

Middle Income Trap

Definition: The Middle-Income trap is a phenomenon where countries are not able to make the necessary transition from middle to high income. This is shown through a dramatic slowing of economic growth once a country has reached a certain level per capita.

Causes: There are many reasons that cause this stall in growth or failure to transition. The first being the upward pressure on wages, causing a reduction in competitiveness on those industries that rely on low-wage production (e.g. clothes manufacturing). The second is a lack of investment in innovation and technology that breeds higher incomes. This can often occur as countries fail to recognise the changing requirements for growth as economies develop. Affordability is also a cause of the middle income trap – the rate at which prices are increasing and what people are earning are not at the same level. Another reason for the middle income trap is ageing populations: When there is a growing number of elderly, not only is the economy less productive, but dependency also increases. As a result, the income that people within the middle income level earn goes towards supporting the elderly, and there is little chance to move up to higher incomes.

Solutions:

Globalisation and opening up is a major opportunity for countries to transition into the high-income category. This allows from international trade which in return brings revenue and income into your country by being able to sell to a much larger market.

- E.g. Singapore was able to use both an open economic reform as well as their central positioning within the globe to create an international market for their industries and companies.
- E.g. China is also constantly looking for new markets. It has started selling to Africa now, and this has helped increase their market and help Chinese workers get good income.

The middle-income trap can be resolved through International Production Networks (IPNs). IPNs are a network that branch across multiple countries, allowing countries to tap into the valuable location-specific advantages when it comes to producing goods. IPNs enable countries to increase the value of what they export and also allow for the increase in income because production becomes cheaper and their exports become more attractive. This increase in income means that the government can invest more resources into upskilling, innovation, education and different industries.

- E.g. South Korea has high IPN which helped it to avoid middle income trap
- E.g. Upscaling in large companies in SK (such as Samsung) means that the economy is earning more than it is spending