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EXPERIENCES IN OVERCOMING THE MIDDLE-INCOME TRAP IN SOME COUNTRIES AND POLICY SUGGESTIONS FOR VIETNAM

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Abstract

The middle-income trap is when a country is stuck at the middle-income level for a long time after passing the threshold of a low-income developing country. Many countries risk falling into the middle-income trap, requiring timely and comprehensive solutions to develop the country according to the set roadmap. Vietnam's economy has developed strongly in recent years and achieved many positive results. To avoid falling into the middle-income trap, Vietnam must now have a rapid and sustainable economic development strategy, effectively promoting its strengths and potential. This article studies the experiences of overcoming the middle-income trap of some countries, thereby providing some policy suggestions for Vietnam to overcome the income trap.

Keywords: *Income trap; Middle-income trap; Vietnam*

1. Middle-income trap: concept and characteristics

1.1. Concept of the middle-income trap

In economic terms, the middle-income trap is a concept that refers to the situation where a country escapes poverty, and joins the group of middle-income countries but still fails to become a developed country after many decades. The middle-income trap occurs when a country is stuck at the middle-income level achieved by exploiting resources and certain initial advantages such as cheap labor, without being able to overcome that threshold to raise income to a higher level[1]

"The "middle-income trap" is a state in which an economy has passed the low-income threshold (below 1,025 USD/person) to become a middle-income country (1,025 - 12,475 USD/person), but is stuck at this income level, unable to continue to rise to

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become a high-income country (above 12,475 USD/person). This "stuckness" has factors such as: no longer having the advantage of cheap labor costs like low-income countries; and also not having the advantage of infrastructure, highly qualified human resources, and modern techniques and technology like high-income countries.

1.2. Characteristics of the middle-income trap

Low development investment: Countries caught in the middle-income trap often have difficulty attracting investment in key infrastructure and industrial sectors to promote sustainable economic growth. This limits the ability of the economy to grow and slows down the development process.

Low labor market: Despite having a large working population, these countries often have difficulty improving labor productivity and creating enough jobs for the working population. The lack of quality jobs can lead to inequitable income distribution and increased social unrest.

Low development of manufacturing: Manufacturing and production sectors in these countries often lack investment in improving production capacity and technological innovation, leading to a dependence on low-value goods production and low competitiveness.

Underdeveloped industry: Countries caught in the middle-income trap often do not invest enough in high-value-added industries. This leads to a heavy dependence on the production of raw materials and unprocessed goods, reducing competitiveness and the ability to adapt to global economic changes.

Lack of technology: Investment in research and development is often insufficient to maintain and improve global competitiveness. Countries caught in the middle-income trap often face inefficiencies in adopting new technology and technical innovation, reducing the long-term growth potential of the economy.

1.3. Risk of Vietnam falling into the middle-income trap

First, Vietnam's gross domestic product (GDP) growth rate has not been as expected. Since 2020, due to the severe impact of the COVID-19 pandemic and the negative effects of the world economy, Vietnam's per capita income has increased slowly. In 2019, Vietnam's per capita GDP was 3,425 USD; then increased to 3,526 USD in 2020; in 2021 it was 3,694 USD; in 2022 it was 4,120 USD; by 2023, Vietnam's per capita GDP was 4,284 USD, and increase of 160 USD compared to 2022. The slowing growth of Vietnam's economy over the past 5 years has posed several challenges to the ability to narrow the development gap with other countries in the region. Over the past 40 years, the Vietnamese economy has experienced three crises in 1997-1999; 2008-2011, and 2020-2021. After each crisis, our country's economy tends to grow more slowly. Specifically, the average economic growth of the whole country in the period 1991-2000 was about 7.6%; the period 2000-2010 was about 6.6% and the period 2011-2020 was about 6%. The slow economic growth rate that has lasted for many years is a sign that the Vietnamese economy is slowing down.

Second, the contribution of total factor productivity (TFP) is low. Although it has increased continuously over the years, Vietnam's TFP growth rate is still modest and has not made a breakthrough. In the period 2011 - 2020, TFP increased by an average of 2.51%/year, of which the period 2011 - 2015 increased by 2.15%/year; the period 2016 - 2019 increased by 3.37%/year; in 2020, due to the impact of the Covid-19 epidemic, TFP increased by only 0.96%. On average, in the period 2016 - 2020, Vietnam's TFP increased by 2.88%/year[2]. However, the increase in total factor productivity is not due to the superior development of this factor itself but due to a decline in scale at the level necessary to maintain the expected growth rate. The modest contribution of the TFP factor shows that Vietnam's growth in recent times has been carried out according to the extensive growth model, slowly shifting to in-depth development, and growth is also more inclined towards the capital factor than the labor factor. If this situation continues, it will make Vietnam's economic growth unsustainable. On the other hand, the efficiency and productivity of Vietnam's public investment are still low. We know that public investment affects economic growth through: (i) Efficiency, that is, how much infrastructure a certain amount of public investment brings to the economy; (ii) Productivity, that is, how much the physical infrastructure created has a spillover effect on the economy. In low-income developing countries, the public investment rate is about 7% of GDP (2018). Public investment in emerging economies often fluctuates between 5 - 7% of GDP. In Vietnam, in 2023, public investment accounted for about 6.8% of GDP, equivalent to emerging economies[3]. Thus, the efficiency of public investment in Vietnam is slightly higher than that of low-income developing economies and lower than that of emerging economies. In terms of public investment productivity, Vietnam is between the group of emerging economies and developed countries.

Third, Vietnam's labor productivity is still low. In the past two decades, Vietnam has made many efforts to improve labor productivity, thanks to which labor productivity has improved significantly in both value and speed. Although Vietnam's labor productivity increased by an average of 5.4% per year in the 2011-2020 period, it is still low in the ASEAN bloc. However, compared to other countries in the same region, the difference in labor productivity in Vietnam is becoming more evident. According to calculations by the International Labor Organization (ILO), Vietnam's labor productivity is 7 times lower than Malaysia; 4 times lower than China; 3 times lower than Thailand; 2 times lower than the Philippines, and 26 times lower than Singapore. Vietnam's labor productivity is only higher than Cambodia (2.4 times); Myanmar (1.6 times); Laos (1.2 times). To catch up with labor productivity and escape the middle-income trap, Vietnam needs to continuously increase labor productivity at a rate of 6.3 - 7.3%/year. Recently, Vietnam's labor productivity has improved significantly, increasing steadily over the years. Accordingly, compared to the previous year, labor productivity in 2018 increased by 5.55%, and in 2019 increased by 6.28%; in 2020, it increased by about 1.5 times compared to 2015. In 2023, the labor productivity of the whole economy is estimated to reach 199.3 million VND/worker (equivalent to 8,380 USD/worker, an increase of 274 USD compared to 2022); At comparable prices, labor productivity increased by 3.65% due to improved labor qualifications (the rate of trained workers with degrees and certificates in 2023 is estimated at 27%, 0.6 percentage points higher than in 2022) [4]. The average social growth rate in the 2016 - 2020 period reached 5.8%/year, higher than the 4.3%/year in the 2011 - 2015 period. However, this increase is not enough to help Vietnam overcome the middle-income trap. On the other hand, there is still a gap in labor productivity between economic sectors in Vietnam. Labor productivity in the industrial sector is higher than that of the service sector and is about 3 - 3.5 times higher than that of the agricultural sector.

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Fourth, economic restructuring is still slow. Although Vietnam has made positive changes in economic restructuring, specifically in the period 2010 - 2022, the proportion of agriculture, forestry, and fishery tends to decrease from 15.38% to 11.88%; the proportion of services increases from 40.63% to 41.33%; the proportion of industry - construction increases from 33.02% to 38.26%[5]. The main driving force of the transformation process is from the foreign direct investment (FDI) sector, not domestic enterprises. Although domestic enterprises have improved in their contribution to import and export turnover, they are less competitive in affecting the trade balance. In 2023, the economic structure of the agriculture, forestry, and fishery sectors accounts for 11.96%; The industrial and construction sector accounts for 37.12%; the service sector accounts for 42.54%; product taxes minus product subsidies account for 8.38% (the corresponding structure in 2022 is 11.96%; 38.17%; 41.32%; 8.55%)[6]

In addition, the performance of state-owned enterprises is not commensurate with the resources they hold, and Vietnam's investment efficiency is low, as shown by the ICOR index, which continues to increase and remains high. The ICOR index in the 2010-2019 period reached 5.9, and in 2020-2021, due to the impact of the COVID-19 pandemic, the ICOR index (investment capital efficiency) skyrocketed to 12.47 and 15.51. However, in 2022, when the pandemic is under control, this index will return to 5.92, equivalent to the pre-pandemic period. When compared to other countries that have gone through a similar development stage as Vietnam, Vietnam's ICOR coefficient is relatively high.

Fifth, the country's competitiveness remains low. In recent years, Vietnam has continuously improved its socialist-oriented market economic institutions, improved the investment environment, attracted foreign investment, and promoted administrative reforms. However, the actual operation of the Vietnamese economy has also revealed some limitations such as intervention in the market price mechanism; the state-owned enterprise sector is still large; the system of overlapping legal documents has many shortcomings; several officials still push the issue around, and are afraid of responsibility in handling work; corruption and waste in public investment still occur. Meanwhile, Vietnam's Global Competitiveness Index (GCI) and Global Innovation Index (GII) are decreasing compared to countries with the same income level.

2. Experiences of some countries in overcoming the middle-income trap

2.1. Experiences of Japan

Japan is the second largest country in Asia and the third largest in the world in terms of economic development, but more than 100 years ago, Japan was also a self-sufficient agricultural country with fragmented production, and even the land, climate, and weather conditions for agricultural production development were more difficult than Vietnam. Japan quickly transformed its purely agricultural economy into an industrial and service economy, thanks to its ability to choose and implement an industrialization model based on the dynamic interaction of two systems of internal and external forces, and successfully transformed external factors into internal forces.

Japan carried out industrialization from the second half of the 19th century, and by the beginning of the 20th century, the industrialization process had achieved many important achievements, in which several heavy industries had reached the world's modern level. After World War II, the Japanese Government determined to both restore the economy with the goal of "ensuring food security and reforming the rural economy"; and to promote the country's modernization process to create a new, flexible industrial order to adapt to fluctuations in the domestic and international economy. Starting in 1961, the Japanese Government implemented a series of measures: (i) Raising agricultural product prices and encouraging people to increase productivity; (ii) Cutting taxes and lowering interest rates to facilitate borrowing and reduce production costs; (iii) Implementing many measures to promote trade liberalization and narrow the income gap.

In parallel with the above measures, Japan implemented the strategy of industrialization of the country through measures to exploit external resources to the maximum and use those resources effectively in accordance with the situation of the country, thanks to which Japan has become a miraculous phenomenon for the world. Industrial production has not only increased in quantity but also diversified in types, making Japan one of the countries with the most advantages in the world in industry.

2.2. Experience in Korea

Korea is known as the “miracle of the Han River” in bringing its per capita income into the group of high-income countries. After World War II, Korea was a poor and backward country. Especially after the end of the Korean War (1953), the Korean economy was severely damaged, with per capita income of about 67 USD/year. In the early 1970s, Korea had to face a series of domestic and international fluctuations, including the increasing trend of protectionism in developed countries.

The period of escaping the middle-income threshold of Korea began in 1969 and ended in 1995 (26 years), focusing on two areas: (i) For agriculture, Korea initiated the construction of the new village movement to develop agriculture and increase people's income; (ii) For industry, building and implementing the 5-year plan to modernize the country to promote the industrialization process and expand the market. Initially, the Government provided each village with 300 bags of cement, and people worked hard to build villages. After a short time, more than 16,000 villages were built and developed, creating a clear change in the appearance of the countryside. In 1972, the Government increased the support level to 500 bags of cement and one ton of iron and steel for villages with good results. Thanks to that, the rural areas have changed dramatically.

The industrialization process proceeded sequentially, from agriculture to industry, from light industry requiring little capital to heavy industry and petrochemical industry, then to electronics and sophisticated industry. By the late 1980s, Korea was able to produce high-quality electronic products machinery, and equipment with famous brands in the global market. South Korea is a successful case in economic development and a country that fell into the middle-income trap during the 1997 crisis, and then quickly escaped thanks to the government's strong reform policies in a series of areas, such as law, finance, business, etc. Many factors create this long-term sustainable growth, such as implementing an export-oriented growth strategy, institutional and public policy reform, investing in high-quality human resources and entrepreneurs, effectively using public resources for infrastructure development and education, the ability to flexibly adjust to changes in businessmen and policymakers, and the ability to maintain a fairly even income distribution.

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With the basic philosophy of "export first" and "building the country by promoting exports", the Korean government has made strong interventions by providing investment resources and macroeconomic stabilization measures. All export industries were supported by the Korean government in the initial stage. After consolidating technological capabilities, in the mid-20th century, Korea began to liberalize trade by reducing tariffs. However, tariff preferences for strategic industries were eliminated, and this did not lead to the collapse of Korean industry, on the contrary, created the necessary pressure for many industries to compete to become number one in the world.

In terms of industrial policy, the Korean government was committed to creating a strong economy based on domestic ownership, with a tendency toward "big push" industrialization. Korea was also under pressure to upgrade and restructure its industry from capital- and labor-intensive to technology-intensive. The main difficulty in this process was that Korea lacked the technological capabilities to move to higher value-added activities. At this point, government intervention through Korea's large enterprises (chaebol) came into play. The high-tech industries of the chaebol were protected from global competition and had access to financial support. Two important factors in this initial stage were the commitment of the government and state-owned banks to reduce the risks of technological development.

Another highlight of Korea is its rapid human resource development. The rapid development of skilled labor-intensive export industries has promoted the education of society. The Korean government, by identifying the future need for a skilled workforce for industrial development, has introduced many human resource management programs. Therefore, when new technology flows from abroad, Korea has performed very well due to its investment in well-trained human resources from the early stages of industrialization.

2.3. Thailand's Experience

Thailand is one of the successful countries in economic development. After several decades of high growth, the Thai economy has increased 15 times, GDP increased from less than 9 billion USD in 1960 to 140 billion USD in 2000 prices. Per capita national income in 2003 also increased 6 times compared to 1960. Ten years after the Asian financial crisis (1997), the Thai economy is considered healthier, integrated with the regional and world economy, and less vulnerable. However, the Thai economy still seems to be stuck in finding long-term growth prospects although the country still has a lot of potential.

In principle, economic growth based on industrialization must be through the development of the manufacturing industry. The Thai economy from 1978 to the middle of the first decade of the 21st century also developed based on industrial growth, with the industrial ratio reaching 46% of GDP. However, Thailand is still mainly focused on labor- and resource-intensive industries as before the crisis. Economic restructuring has not occurred. According to many assessments, Thailand's current industry is mainly processing and assembling, meaning that Thailand has not mastered the technology, but is still mainly dependent on foreign technology.

Thailand's post-crisis recovery was driven by export growth and private consumption driven by fiscal and credit incentives. However, private capital has largely flowed into the civil construction sector rather than into the manufacturing sector, which is the driving force and strength of the Thai economy. Thailand's export-to-GDP ratio has increased from 47% to around 67% over the past decade thanks to a dramatic shift in its export structure. Thailand's exports to East Asia have increased rapidly and Thai exports have moved up the value chain. However, Thailand's comparative advantages are being eroded by the rise of regional countries such as China and Vietnam. Thailand is now "stuck" under pressure from countries exporting cheap labor-intensive goods, as well as high-tech goods from more developed countries. As a result, many Thai investors have not continued to invest in previously competitive industries, while investment opportunities in new industries seem to be shrinking due to Chinese competition. Thailand's export growth over the past decade shows that the shortage of skilled labor will create barriers to the country's growth. An important issue and the root cause of current social unrest is that during the growth process, Bangkok and its surrounding areas have developed too quickly into a high-income region due to the high concentration of industries, in contrast to the less developed areas in the rest of the country. As a result, inequality and disparities in development policies between regions, areas, and groups in society have created negative social aspects leading to political crises in Thailand in recent years.

2.4. Experience in the Philippines

In the 1950s, the Philippines was the most developed country in the region, surpassing even South Korea, and set a goal of "bringing the Philippines into the ranks of the world's richest countries by 2020". However, political instability, infrastructure weaknesses, and social disparities were obstacles to economic development and business activities. Another problem for the Philippines was the weakness in the public finance sector. Tax revenue calculated as a percentage of GDP remained lower than before 1997, while state debt remained high, at around 75% of GDP. Philippine businesses lost competitiveness in the world market due to the lack of an environment and mechanisms to create the necessary incentives for businesses to invest in technological innovation and improve productivity. In addition, corruption is rampant, widespread, and deeply ingrained in society, economic activities depend heavily on political protection, and development mechanisms are dominated by those with special privileges.

The Asian Development Bank study has shown that the fundamental obstacles to the growth of the Philippine economy are: (i) Too tight financial conditions; (ii) Weak infrastructure, especially transportation and electricity distribution; (iii) Low investor confidence due to political instability; (iv) Manufacturing development not in line with market demand. Accordingly, some of the main reasons why the Philippines cannot escape the middle-income trap can be drawn as follows:

Low savings and investment. The low savings rate has made the Philippines lack the resources to accumulate factors, especially technology for long-term growth. Another consequence of the low savings rate is a serious trade deficit due to both reduced exports and increased imports due to the Philippines' industrialization strategy and infrastructure construction.

Weak financial management. Although the fiscal picture of the Philippines has improved a lot in the past decades, the measures to generate financial revenue for the Government have not improved, thus failing to provide economic and social services to stabilize the macroeconomy.

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Reform efforts lacked determination and consistency. Political instability in the Philippines has weakened policymakers' motivation to reform, especially in removing protectionism, and monopolies, and addressing peasant problems.

2.5. Malaysia's Experience

Malaysia began its industrialization process in the 1960s to eliminate the purely agricultural economy and diversify its economic structure, developing the manufacturing industry. Initially, Malaysia also focused on producing goods to replace imports but later shifted strongly to producing export-oriented goods. However, Malaysia is heavily dependent on foreign countries, especially in terms of capital, technology and management. Although the automotive industry in Malaysia has grown strongly in quantity, high-tech raw materials, key components and important processes such as design and marketing are still mainly produced by foreign-invested enterprises, or directly imported. As a result, local people only perform assembly or produce simple parts while most of the value is still created and held by foreigners. After more than four decades of industrialization, the lack of discipline, skills and middle and senior management remains an unsolved problem. According to experts, the main reasons why Malaysia has not surpassed the middle-income level in the past half century are: (i) Long-term shortage of skilled workers, still having to rely on foreign labor; (ii) Education has not met the requirements of economic development; (iii) Public spending on research and development is still low (0.2% of GDP); (iv) Incomplete economic institutions, there is still inequality in competition between types of enterprises, in which state-owned enterprises still have a monopoly in some fields, especially finance and telecommunications.

3. Solutions for Vietnam to surpass the average income level

3.1. Strongly develop education, training and scientific research activities, equipping the necessary knowledge and skills of a global citizen.

Educational activities need to be practical, aiming to equip workers with the necessary knowledge and skills, linked to the reality of economic life, avoiding the situation where learning does not go hand in hand with practice. In particular, it is necessary to focus on training human resources for new fields such as electronics technology, and information technology. New emerging industries need to focus on training to catch up with the development trends of the world. Focus on investing in research and development, education and training of high-quality human resources, developing intangible assets; strengthen the construction of a national innovation system according to international standards; attach importance to protecting the right to freedom of creation and intellectual property rights; promote the development of information technology and communications.

3.2. Promote the transformation of the economic growth model from breadth to depth

Scientific and technological advances need to be widely applied in industries with strengths and comparative advantages, competitive advantages to effectively use resources, optimize scale and productivity, eliminate the law of diminishing marginal productivity, and move towards a state of increasing marginal productivity. Vietnam needs to identify key industries and sectors to focus on investment. The State needs to develop appropriate policy mechanisms to encourage and motivate businesses in areas where Vietnam has strengths, including incentives on taxes, interest rates, land, etc., while focusing on attracting economic sectors, especially the private sector, to participate.

3.3. Perfecting the socialist-oriented market economic institution

To perfect the socialist-oriented market economic institution, the core issue is to properly handle the relationship between the State and the market according to the basic principle that the market decides the allocation of resources; at the same time, promote the necessary and sufficient role of the State. Allocate resources according to the laws of the market to achieve optimal efficiency. The State performs well the role of creating and orienting development, ensuring macroeconomic stability; enhancing the provision of high-quality public services; ensuring a fair and healthy competitive environment; implementing regulation, supervision, and maintaining market discipline; compensating for limitations, inadequacies, and overcoming market shortcomings; ensuring social justice and sustainable development.

The State's economic management role needs to be promoted in accordance with strategic orientations, planning, policies, standards and macro management and operation mainly through the budget and financial and monetary instruments. The allocation and use of public resources and State investment capital must also apply market mechanisms to achieve the necessary efficiency. Amend the decentralization system between the central and local levels, especially in terms of budget, so that local authorities can focus on building infrastructure according to planning; developing and managing public goods and services; and managing and supervising the market. The State should gradually transfer public services to the private sector and social organizations if conditions permit, while resolutely preventing and combating corruption and group interests, striving to become a country with a high transparency index in the world.

3.4. Proactive and active international integration

Vietnam needs to actively promote international negotiations, sign bilateral and multilateral agreements, and actively and effectively exploit external resources including investment capital, technology, knowledge, and management skills to create fundamental changes in the state of economic operation. The experience of countries that have successfully overcome the middle-income trap shows that the core factor is creativity, which is maximized thanks to institutional support.

3.5. Protect the environment, ensure fairness and social security

The State and the whole society care for the cause of environmental and resource protection, focusing on the stage of deciding on project planning to tighten management and handling violations; strongly and extensively propagating education from schools to the whole society. All economic units are actively transforming to green growth, green development, green supply so that people can consume green, linking economic growth with social equity, practically improving the quality of human life. This is the content of a comprehensive/inclusive development model that the whole world is aiming for. Regarding development and implementation of social equity, the long-term direction is to move towards forming a society with a middle class accounting for the majority of the population; the low-income class accounts for about 15 - 20% of the population; the rich class accounts for only 10 - 15% of the population and the income of this class is only 5 - 7 times higher than the average of the middle class. It is necessary

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to focus on promoting the role of small and medium enterprises; well implementing fair and effective distribution and redistribution policies, especially tax, fee and public service policies. Promote hunger eradication and poverty reduction, focusing on regions and areas with many difficulties. The State better implements social security and welfare policies, especially for rural and mountainous areas.

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