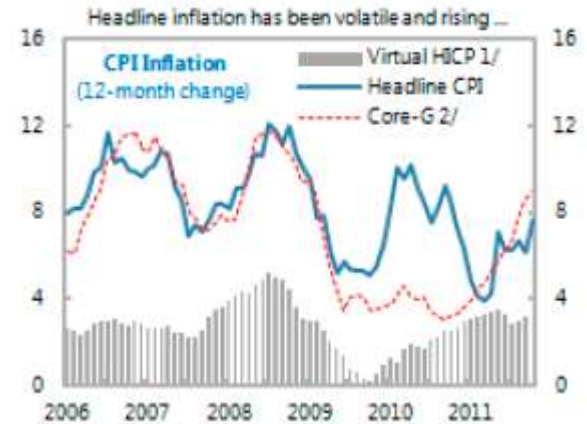
Economic Problems:

- to little savings
- rapid credit expansion
- housing bubble
- high interest rates attract
- foreign portfolio capital

- Europe stagnating

Political Problems:

- Kurds
- Iraqi
- Iran
- Syria
- Israel
- EU and USA



Malaysia: People First?

29 million (65% Bumiputera, 26% Chinese, 8% Indian, 1% other); predominantly Muslim; independence from Britain 1957 – democratic; oil, gas and agricultural resources; member of ASEAN

Development Strategies

1957-1969 import substitution
1971 New Economic Policy (NEP)

- restructuring ethnic identity and ending poverty
- build modern infrastructure
- export-led growth

1991 - Vision 2020

- move up value-chain
- knowledge & innovation
- reduce socio-economic inequalities
- improve quality of life
- implementation capacity

2009 - New Economic Model

- phase out NEP
- push technology, innovation, productivity & creativity

World Bank, Doing Business 2012

	<u>2012</u>	<u>2011</u>	<u>change</u>
Doing business	18 th	23 rd	+5
starting a business	50	111	+61
getting credit	1	1	-
protecting investors	4	4	-
construction permits	113	111	-2
paying taxes	41	39	-2
enforcing contracts	31	60	+29



Malaysia's Solid Growth

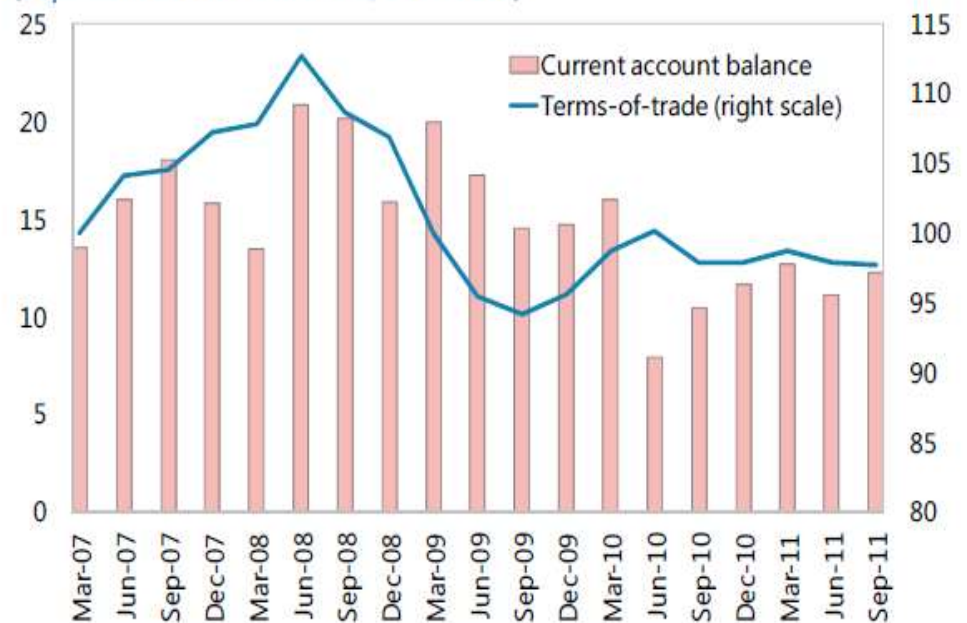
Per capital GDP \$15,578
 Real GDP growth 4.8%/yr.
 consumption/GDP 59%
 investment 22%
 national savings 33%
 Fiscal deficits average -3.6%
 Inflation averages 2.4%
 Unemployment 3.4%

Labor productivity 3%
 Total factor productivity 2.1%
 ULC 2.2%
 Exch. Rate R/\$ 3.8 -> 3.06

(US \$\$)	2010	2011	2012
Balance of trade	42	45	47
services	.53	-.51	.31
Current account	27.3	29.8	31.0
Fx reserves	106	138	147

Current Account Balance and Terms-of-Trade

(In percent of GDP and index, 2007=100)

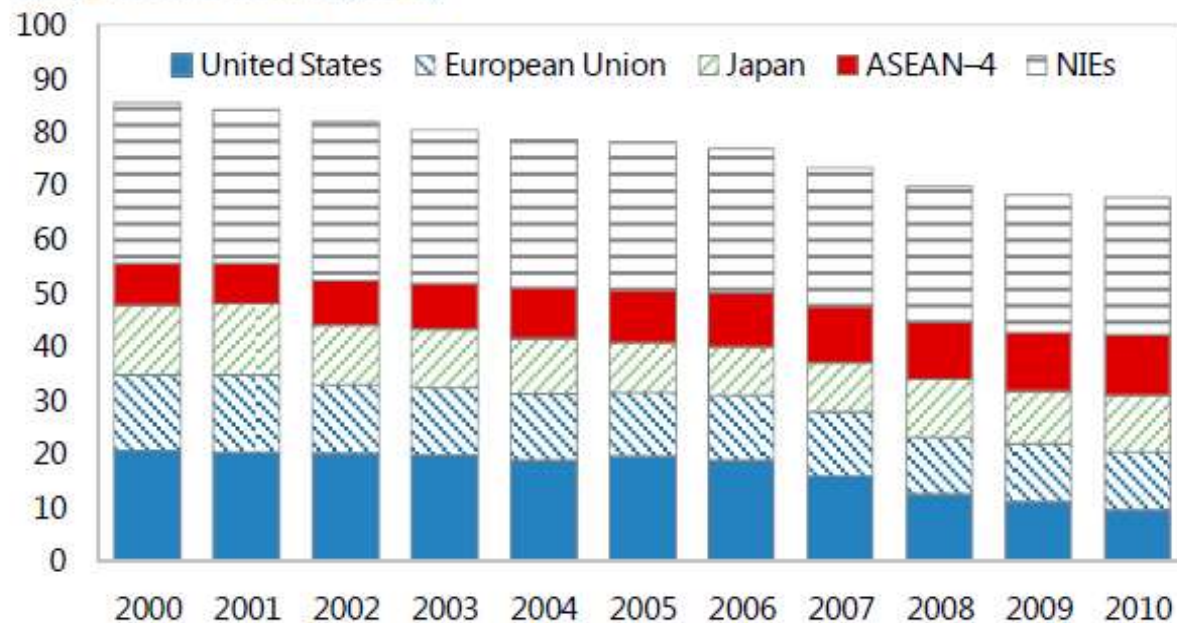


Sources: CEIC Data Co. Ltd; Haver Analytics; and IMF staff estimates.

Issue # one – Malaysia's growth leveraged on Developed Country growth

Share of Exports by Selected Destinations 1/

(In percent of total exports)



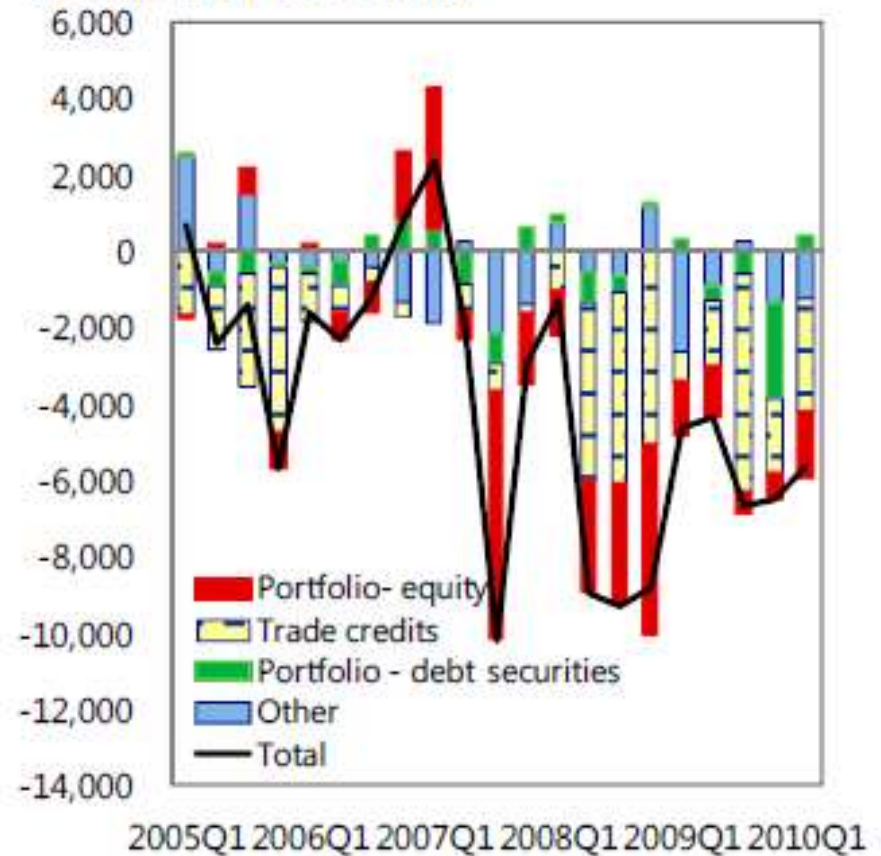
Sources: CEIC Data Co. Ltd; and IMF staff estimates.

1/ ASEAN-4 refers to Indonesia, the Philippines, Thailand, and Vietnam. NIEs refers to Hong Kong SAR, Korea, Singapore, and Taiwan Province of China.

Issue # 2 Too little domestic investment

Malaysia: Capital Flows—Nonfinancial Private Sector Net 1/

(In millions of U.S. dollars)



Sources: IMF, BPTS database; and IMF staff estimates.
1/ Excludes foreign direct investment.

Issue # 3 Moving up value-added chain

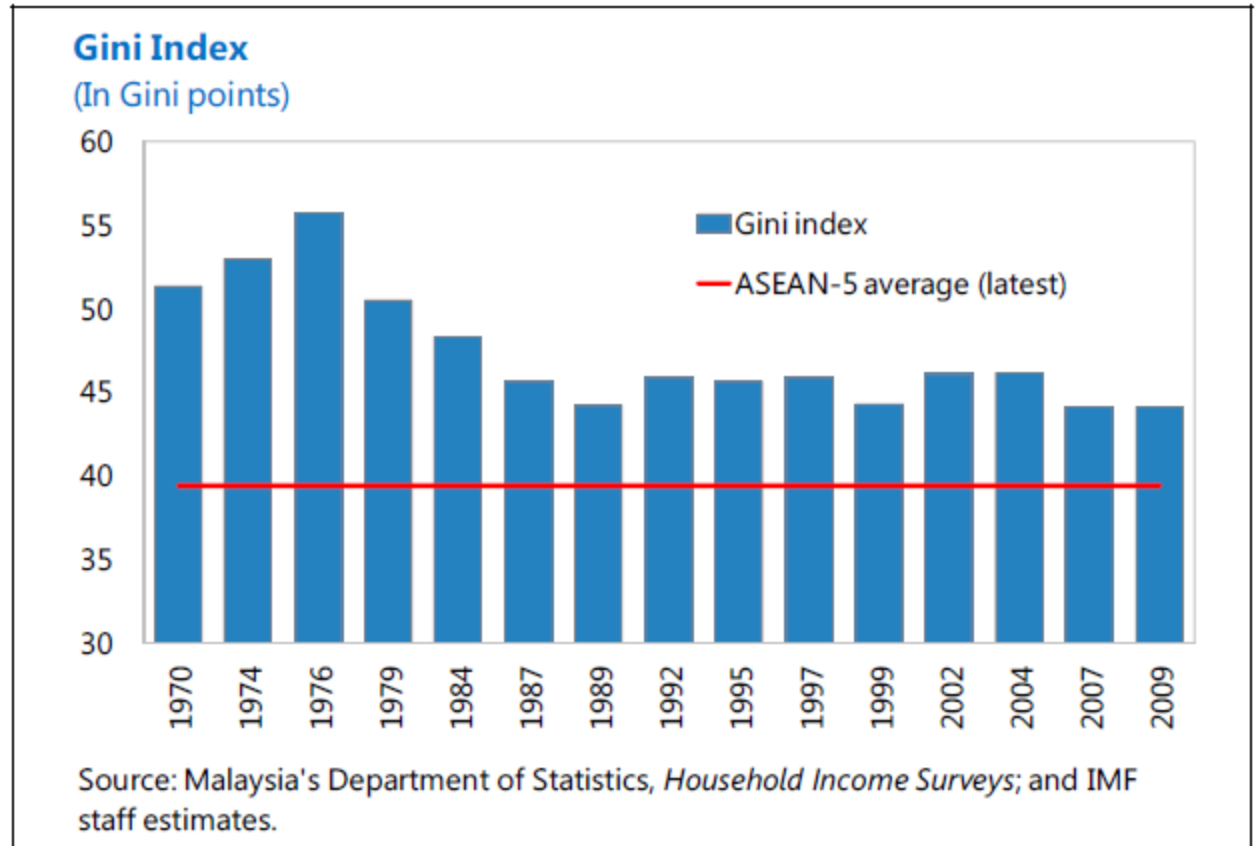
EXPORTS OF MANUFACTURED GOODS

(% annual change)

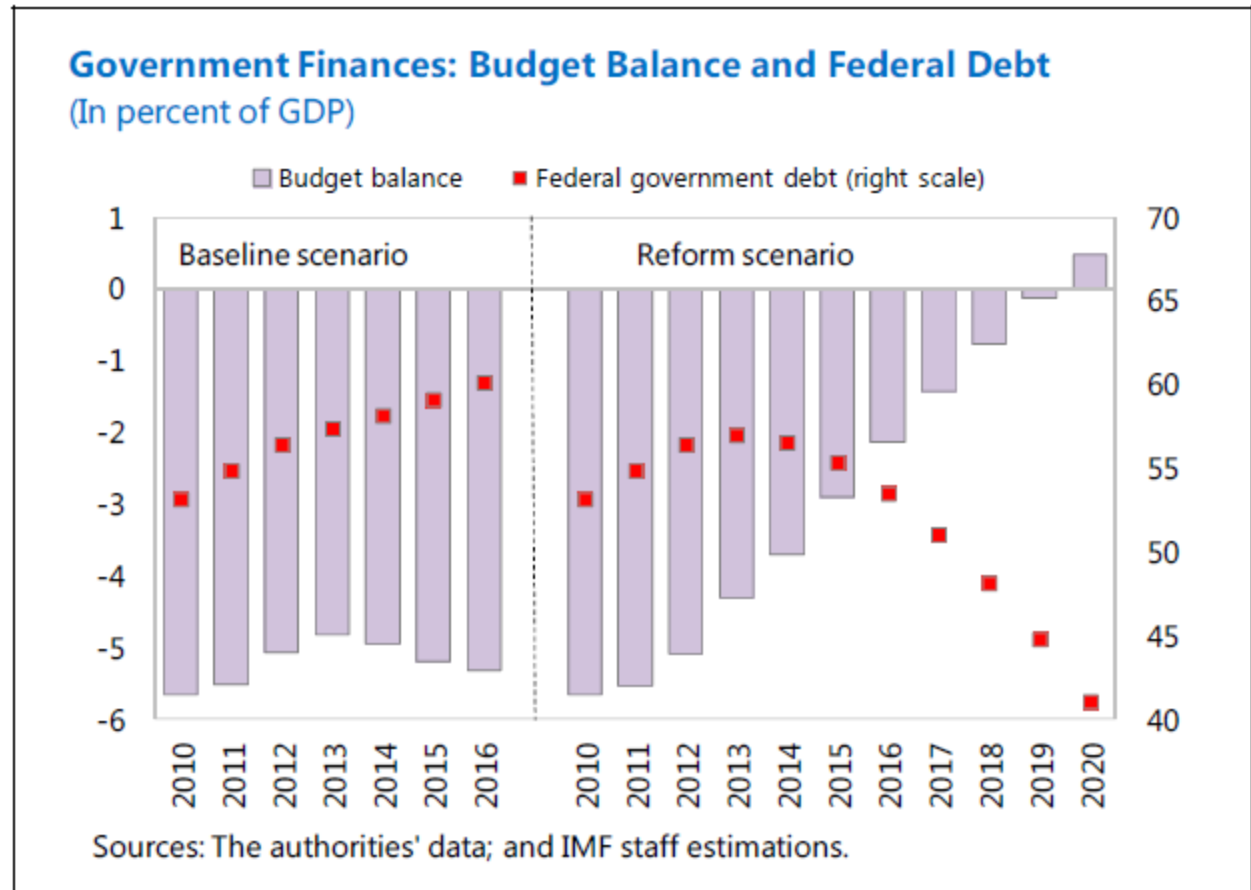
	2009	2009				2010	2010				2011		
		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	Q1	Q2	Q3
Total manufacturing exports	-12.6	-19.4	-22.3	-17.4	12.1	12.9	32.3	17.3	6.0	1.5	3.5	4.2	6.2
Electronics, electrical machinery and appliances	-10.9	-19.0	-23.0	-16.1	18.3	9.7	36.3	16.1	3.9	-8.0	-7.5	-4.9	-3.9
Chemicals, chemical and plastic products	-15.7	-28.8	-23.7	-19.3	15.4	21.4	50.0	22.1	10.6	10.3	8.8	9.2	20.2
Iron, steel and metal products	-22.1	-28.7	-21.4	-26.0	-10.1	15.5	26.3	17.4	-4.2	25.1	11.2	15.3	27.0
Machinery and equipment	-10.5	-17.8	-19.5	-9.3	6.7	12.2	16.7	24.8	8.0	1.3	4.8	3.7	16.8
Transport equipment	12.8	23.0	-14.0	18.5	29.1	-8.3	36.8	-8.2	-30.0	-27.9	-19.3	-6.1	8.6
Petroleum products	-31.1	-42.2	-49.9	-34.9	23.4	29.1	29.6	39.3	17.1	32.6	59.2	26.3	11.5
Rubber products	-2.6	-5.3	-5.1	-11.8	14.2	28.4	36.6	32.9	24.1	21.7	12.9	-0.4	21.6
Wood products	-14.7	-17.8	-18.7	-20.5	-1.2	5.5	21.0	9.4	4.8	-9.1	-7.2	3.4	-2.1
Food, beverages and tobacco	-14.5	-1.3	-14.3	-28.9	-9.1	14.5	4.6	7.4	20.1	25.4	18.5	20.7	15.9
Textiles, apparel and footwear	-14.1	-9.3	-15.2	-21.5	-8.6	3.0	-0.7	2.0	0.8	9.6	16.7	17.4	17.0
Non-metallic mineral products	-1.1	15.2	6.0	-10.4	-9.4	-4.9	-2.1	-11.1	-11.5	5.9	15.2	12.4	24.3
Other manufactured goods	-4.7	-9.3	-5.9	-5.0	0.7	20.2	35.9	20.3	15.4	12.8	20.0	25.3	19.7

Source: Department of Statistics, Malaysia.

Issue # 4 Ensuring inclusive and sustainable growth



Issue #5 Repairing Fiscal Balance and Reducing Debt



Will these strategies succeed?

Mexico

offshore oil
exp-led growth
defeat drug lords
maintain competitiveness



?

South Africa

spend to reduce unemployment
tolerate inflation; devaluation
build minerals, agribusiness
infrastructure, tourism green



?

Turkey

debt adjustment
export-led growth
education
floating currency
borrowing abroad



?

Can **Malaysia** get “**Unstuck**”?

- Move investment and exports up-value chain
- Stimulate domestic innovation; R&D
- Continue to invest in infrastructure
- Reduce regulatory barriers to *Doing Business*
- Enhance labor skills in needed categories
- Encourage greater flexibility in education
- Encourage critical thinking, science, engineering
- Stimulate entrepreneurship, domestically
- Hold down ULC's (e.g., push hard on productivity)
- Reduce risk aversion by firms; individuals