WORLD ECONOMICS: MIDDLE-INCOME TRAP / CHINA

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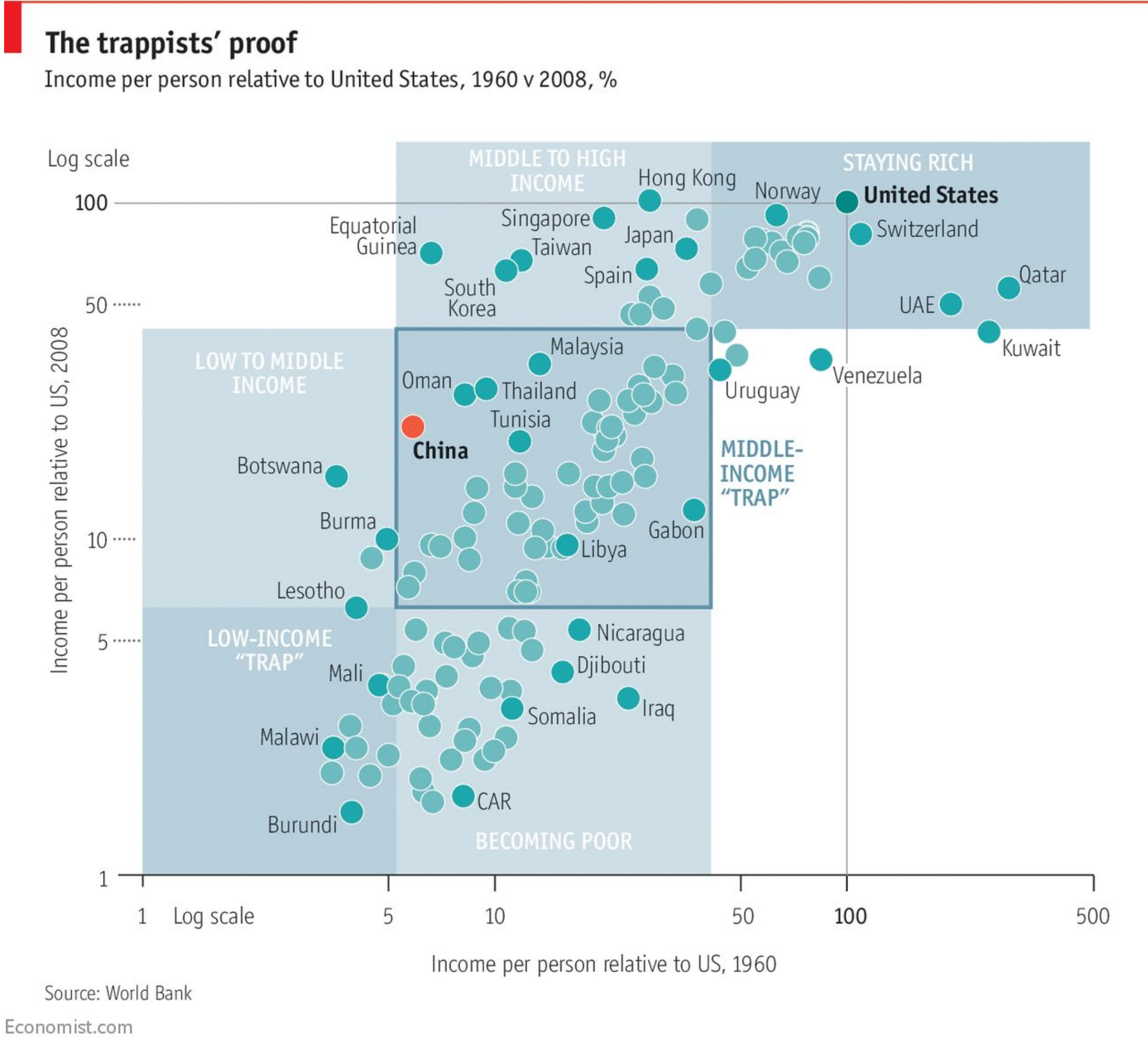
MIDDLE INCOME TRAP

- Paul Krugman, "The Myth of Asia's Miracle", which re-examined the source of the tigers' success
- Geoffrey Garrett "Globalisation's Missing Middle" - *Middle-income countries have not done nearly as well under globalised markets as either richer or poorer countries.*
- Homi Kharas and Indermit Gill of the World Bank nvented the term "middle-income trap", which subsequently took on a life of its own
- The trap can be interpreted in a variety of ways, which may be one reason why so many people believe in it.
  - Some confuse the trap with the simple logic of catch-up growth. According to that logic, poorer countries can grow faster than richer ones because imitation is easier than innovation and because capital earns higher returns when it is scarce. By the same logic, a country's growth will naturally slow down as the gap with the leading economies narrows and the scope for catch-up growth diminishes. All else equal, then, middle-income countries should grow more slowly than poorer ones.
  - But (!) Mr Garrett was making a bolder argument: that middle-income countries tend to grow more slowly than both poorer and richer economies.

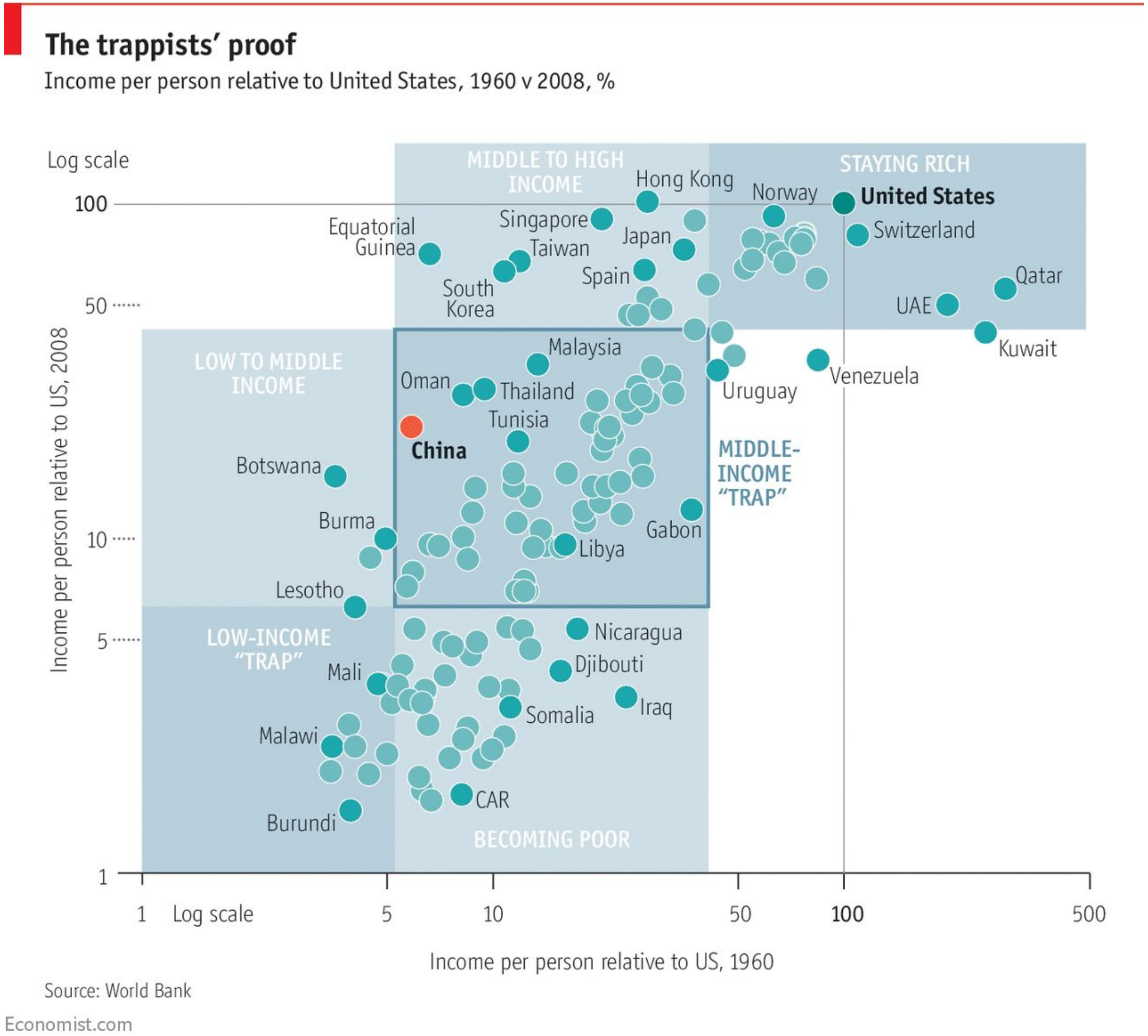
MIDDLE-INCOME TRAP

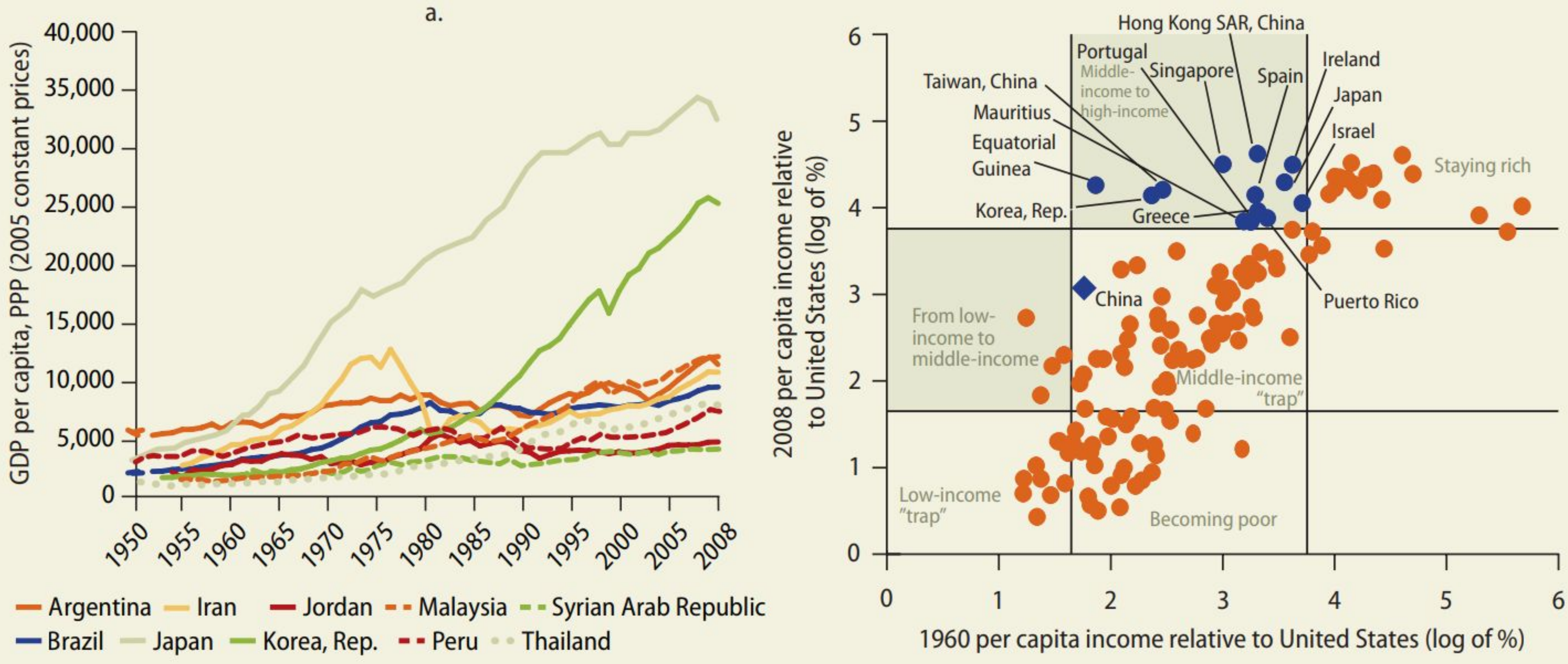
- By far the most prominent trap-watcher is **CHINA**, one of the few middle-income economies that is more than middle-sized.
  - In 2015 Lou Jiwei, then China's finance minister, said that his country had a 50% chance of falling into the trap in the next five to ten years.
  - The same fear haunts Liu He, an influential economic adviser to Xi Jinping, China's president. Mr Liu was one of the driving forces behind a report entitled "China 2030", published in 2012 by his Development Research Centre (DRC) and the World Bank. The report featured a chart that has perhaps done more than any other to spread the idea of a middle-income trap.
  - It showed that of 101 countries which counted as middle-income in 1960, only 13 had achieved high-income status by 2008. The rest spent the intervening 50 years trapped in mediocrity or worse.



- It defines "middle-income" broadly, including any country with a GDP per person that is more than 5.2% of America's (at purchasing-power parity) and less than 42.75%. That definition means that a country with a GDP per person of just $590 (at 1990 prices) counted as middle income in 1960. And at the other end of the middle-income scale, a country with a GDP per person as high as $13,300 in 2008 would also still belong to the same category. The second number is more than 2,000% higher than the first. No wonder so many countries remained stuck in between them.

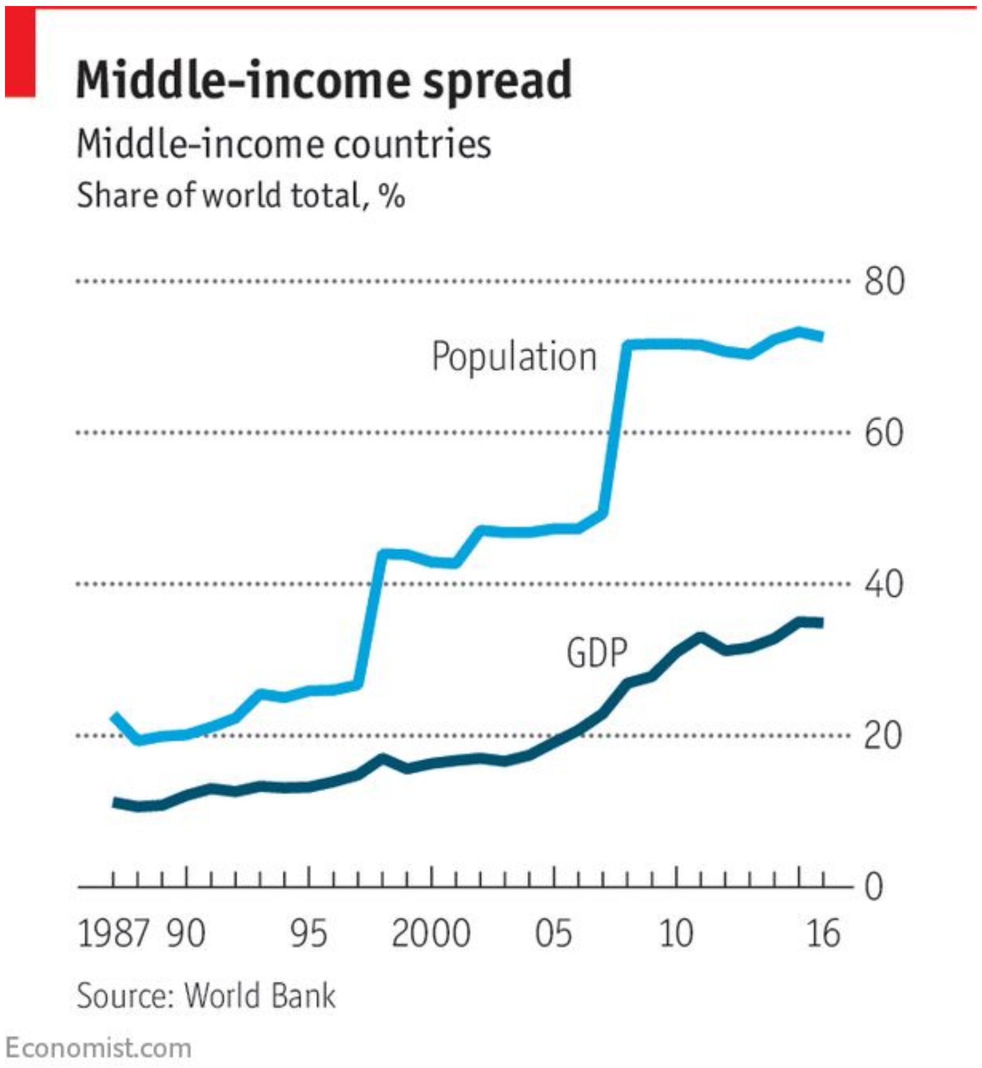
In principle, it would be possible for an economy's GDP per person to grow by over 6% a year for 48 years without escaping it. It is not that middle-income is unusually treacherous. It is just that the definition is unusually capacious.




a.
GDP per capita, PPP (2005 constant prices)
40,000
35,000
30,000
25,000
20,000
15,000
10,000
5,000
0
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2008
Argentina
Iran
Jordan
Malaysia
Syrian Arab Republic
Brazil
Japan
Korea, Rep.
Peru
Thailand
2008 per capita income relative to United States (log of %)
1960 per capita income relative to United States (log of %)
Hong Kong SAR, China
Portugal
Middle-income to high-income
Singapore
Spain
Ireland
Japan
Israel
Taiwan, China
Mauritius
Equatorial Guinea
Korea, Rep.
Greece
Staying rich
China
Puerto Rico
From low-income to middle-income
Middle-income "trap"
Low-income "trap"
Becoming poor

COUNTRIES THAT ARE NEITHER RICH NOR POOR CAN HOLD THEIR OWN AGAINST RIVALS AT BOTH EXTREMES

- Slow and queasy
  - it seems to make sense that middle-income countries will be squeezed between higher-tech and lower-wage rivals on either side. *But those rivals rely on high technology or low wages for a reason.*
    - Rich economies need advanced technologies and skills to offset high wages.
    - Poor countries, for their part, need low wages to offset low levels of technology and skill.
    - The obvious conclusion is that middle-income countries can and do compete with both, combining middling wages with middling levels of skill, technology and productivity.



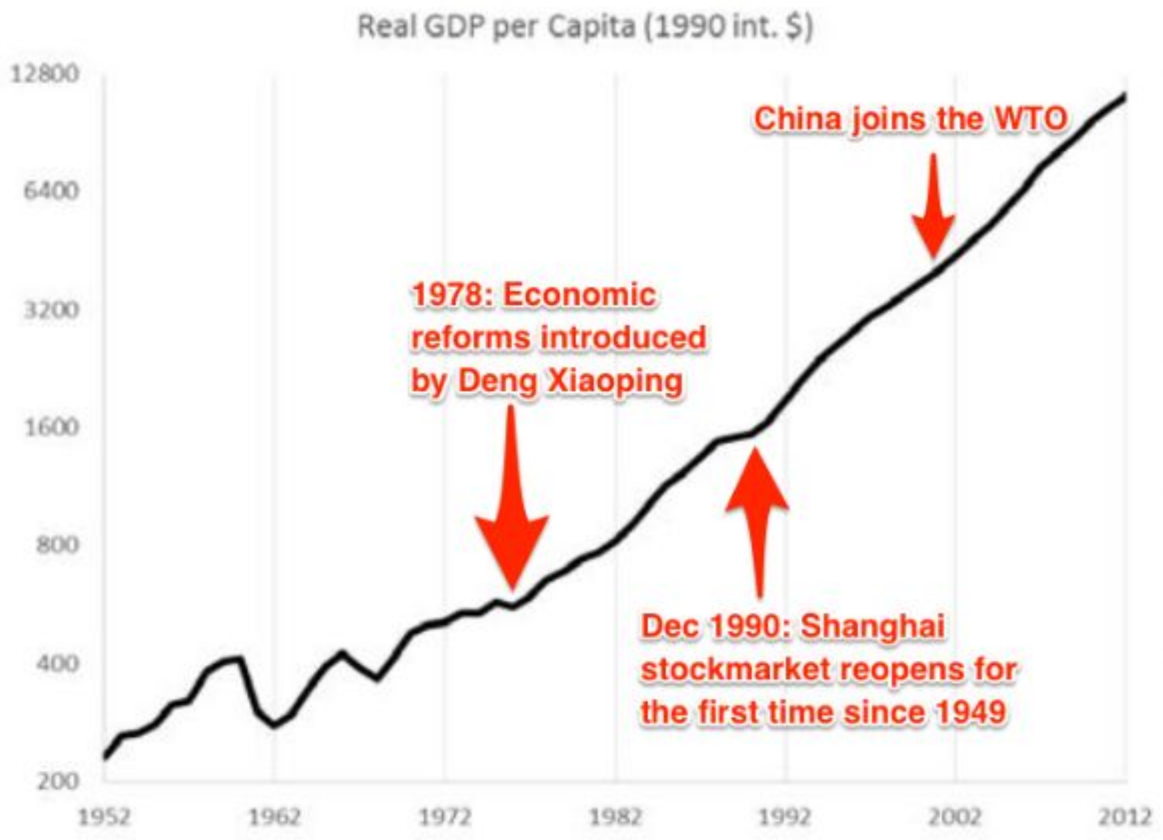
MIDDLE-INCOME TRAP

- Middle-income countries are often more accurately described as mixed-income economies.
- Shaping the mix are at least **four possible sources of growth in GDP per person**.
  1. moving workers from overmanned fields to more productive factories (structural transformation).
  2. adding more capital such as machinery per worker (capital-deepening).
  3. augmenting capital or labour by making it more sophisticated, perhaps by adopting techniques that a firm, industry or country has not previously embraced (technological diffusion).
  4. the final source of growth derives from advances in technology that introduce something new to the world at large (technological innovation).
- So development does not proceed in discrete stages that require a nationwide leap from one stage to the next. It is more like a long-distance race, with a leading pack and many stragglers, in which the result is an average of everyone's finishing times. The more stragglers in the race, the more room for improvement.

CHINA GDP ANNUAL GROWTH RATE

HISTORY

- epresented the success of the First Five-Year Plan, during which "6000 Soviet advisers helped establish and operate the 156 large-scale capital intensive Soviet-assisted projects", significantly increasing the pace and quality (productivity) of industrialization in the country. However, it was followed by the Great Leap Forward (1958-1962), which undid many of the gains through worsening of incentives by banning material incentives and restricting markets.



HISTORY

- These reforms were then unwound between 1962 and 1966, leading to another period of productivity and per capita GDP growth, before the events of the Cultural Revolution (where strikers clashed with the authorities) set the economy back once again.
- the Third Plenary Session of the 11th Central Committee of the Communist Party in December 1978 was the defining moment in shifting the country from its unsteady early economic trajectory on to a more sustainable path. It laid the groundwork for future growth by introducing reforms that allowed farmers to sell their produce in local markets and began the shift from collective farming to the household responsibility system.
- A year later the Law on Chinese Foreign Equity Joint Ventures was introduced, allowing foreign capital to enter China helping to boost regional economies although it took until the mid-1980s for the government to gradually ease pricing restrictions and allow companies to retain profits and set up their own wage structures. This not only helped to boost GDP from an annual average of 6% between 1953-1978 to 9.4% between 1978-2012 but also increased the pace of urbanization as workers were drawn from the countryside into higher-paying jobs in cities.
- This process of market liberalization led to the establishment of China as a major global exporter. It eventually allowed for the reopening of the Shanghai stock exchange in December 1990 for the first time in over 40 years and, ultimately, to China's accession to the World Trade Organisation
- These reforms had a significant impact both on per capita GDP and the pace of the falling share of the labour force working in agriculture.

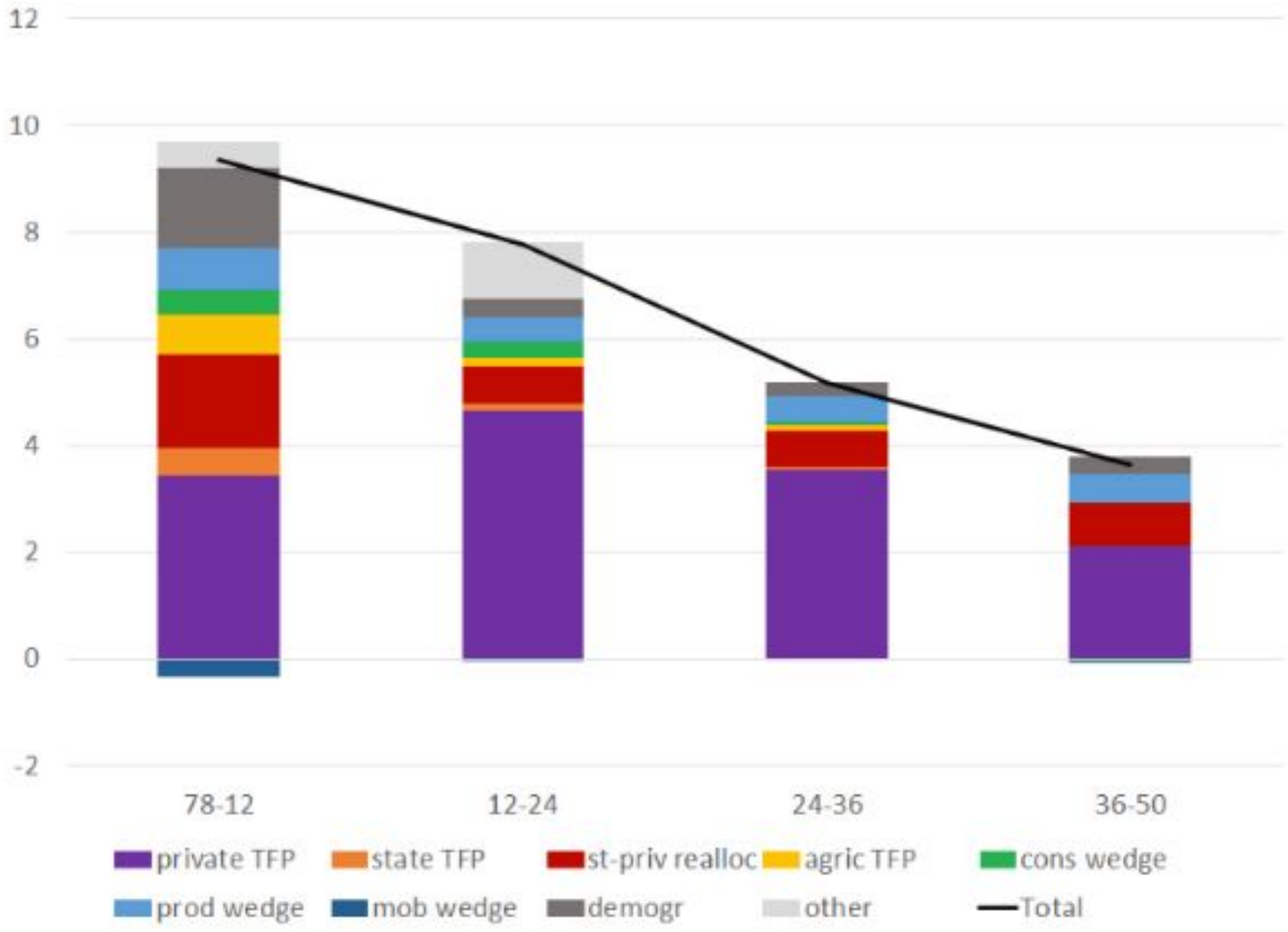


Figure 12: Actual and post-78 trend GDP growth.

HOW CHINA INTERFERES IN AUSTRALIA

- Few countries on the planet have benefited as clearly from China as Australia has. Its society has been enriched by waves of Chinese migrants and sojourners for 160 years. Its national income grew as much as 13 percent in a single decade as a result of China's resource-intensive construction boom, according to the Australian Reserve Bank. And an easing of the resources boom has been offset by the spending power of 180,000 Chinese students and a million tourists each year, along with hundreds of thousands of migrants who have mostly thrived in their new country.

ARE CHINA AND BRAZIL TRANSFORMING AFRICAN AGRICULTURE?

- Chinese and Brazilian engagements in four African countries – Ethiopia, Ghana, Mozambique and Zimbabwe – as well as the origins of Chinese and Brazilian agricultural policies, technology and capital by looking at the two countries' domestic contexts.
  - They reveal a rich mix of engagements, including:
  - agricultural investments by private and state owned enterprises
  - tri-lateral development cooperation efforts
  - technological adaptation initiatives
  - training programmes
  - 'under-the-radar' involvement in agriculture by Chinese migrants.
- These diverse experiences challenge simplistic narratives of either "South–South" collaboration or "neo-imperial" expansion of "rising powers".