Exclusive

Middle-income trap: A pseudo thesis

By Wang Shaoguang | chinawatch.cn | Updated: 2019-02-14 11:41

In the past decade, the concept of the "middle-income trap" has attracted wide attention from economists, media, government officials, international organizations and even the general public worldwide.

If there are any traps in economic development, low income or poverty will no doubt be one of them. For the majority of the three million years of human history, people lived in poverty -- except for a few wealthy ones -- due to low economic growth rates and barely changing incomes.

It was not until 200 years ago when the Industrial Revolution took place in the later half of the 18th century that a large wealth gap began to emerge, marked by an accelerated growth rate in some countries and regions.

In 1827, the Netherlands became the first country to cross over the low-income threshold to become a low- and middle-income country. In the half century afterward, the United Kingdom (1845), Australia (1851), Belgium (1854), New Zealand (1860), the United States (1860), Switzerland (1868), Uruguay (1870), Denmark (1872), France (1874), Germany (1874) and Austria (1876) joined the low- and middle-income club, one after the other.

Here is the question -- is there rally a middle-income trap? When reviewing the past journey traveled by the developed countries in the West, there does seem to have such a trap.

Take the Netherlands, for example. After it became a low- and middle-income country in 1827, it took the country 128 years to graduate to the middle-to-high income list in 1955. It took the United States less time, but even that country required still 81 years to make the transition.

For these countries to transform to high income, the journey was quite difficult, too. It took the United States 21 years, Canada 19 years, Australia 20 years and New Zealand 23 years.

It's seemingly fair to say that the developed countries in the West were all once struggling with the middle income gap (which includes two stages of middle income and upper-middle income) for nearly a century or even longer.

However, their experience may not be applicable to emerging economies, at least not universally.

In an article published in the Foreign Affairs in 2004, Geoffrey Garret, an Australian expert who was teaching in the United States, proposed that middle-income countries could neither race ahead of rich counties through technology, not could they compete with poor countries in offering low prices.

To support his point of view, Garret sorted the world's countries into three groupings of low, middle and high incomes based on per capita income in 1980, and calculated their respective growth by

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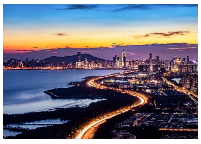

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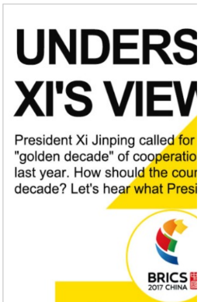

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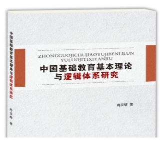

Searching for China's basic education logic

2000. The results found that the per capita income would increase by roughly 50 percent in high-income countries, 160 percent in low-income group, but less than 20 percent in the middle-income economies.

In 2007, in a long report An Eastern Asian Renaissance: Ideas for Economic Growth, two World Bank researchers cited Garret's article and used the term "middle-income trap" for the first time ever. The concept suddenly became popular several years later. Upon hearing it, many people come to the conclusion without proper reason that high-income countries have already been there, low-income ones will find it easy to develop with late-comer advantages and only middle-income ones may well fall into and get stuck in the trap.

In fact, neither Garret nor the World Bank report has referred to the word "trap" in a strict sense. The former never used the word at all, and the latter, in an article 10 years later, explained that what they meant was that middle-income countries may enter a stagnant growth stage, not that they were more likely to fall into a growth trap compared with low-income and high-income countries.

Why did researchers pay special attention to the middle-income economies? The reason is partly ascribed to the lack of satisfactory theory to explaining middle-income economies. By contrast, we have the Slow Growth Model to help understand low-income economies and the Endogenous Growth Theory for high income economies. That's why authors of the 2007 World Bank report said 10 years later that the middle-income trap was more an “ignorance trap”.

Fallacious prophecy

When talking about middle-income countries, what comes to mind first are the Latin American countries that are stuck in the middle-income trap as if what they experienced is the destiny for all late-comers. There actually are several countries in this region who got into the low- and middle-income stage quite early, including Uruguay (1870), Argentina (1890), Chile (1891), Venezuela (1925), Mexico (1942), Panama (1945), Colombia (1946) and Brazil (1958). Till now, except for Uruguay and Chile -- which became high-income countries in 2012, -- the rest are still stuck in the middle- and high-income group.

However, experience from this one region may not be universally applicable. The history shows that most late-comers stayed for a shorter time in the middle-income stage than today's high income countries did.

Research shows that later-coming countries maintain a higher growth rate than Western developed countries in the general picture. Of the 124 countries for which we have continuous data, 45 have completed the transition from low- and middle-income to middle-to-high income through 2013.

An analysis of the 45 economies can help clarify misunderstandings of middle-income trap. There were 36 that finished the transition before 1950, and the other nine after 1950. But the time spent by the first 36 countries was longer than the later nine. For example, it took the Netherlands 128 years, but China only 17 years.

Of the 45 economies, 30 (most of them are European and North American countries) had transformed from upper-middle income to high income before 2013. Five completed the transition before 1950; the other 25 after 1950. Of the former group, New Zealand spent as long as 23 years, and Switzerland the shortest of 14; of the latter group, Argentina spent the longest of 41 years, and Hong Kong and South Korea the shortest of seven years.

When the People's Republic of China was founded in 1949, it was one of the poorest counties in the world. After 50 years' effort, in 1999 more than 700 million people shook off the poverty and China became a low- and middle-income country, according to World Bank statistics. Since then all we hear have been warnings of the middle-income trap for China.

Will China get stuck in this trap? On one hand, China does face a multitude of challenges in transforming from middle income to high income. On the other hand, China has the capability to deal with the various challenges.

This confidence is firmly grounded upon solid statistics. According to World Bank standards, China only spent 12 years in the low- and middle-income stage before it strode toward the next stage of middle- and high-income.

Although China's growth rate slowed down a bit in recent years, it still maintains a medium-high growth momentum. So we have every confidence that it will take China less than 15 years to become a high-income country. In other words, this transition should be accomplished by 2025.

Therefore, when it comes to China, the middle-income trap is a fallacy.

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