

# The "Middle Income Trap" in China: Enlightenment from Latin American Countries

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## Abstract

According to the statistics from the National Bureau of Statistics of China, China's per capita income is already higher than the average of middle-income countries. However, from the analysis of the economic development of various countries in the world, only a few countries such as South Korea and Japan have successfully crossed the "middle income trap". After entering the middle income, most countries have been hovering in this range and cannot be crossed. This article analyzes the lessons learned by Latin American countries when they crossed the "middle income trap". On this basis, some experiences in avoiding the "middle-income trap" in China are put forward to provide useful references for China to successfully overcome the "middle-income trap" in the future.

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In 2019, China's per capita GDP exceeded US\$10,000, which is already higher than the average level of middle-income countries. After China's entry into middle-income countries, the process of industrialization and urbanization has developed rapidly, and at the same time, it has better promoted the sustainable development of social economy. However, with the rapid economic development, China is also facing many problems, such as the imbalance between resource demand and the ecological environment, unfair income distribution, and unreasonable population structure, which seriously threaten the sustainable development of the Chinese economy. If China wants to overcome the "middle-income trap" problem well, it needs to make innovations in personnel training, system innovation, and resource coordination. At the same time, China must also learn from the failures of Latin American countries and implement effective policies based on the actual situation of its own development in order to successfully overcome the "middle income trap."

## 1. The Background of the "Middle Income Trap"

### 1.1. Concept of "Middle Income Trap"

The concept of "middle income trap" was first put forward in the World Bank's East Asia Economic Development Report (2006). It means that the per capita income of a country reaches the middle level in the

world<sup>a</sup>, as a result of a series of problems in economic development, industrial upgrading will be difficult, the degree of richness and poverty will deepen, and social contradictions will intensify, leading to economic stagnation. At the same time, people often have two misunderstandings about the "middle income trap". The first is that middle income refers to GDP per capita, not the total GDP of a country. Second, entering middle income refers to a region or country, not a family or a simple individual.

### 1.2. "Middle Income Trap" Cases Comparison among Countries

As early as the late 1960s to the early 1970s, some Latin American countries had entered the ranks of middle-income countries. In the mid-1970s, Brazil's per capita GDP was close to 5,000 U.S. dollars and successfully entered the ranks of middle-income countries. However, according to World Bank statistics, Brazil's per capita GDP in 2019 was 9,717 U.S. dollars, still not breaking through the United Nations-designated middle-income countries. Standards. The economic situation has stayed at the same level for a long time and cannot enter the ranks of high-income countries. The same was true in Mexico during the same period. The economic growth rate was basically maintained at about 6%, and the results entered the ranks of middle-income countries, known as the "Mexico miracle." From the 1980s to the present, Mexico's economic growth has been unstable. Per capita GDP has slowly increased from US\$2,762.6 in the early 1980s to US\$1,0361.3 in 2014. From 2014 to the present, the per capita GDP has fallen to US\$9,863. The more serious country is Colombia. Colombia's per capita GDP grew more slowly, with almost no growth from 1978 to 1994. And there was some decline after 2014.

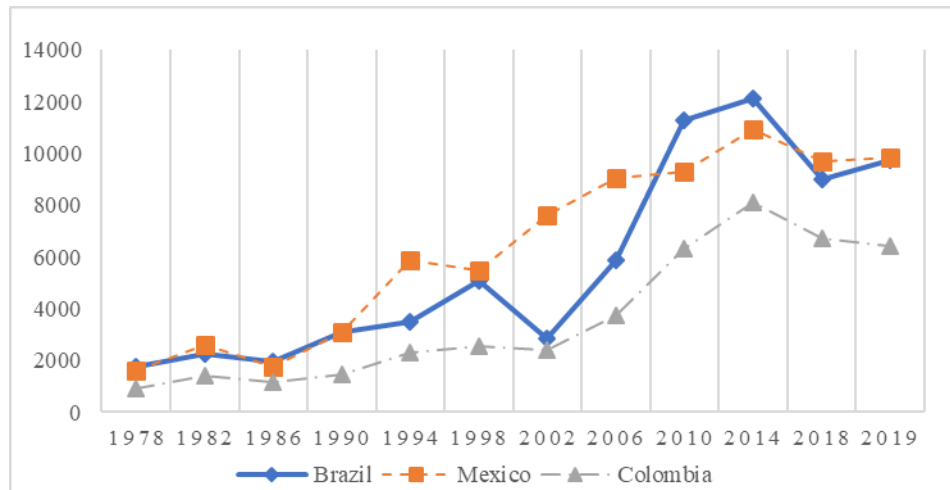


Fig. 1. Changes in per capita GDP growth in Brazil, Mexico, and Colombia

Source: [www.stats.gov.cn](http://www.stats.gov.cn).

### 1.3. The Basic Characteristics of Latin America and Other Countries Falling into the "Middle Income Trap"

#### 1.3.1. Economic growth lacks the necessary momentum

<sup>a</sup> The per capita GDP is in the stage of 4000 USD-12700 USD (data may vary).

Latin American countries have long implemented an inward-looking development strategy (import substitution strategy), while some Southeast Asian countries have long implemented an export-oriented development strategy (export substitution strategy). According to the comparative advantage theory to guide the industrial layout of various countries, its industrial development has always been at the international low-end level. However, after entering the ranks of middle-income countries, the advantage of the demographic dividend has gradually disappeared, and the industrial model based on labor and resources has gradually changed to technology and capital-intensive enterprises. However, it is still difficult to compare with high-income countries.

### *1.3.2. Widening gap between rich and poor*

Most of the countries falling into the "middle income trap" have experienced rapid economic growth and have entered the ranks of middle-income countries, after that, the speed of economic development slowed down significantly, and some countries even stagnated or regressed. At the same time of rapid economic growth, the ignorance of social progress has also led to an excessive income distribution gap. After entering middle-income countries, such as Argentina, Chile, Brazil and other countries, the Gini coefficient has generally risen, which also makes the two-level polarization serious. Fair development can improve income distribution, alleviate social contradictions and conflicts, and is conducive to sustainable economic development.

### *1.3.3. Lack of innovation driving force*

In the long run, technological progress is the driving force behind economic growth. The endogenous growth theory believes that only by establishing a good technical management system and digesting and absorbing innovation mechanisms can industrial technological progress and upgrading be realized. Countries that are prone to fall into the "middle-income trap", when capital returns are diminishing, production factors and industrial upgrading will not be achieved. Fewer production factors and slow industrial upgrades will seriously affect the competitiveness of the domestic market in the international arena, and economic development is even more "destroy".

### *1.3.4. Environmental damage*

Simply pursuing rapid economic growth will inevitably lead to continued deterioration of the environment. The environment bears the ability of sustainable economic development. After entering the ranks of middle-sized countries, Brazil, Mexico, Colombia and other countries regard economic growth as the ultimate goal, even at the expense of the environment, but let the environment hinder economic development. Especially in Brazil, the air pollution is very serious. The amount of toxic substances per cubic meter in the air in São Paulo is about twice as high as the relevant regulations of the World Health Organization. Every year, tens of thousands of people are hospitalized for respiratory diseases, causing serious economic losses.

## **2. Lessons from Latin American Countries Falling into the "Middle Income Trap"**

After the per capita GDP of Latin American households reached US\$1,000, they became more anxious to develop the economy and formed a model of "emphasis on growth but less distribution". Although the per capita GDP quickly reached 3,000 U.S. dollars, the long-term neglect of the income distribution system and the improvement of the social security system severely intensified social contradictions, and the society has shown continued turmoil. What's more serious is that the per capita GDP of Latin American households has been hovering between 4000-5000 US dollars for a long time, and it is difficult to move forward. So far, it has not entered the ranks of high-income countries.

### *2.1. Ignore the balanced development of the economy*

After entering the ranks of middle-income countries, some Latin American countries such as Brazil, Mexico, and Colombia have pursued rapid economic development unilaterally, and have seriously neglected the balance of economic development. In the choice of national balanced growth strategies, Brazil, Mexico, Colombia and other countries rely heavily on export-oriented growth economic models, ignoring the important role of inward-oriented economy in their own economic development. Brazil, Mexico, and Colombia did not have much investment at this stage, accounting for only 20% of the investment rate, while the investment rate of South Korea and Singapore at the same stage of development was around 40%. At the same time, there are also unreasonable factors in the use of foreign capital in Latin America. Foreign capital can flow freely in Latin America, and a large amount of foreign capital has not flowed into areas that need development. And in the process of investment, random withdrawal of funds and transfer of profits have caused losses to Latin American countries.

### *2.2. Ignore the development of innovative technology*

After Brazil, Mexico, Colombia and other Latin American countries entered the ranks of middle-income countries, they did not pay attention to the important position of science and technology in economic development, and lacked capital investment in technological innovation, which led to the decline of social innovation vitality. At this stage, the R&D expenditures of Japan and South Korea accounted for more than 2% of GDP, while the R&D expenditures of countries like Brazil were almost between 0.7% and 1.1%. The R&D expenditures of Japan and South Korea are much higher than those of Latin America and other countries, which are also important factors for countries such as Japan and South Korea to successfully overcome the "middle income trap".

### *2.3. Ignore the development of agriculture*

In the 1960s and 1970s, Latin American countries ignored the important role of agriculture in the development of the national economy, blindly pursuing the speed of industrial development, and developing industries at the expense of agriculture. This leads to uneven development among industries. The economic reforms of Latin American countries mainly involve non-agricultural sectors. Farmers benefit little from the process of economic reforms. On the contrary, they have to sacrifice part of their profits to promote the process of industrialization. This series of policies has led to a large increase in the rural poor population and rural poverty. The problem has further evolved into a social problem. The agricultural development in Latin America mainly faces many problems, which has led to the imbalance of the industrial structure and also laid hidden dangers for the subsequent economic development.

## **3. The Enlightenment of International Experience to China**

### *3.1. Accelerate the Transformation of Economic System Reform*

First of all, we must promote the transformation of economic development mode, from the original simple mode of economic growth based on inputs of production materials, to a new mode of economic growth based on independent innovation and technological research and development. Japan and South Korea attach great importance to the collection and application of technology, knowledge and information, and regard technological development as a priority for development. Through independent research and development of

technology, make it a leading position in the field of high-tech, laying a solid foundation for breaking through the "middle income trap". At the same time, China must also actively promote the troika of consumption, investment and export.

### *3.2. Maintain Social Equity and Improve the Security System*

The people are the creators of history and the promoters of economic development and social stability. In the process of crossing the "middle income trap" in countries such as Japan and South Korea, the Gini coefficient has never been higher than the international warning line of 0.4. They first achieved a general increase in workers' wages and narrowed the gap between the rich and the poor. Then provide a sufficient employment environment, and then raise the wages of small and medium-sized enterprises and manufacturing workers, and basically achieve a balanced initial distribution. At the same time, further improve the compulsory education system and the social and medical insurance management system. While Japan and South Korea are developing economically, there has been no income distribution gap and the expansion of the gap between the rich and the poor, which is conducive to the sustained and healthy economic development and is of great significance to overcome the "middle income trap".

### *3.3. Strengthen System Innovation*

In the late 1990s, the shortcomings of "neoliberalism" were clearly exposed, ignoring social development, increasing the number of unemployed people, widening the gap between the rich and the poor, and the prevailing trend of corruption, which gradually intensified social conflicts. Japan, South Korea and other countries have adopted severe punishment mechanisms for corruption, and used democratic supervision, openness and transparency to further "cure" corruption. With the approaching of the Lewis turning point and the turning point of the demographic dividend, and learning from foreign development experience, China should gradually improve the social welfare of the rural population and the migrant population at this time. At this stage, China still has serious industry barriers and the market competition mechanism is not perfect. China should gradually relax the market access mechanism of some enterprises and improve the technology and service level of the overall industry through free competition in the market.

## **4. Summary**

Based on the above analysis of some countries in Latin America, we can see that China is currently in an important strategic period and also an important period of choice. At this stage of economic development, China is facing many opportunities as well as many unseen challenges. Although China's per capita GDP is higher than the average level of middle-income countries, a series of problems cannot be avoided in the rapid economic development. We must seize the opportunity and avoid the old path of Latin American countries. To realize the sustainable development of the Chinese economy, we must accelerate the transformation of economic system reform, maintain social equity, improve the security system, strengthen institutional innovation, develop science and technology, and improve independent innovation capabilities. Promote the adjustment of economic structure, break industry monopoly, and strive to create a good market access mechanism. In terms of system, continue to streamline administration and delegate power, deepen government functions, severely punish corruption, and at the same time increase the social security system to promote fair social income distribution. Under such comprehensive and multi-sectoral reforms, China believes that China can quickly overcome the "middle-income trap" and become a high-income country.

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