Comment on “Escaping the Middle-Income Trap in Southeast Asia: Micro Evidence on Innovation, Productivity, and Globalization”

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The “middle-income trap” has recently become a powerful buzzword in the international academic and policy communities. Several groups of scholars have proposed different causes of the trap. One of the important causes is that firms in the countries in the trap generally lack innovation. Using microdata, Lee and Narjoko (2015) interestingly examine the relationship among firms’ innovation, productivity, and globalization illustrated by export, foreign direct investment (FDI), and trade liberalization in five selected countries of Southeast Asia, namely Malaysia, Indonesia, Philippines, Thailand, and Vietnam. The study illustrates the significance of globalization via trade and FDI. Lee and Narjoko find positive linkages between productivity gains, especially from process innovation, and export. Foreign ownership is also important for knowledge transfer within the same group of companies. Foreign-owned plants are more productive than locally owned ones, and FDI can generate technological spillovers to host economies. Nonetheless, wholly foreign-owned firms may not be necessarily conducive to productivity and spillovers. Lee and Narjoko also suggest the importance of production network for firms’ innovation and technological capability upgrading. Small and medium enterprises (SMEs), however, benefit less since they face difficulties in participating in globalization activities. Therefore, Lee and Narjoko recommend that government policies should focus on supporting SMEs in the context of production networks. Nonetheless, they argue that studies using microdata on the relationship between innovation and globalization are still at an early stage, and priority should be given to collect better quality data and to make them available to the public.

Being able to participate in global production network can stimulate innovation. Nonetheless, this does not always come automatically. There are two possibilities or roads in participating in global production networks. On the one hand, the “low road” is a trajectory in which firms face intense competition and are engaged in a “race to the bottom.” On the other hand, the “high road” is a trajectory in which firms increase and improve their participation in the global economy, and hence realize sustained income growth. “Upgrading” is a necessary condition for a “high road” path to competitiveness.

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in the context of globalization. The key question, therefore, is how firms can upgrade. Basically, firms can pursue four different upgrading strategies:

1. Process upgrading. Firms upgrade processes – transforming inputs into outputs more efficiently by reorganizing their production systems or introducing superior technology.

2. Product upgrading. Firms upgrade by moving into more sophisticated product lines (which can be defined in terms of increased unit values).

3. Functional upgrading. Firms acquire new functions (or abandon existing functions), so that they could increase the overall skills and knowledge content of their activities. They might complement production with design and research and development (R&D) or marketing, or move out of low-value production activities.

4. Inter-sectoral upgrading. Firms may apply the competence they have acquired in a particular sector to move into a new one.

The role of multinational corporations (MNCs) as lead firms providing technical and marketing knowledge is absolutely critical for the upgrading of local firms. Nevertheless, any upgrading strategy requires local firms’ own vigorous and continuous attempts beyond “passive” learning by doing. Having subcontracting relationship with MNCs does not guarantee upgrading. A study on Malaysian firms cited by Lee and Narjoko (2015) shows that firms that rely on knowledge flows from other firms within the same group of companies are less likely to undertake their own R&D investment. This coincides with the study on the Thai automotive sector that successful first-tier local suppliers gained more advanced technological capabilities by following “independent” learning routes, that is setting up their own R&D functions and leveraging external knowledge sources such as local universities and public research institutes outside their existing production networks with MNCs.

Lee and Narjoko (2015) recommend that policy should take into account foreign equity participation and exports to ensure that any government support provided lead to innovation. At present, government policies in several countries, including those in the middle-income trap, have already given special priorities to exports and FDI. “Learning by exporting” is a widely accepted strategy. However, beyond simply attracting FDI, a more focused policy should target its technological spillovers, as they may not happen automatically. Governments can assist in enhancing linkages between MNCs and local SMEs by providing incentives and acting as intermediaries promoting personnel exchanges and on-the-job training between the two sides, as what have been successfully implemented by Singapore’s Economic Development Board.

Reference

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