

A vertical decorative element consisting of a ladder-like structure at the top, a thin white line in the middle, and a wide, tapered orange-to-brown gradient shape at the bottom.

# The Middle-Income Trap

Annual BIDS Conference on  
Development Economics, Dhaka

7<sup>th</sup> December 2024

# Main Points



1

Middle-income countries—home today to 6 billion people—are in a race against time. The external environment is making things harder, not easier

2

To escape the “middle-income trap,” countries need to undergo two transitions, not one

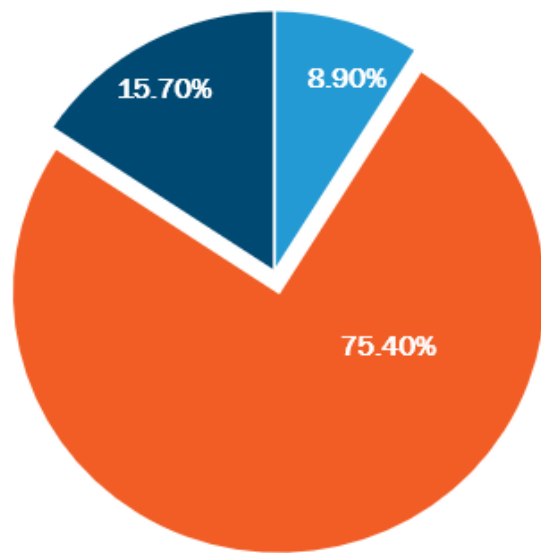
3

To grow quickly through middle income, they have to discipline incumbents, reward merit, and capitalize on crises

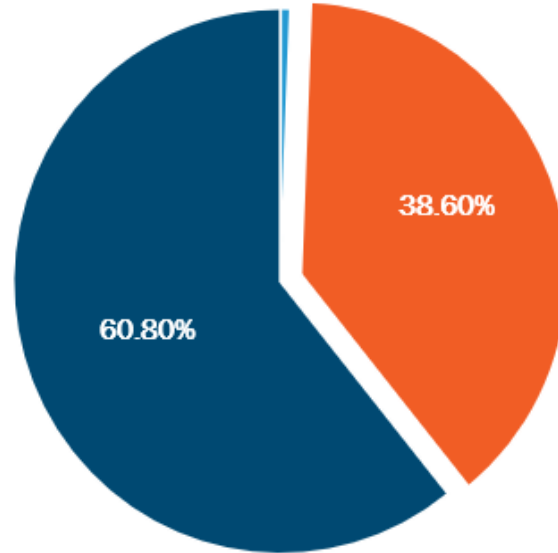
# Middle-income countries are a big and growing part of the global economy



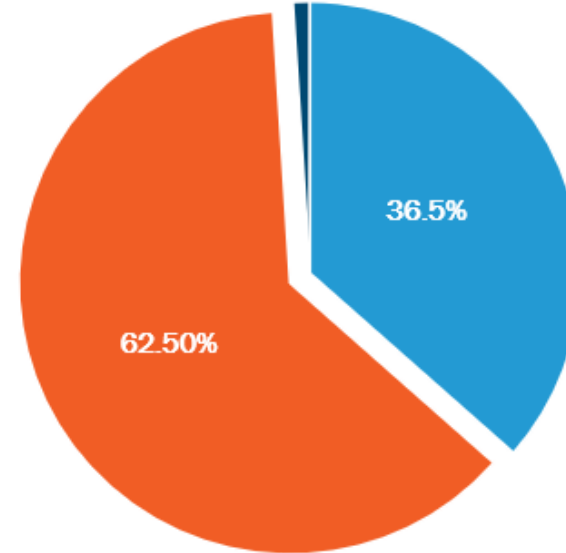
Share of



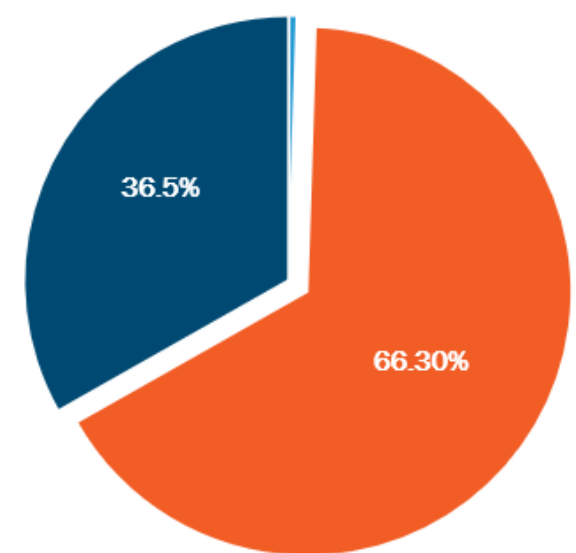
Population



GDP



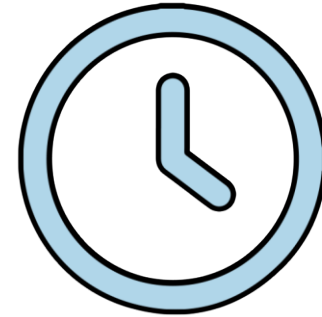
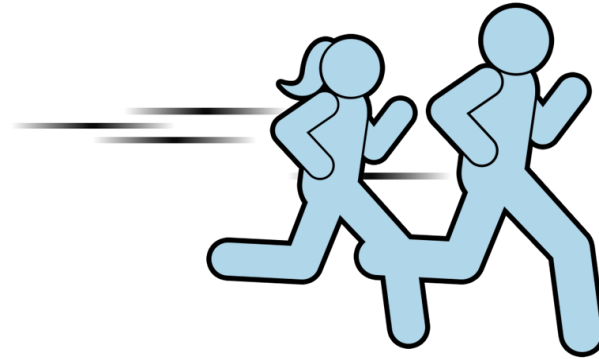
Population living in extreme poverty



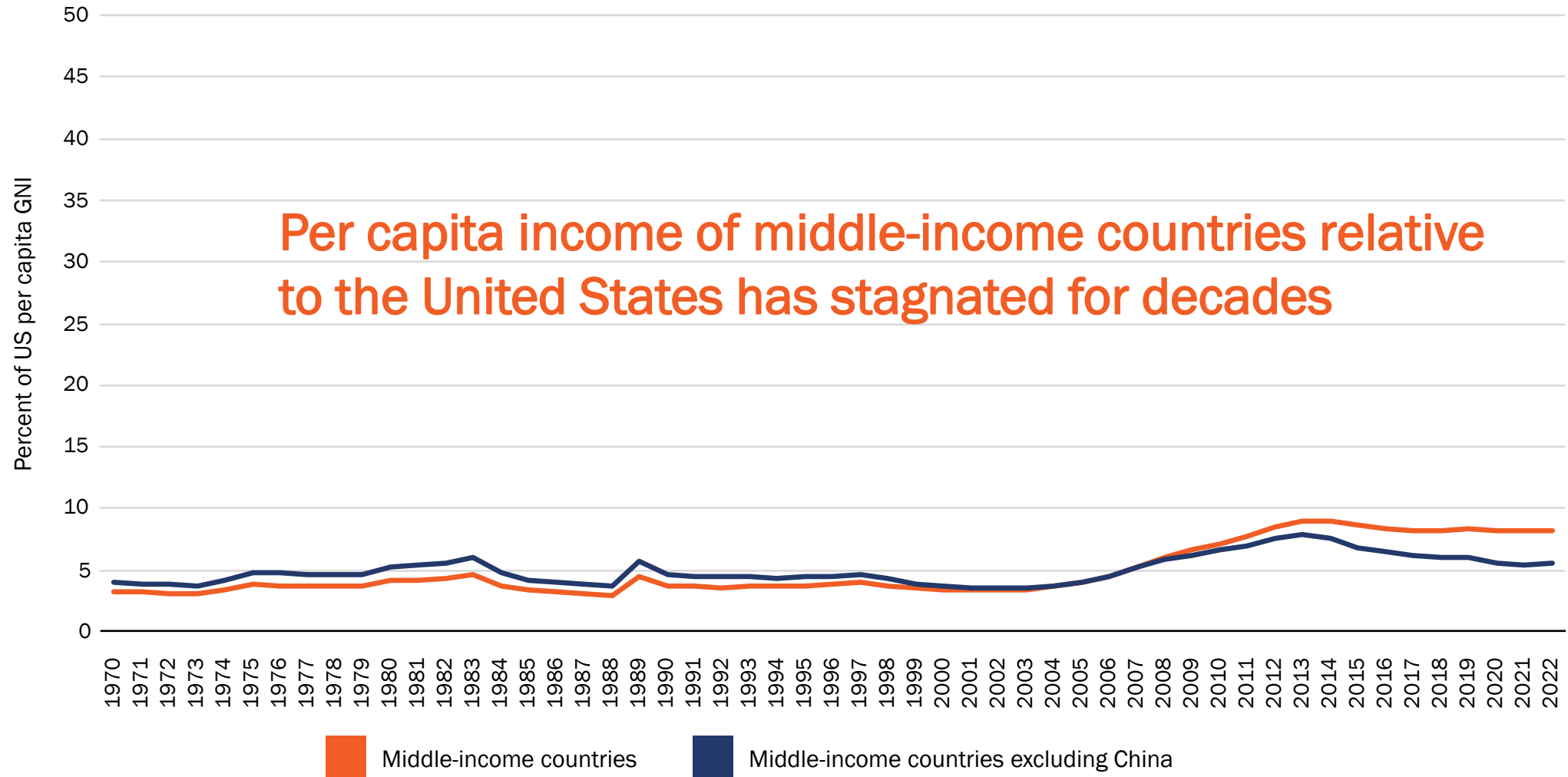
CO<sub>2</sub> Emissions



To get rich is glorious



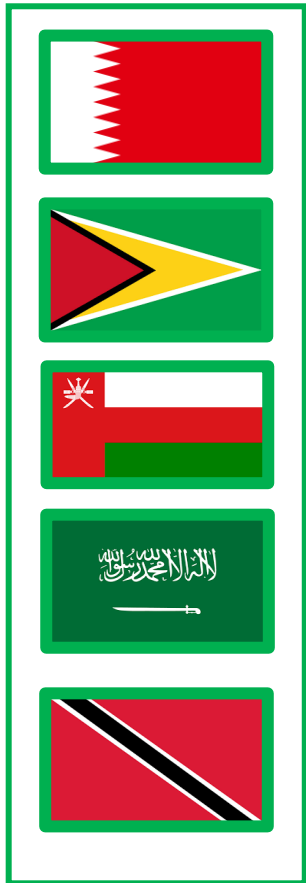
# To get rich is hard





# 34 middle-income economies became high income in 34 years—with a combined population of ONLY 250 million

## Oil exporting



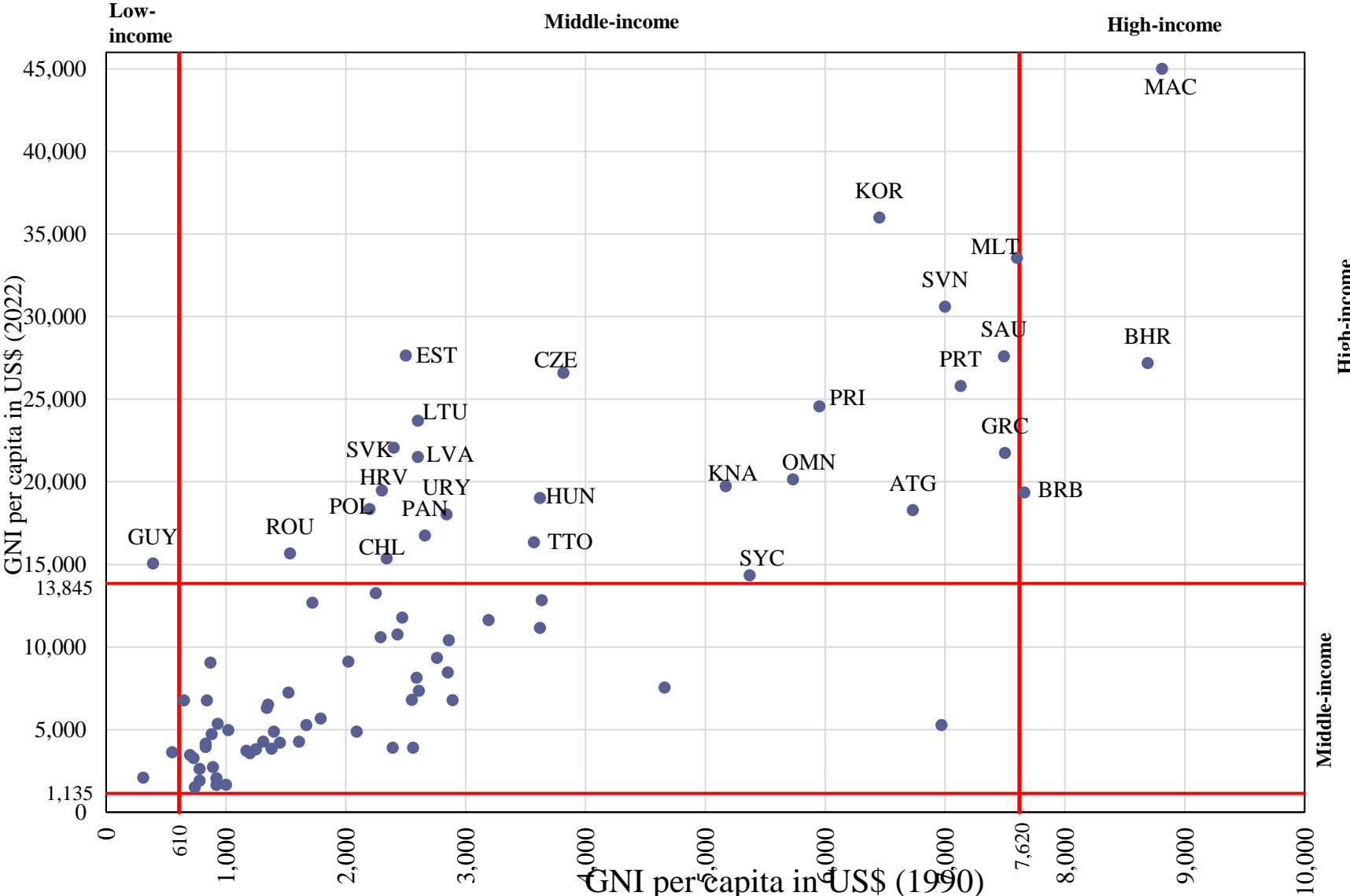
## European Union



## Others



# 34 middle-income economies became high income in 34 years—with a combined population of ONLY 250 million



# Three facts about middle-income economies



**1** Slowing growth

**2** Structural stasis

**3** Shrinking spaces

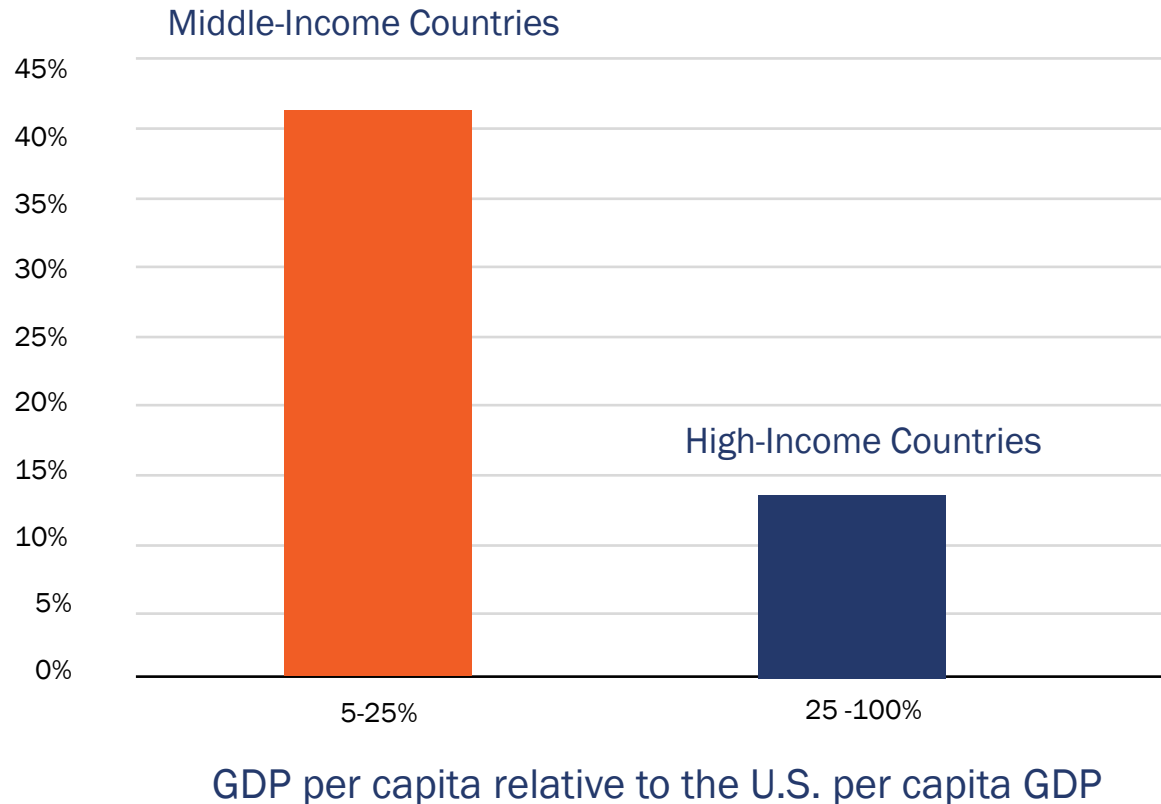


# Slowing growth

## Slowdowns are more likely in middle incomes



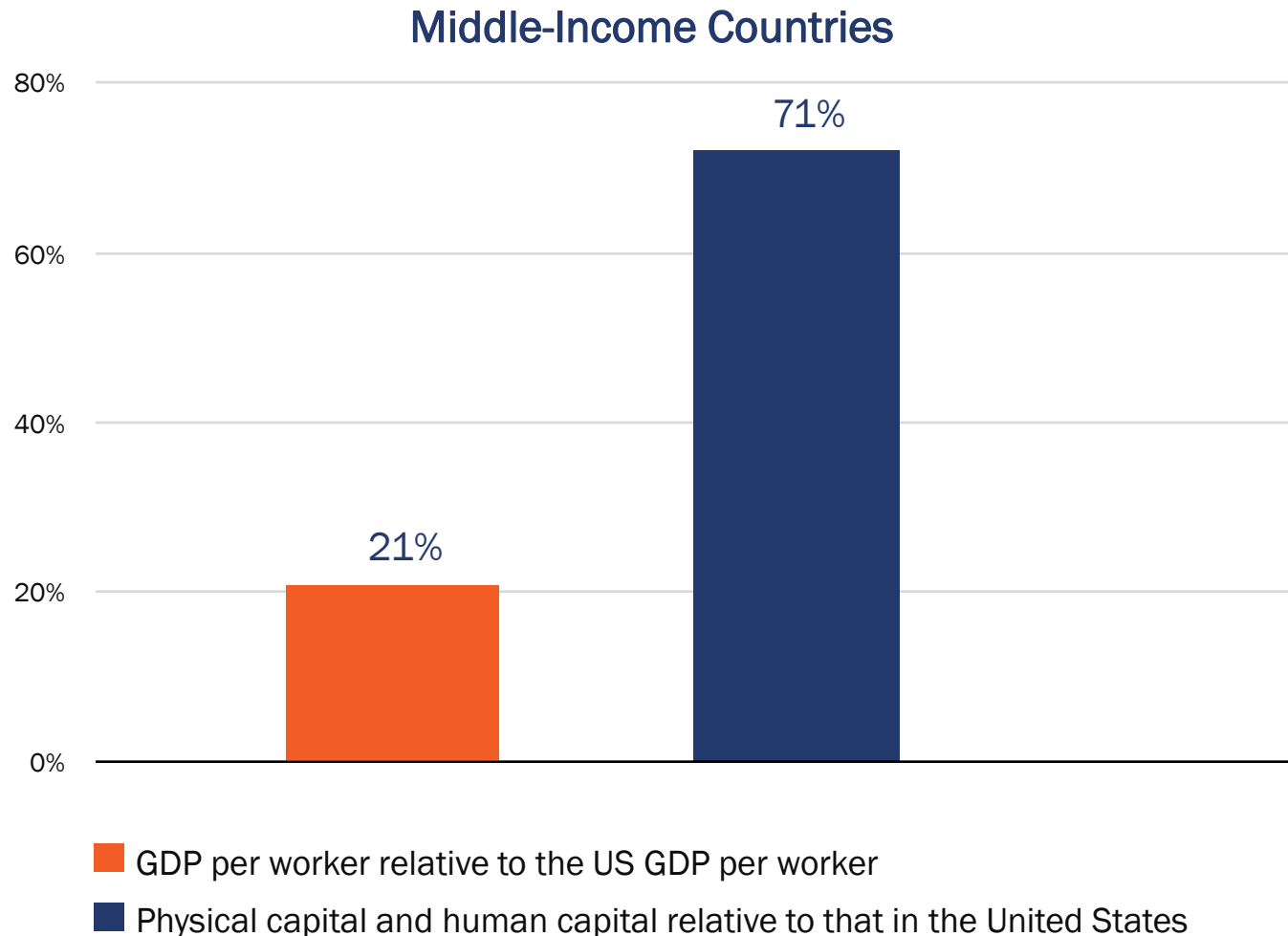
Likelihood of growth slowdowns



**A middle-income country is three times more likely to experience a slowdown compared to a high-income country**

# Structural stasis

Middle income economies have less capital, and use it less efficiently



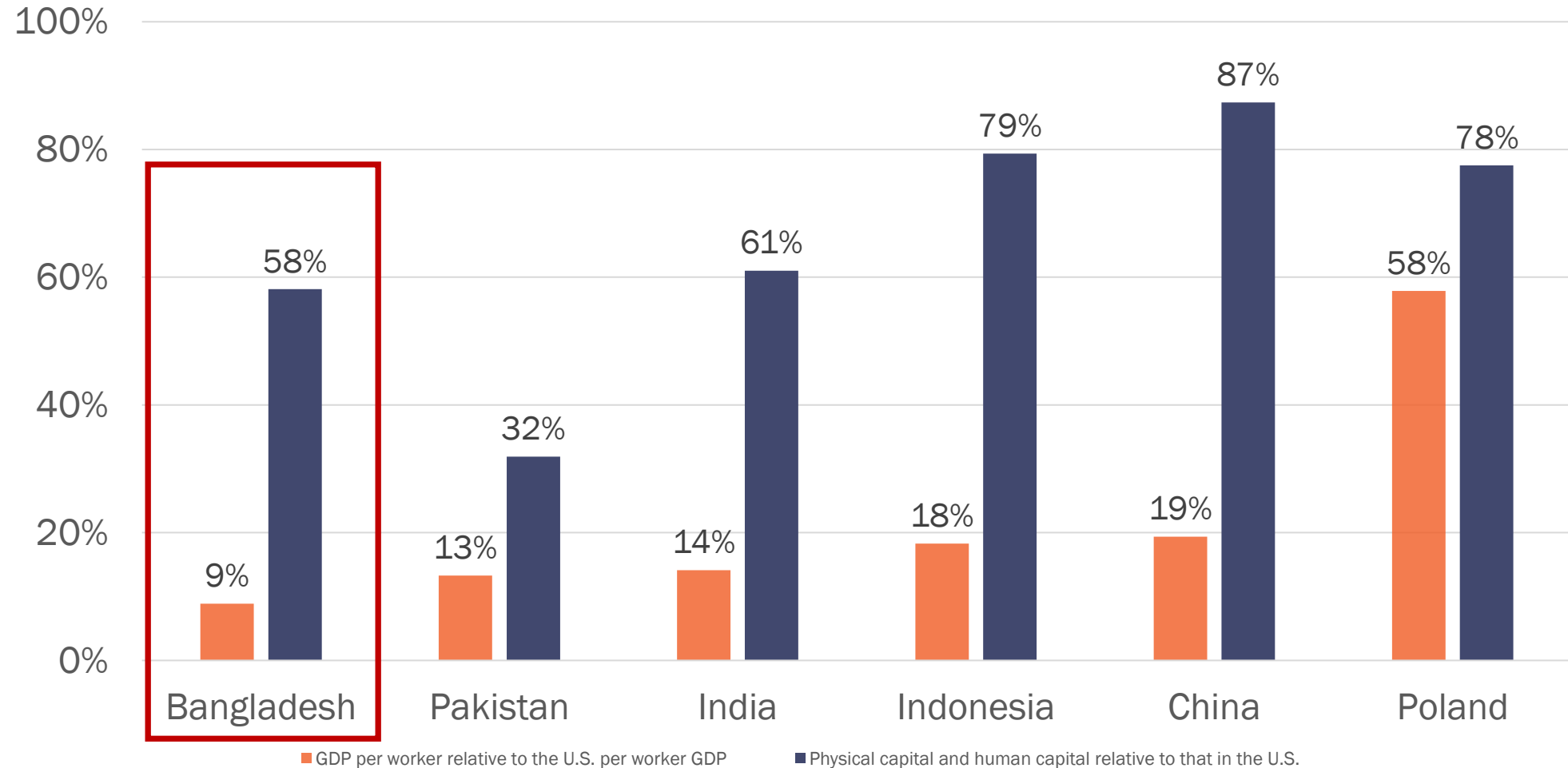
If capital accumulation were enough...

work in middle-income economies would be three-quarters as rewarding as in the US

... not just a fifth

# Structural stasis

Middle income economies have less capital, and use it less efficiently



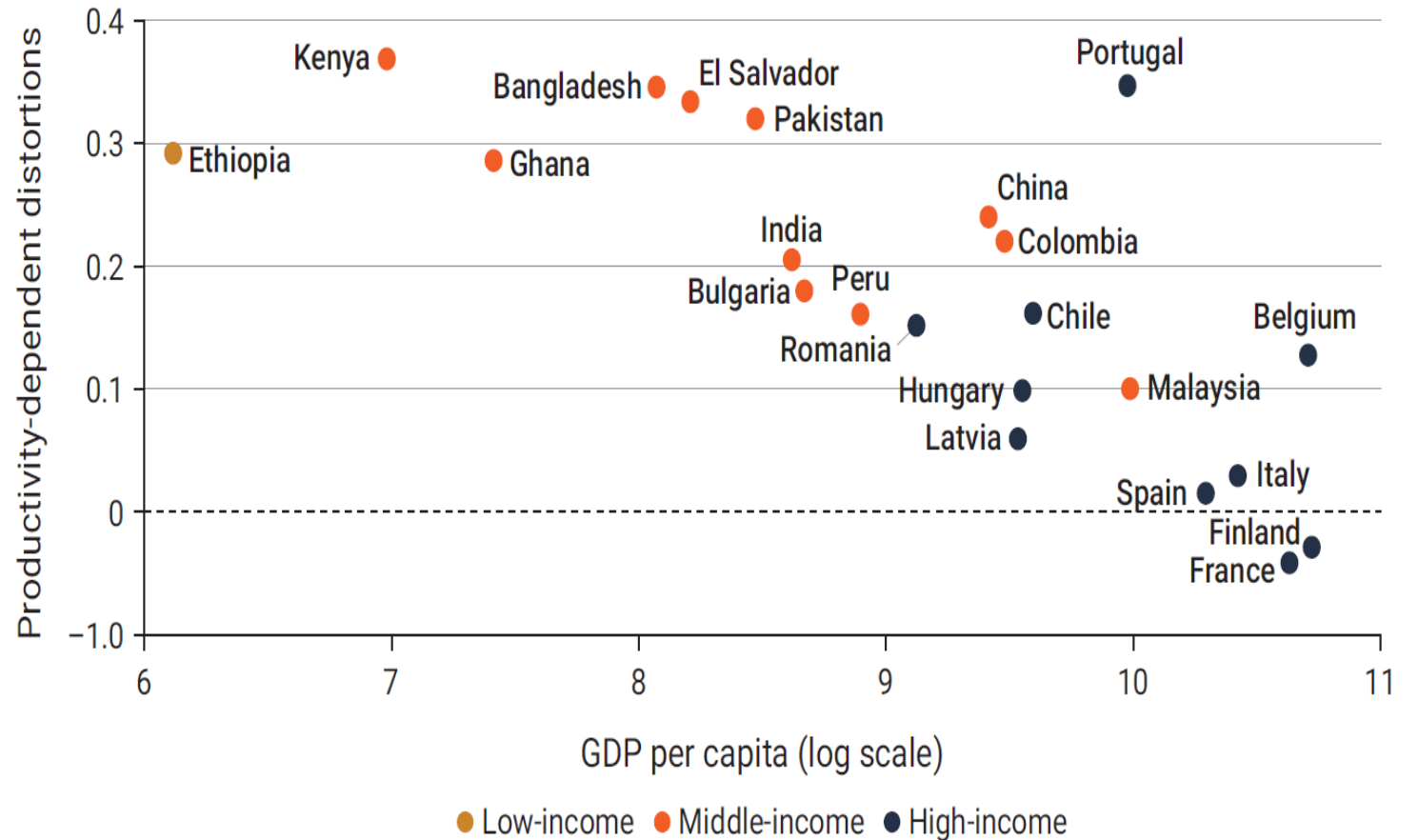
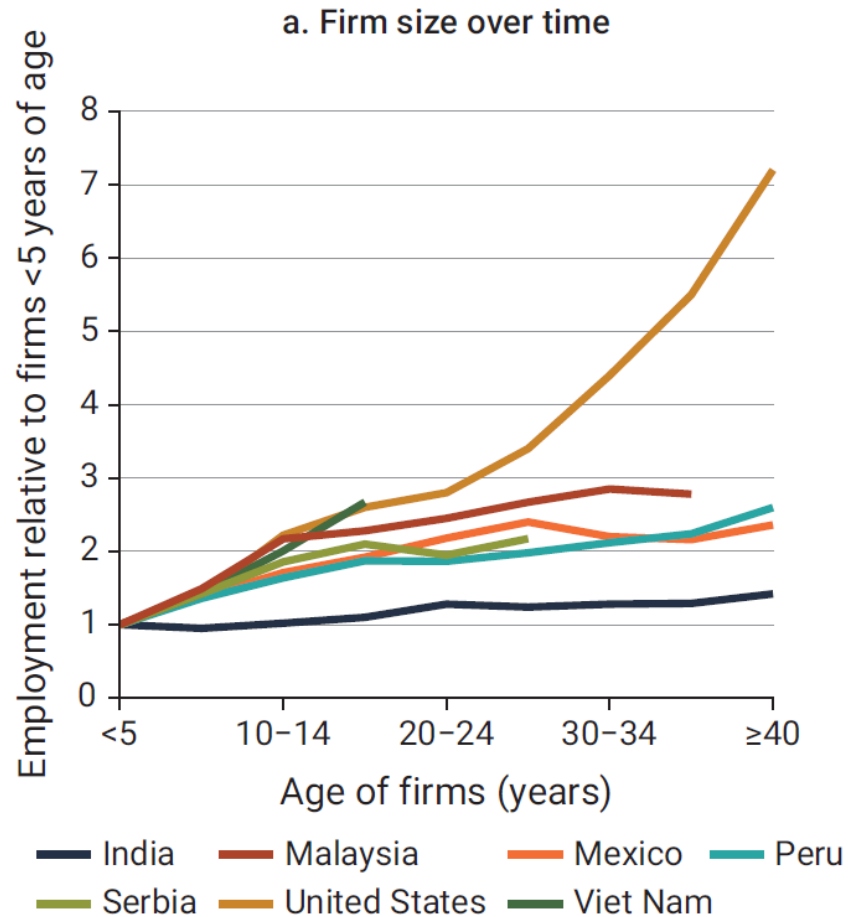
# Inefficient use of capital

“flat and stay” dynamics in middle income countries hold back entrants and incumbents



Productive firms do not expand, and inefficient firms do not exit the market

Productive firms are held back from growing in many middle-income countries



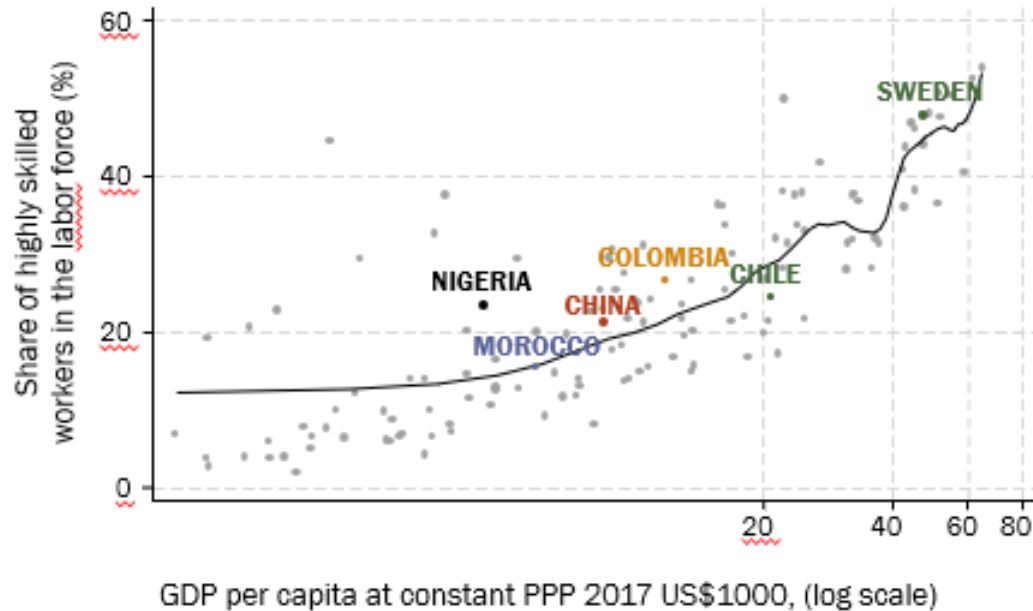
# Inefficient use of human capital and talent

## Creation is held back by strong forces of preservation

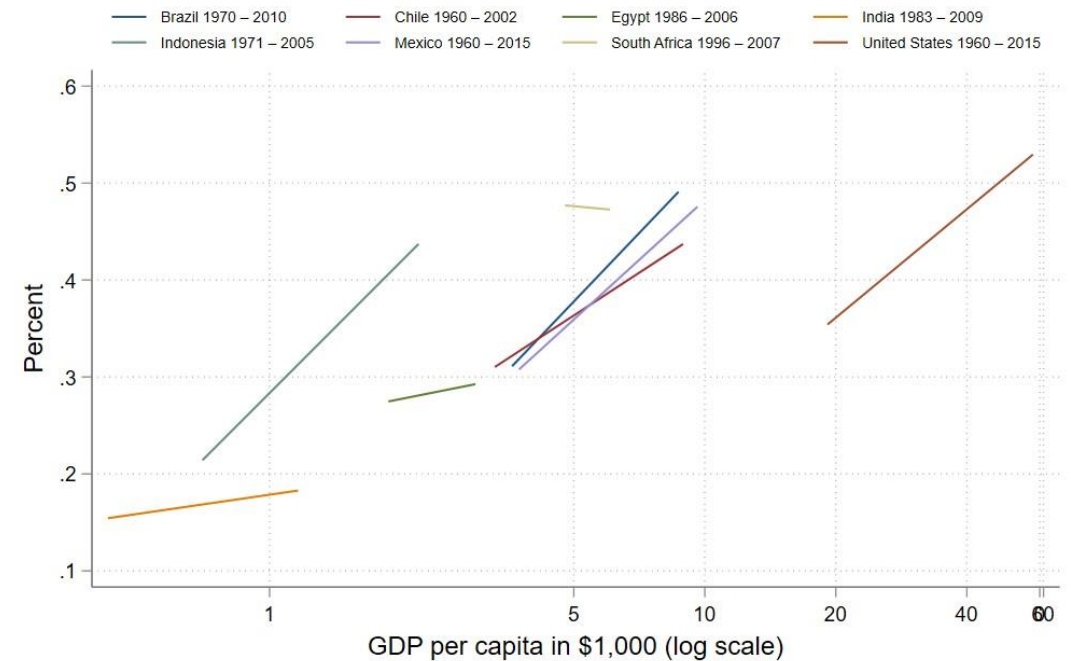


Middle-income countries need to upgrade skills in the workforce

..but use their existing talent pools inefficiently



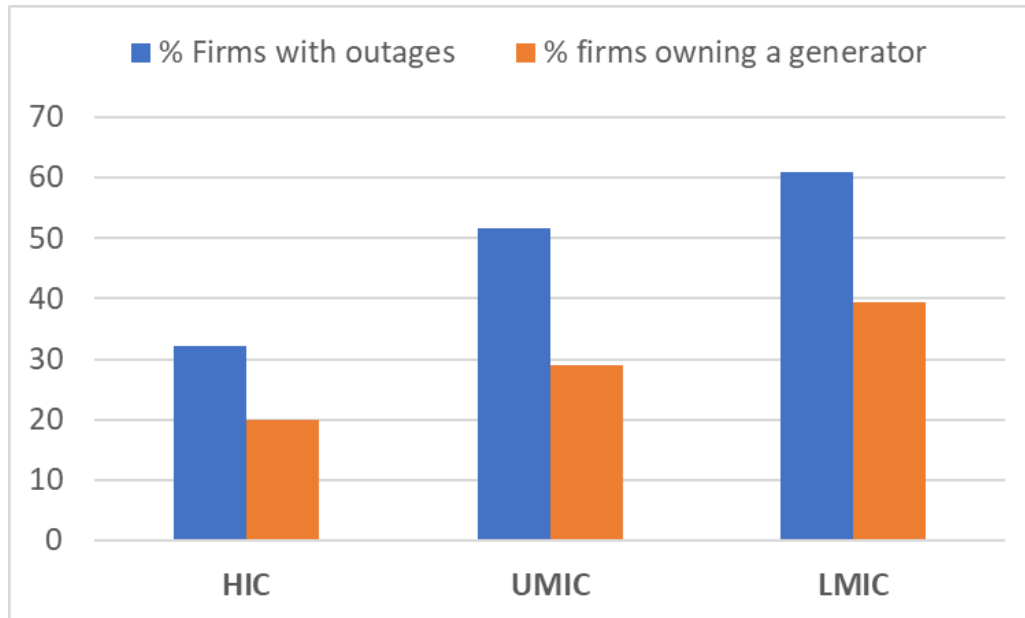
Share of women in professional occupations



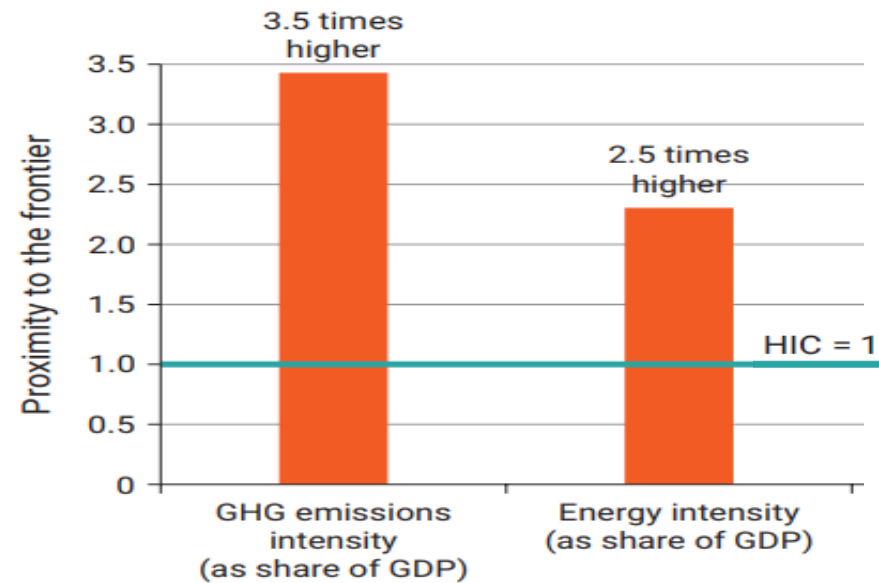
# Inefficient use of energy



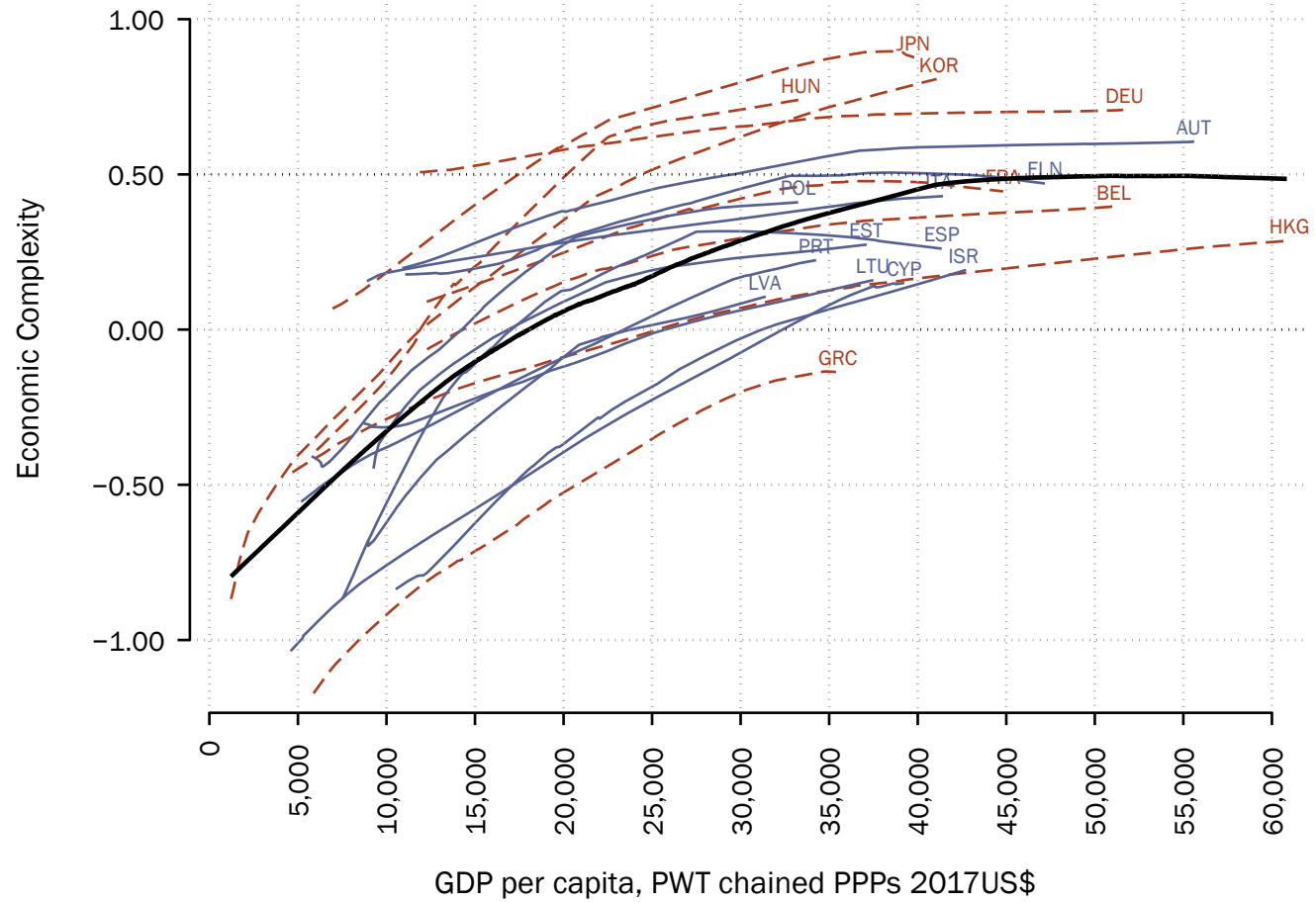
Middle-income countries lack reliable energy



Middle-income countries have much higher emissions and energy intensity



# To grow, middle income countries need economic sophistication



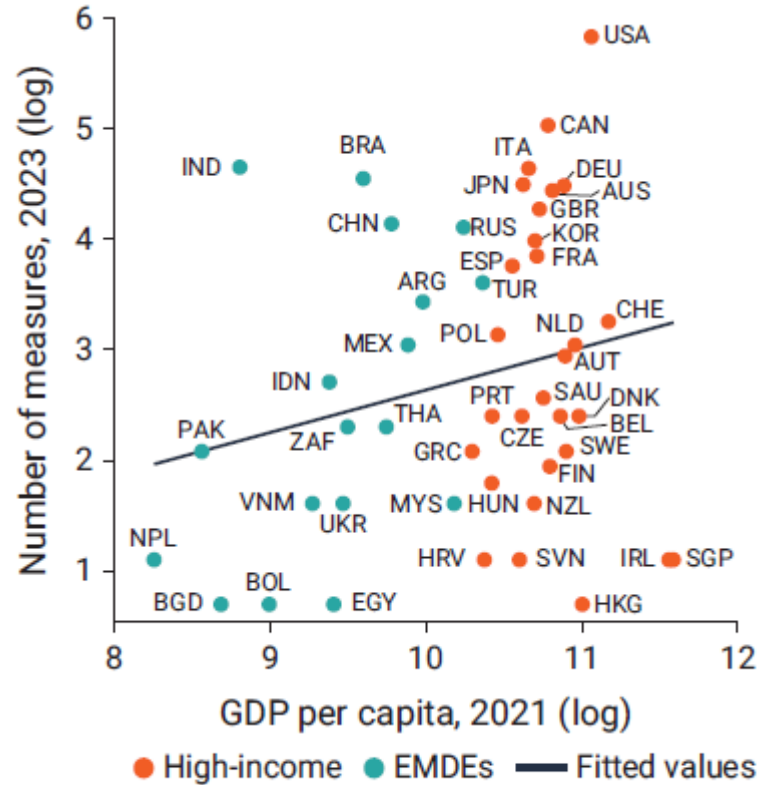
Source: WDR 2024 team and background paper by Bahar, Bustos, and Yildirim (2024)

# Shrinking spaces

Today's middle-income countries face stiffening headwinds

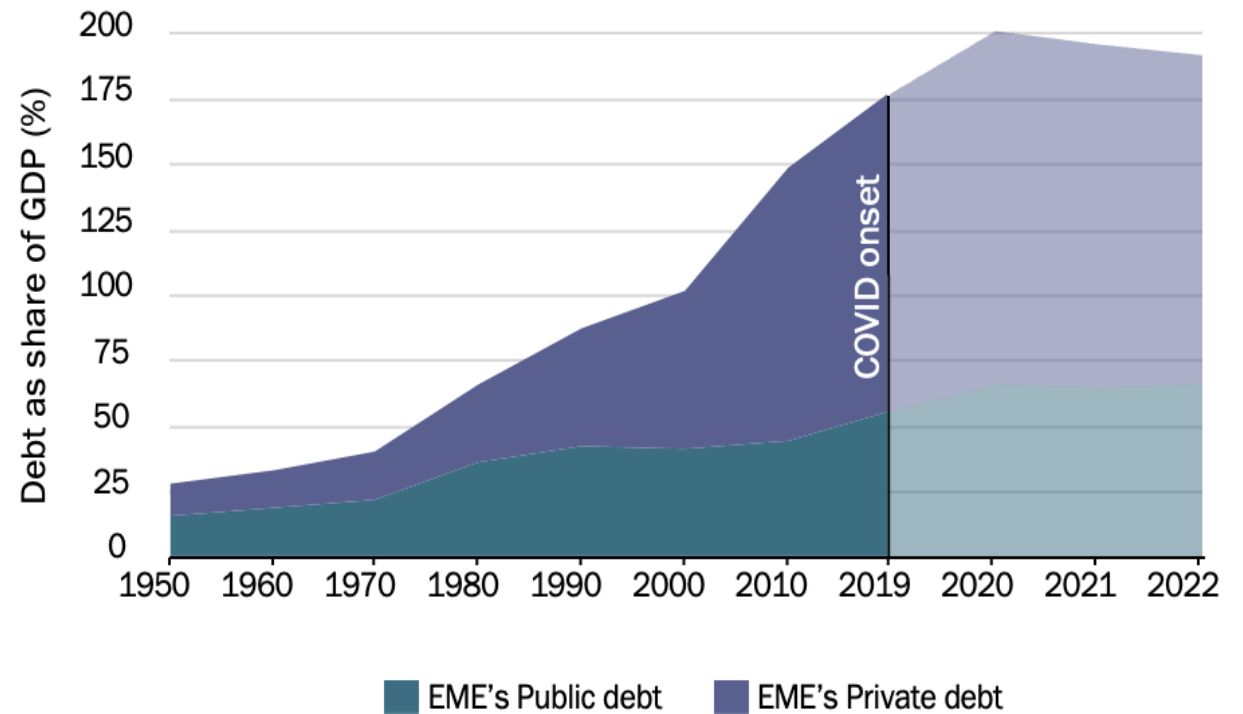


Wealthier nations implement more protectionist policies



Barattieri, Mattoo, and Taglioni 2024

Most developing economies are more severely indebted than ever



Source: WDR 2024 team using the International Monetary Fund's 2023; Global Debt Monitor data and Kose and Ohnsorge (2023).



# As countries and economies get economically complex, growth strategies have to become commensurately complex



To escape the “middle-income trap,” countries need to undergo two transitions, not one

## 1st Transition

## 2nd Transition



**INVESTMENT**

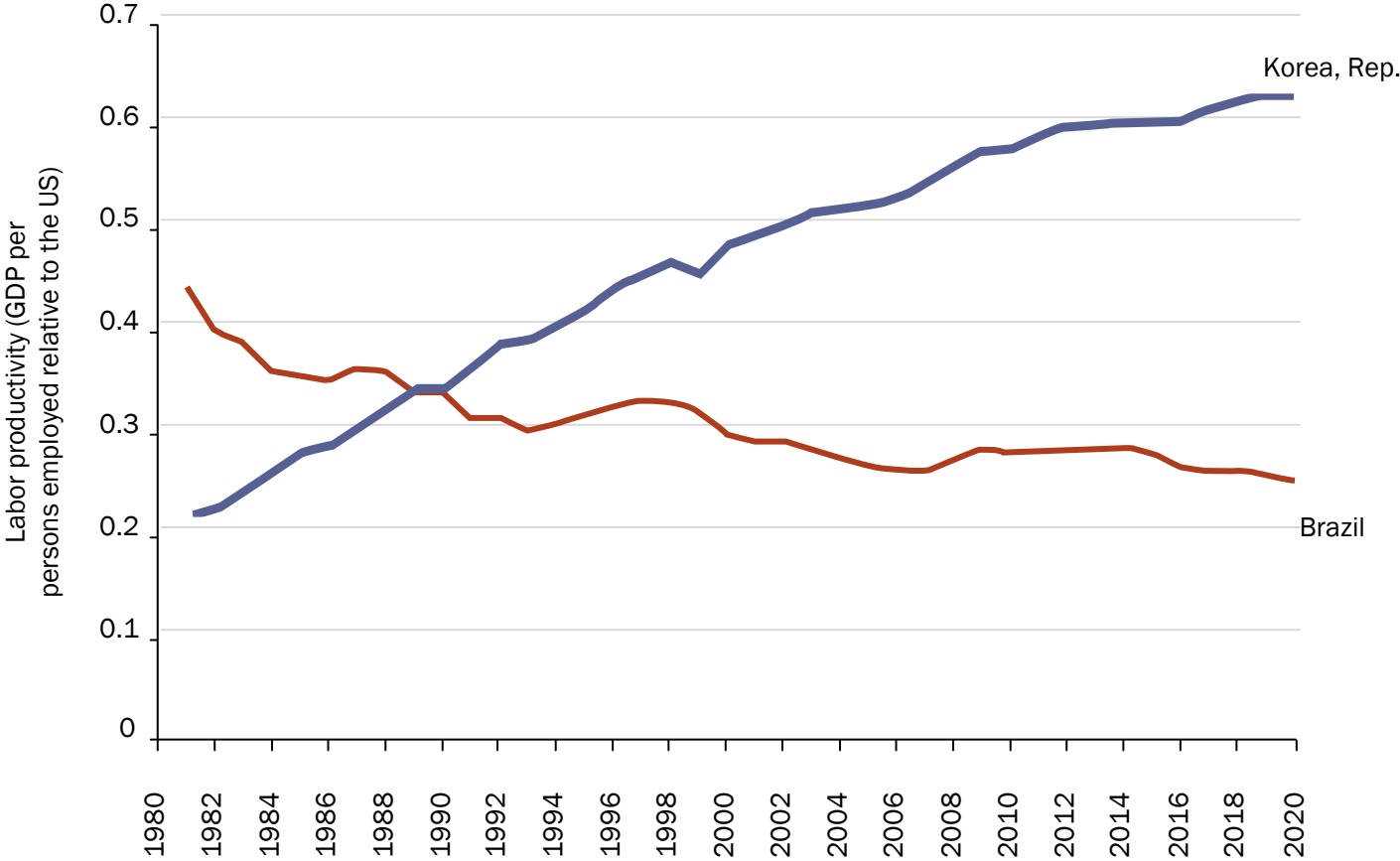


**INVESTMENT  
+ INFUSION**



**INVESTMENT  
+ INFUSION  
+ INNOVATION**

# Bypassing infusion makes it challenging to transition toward innovation

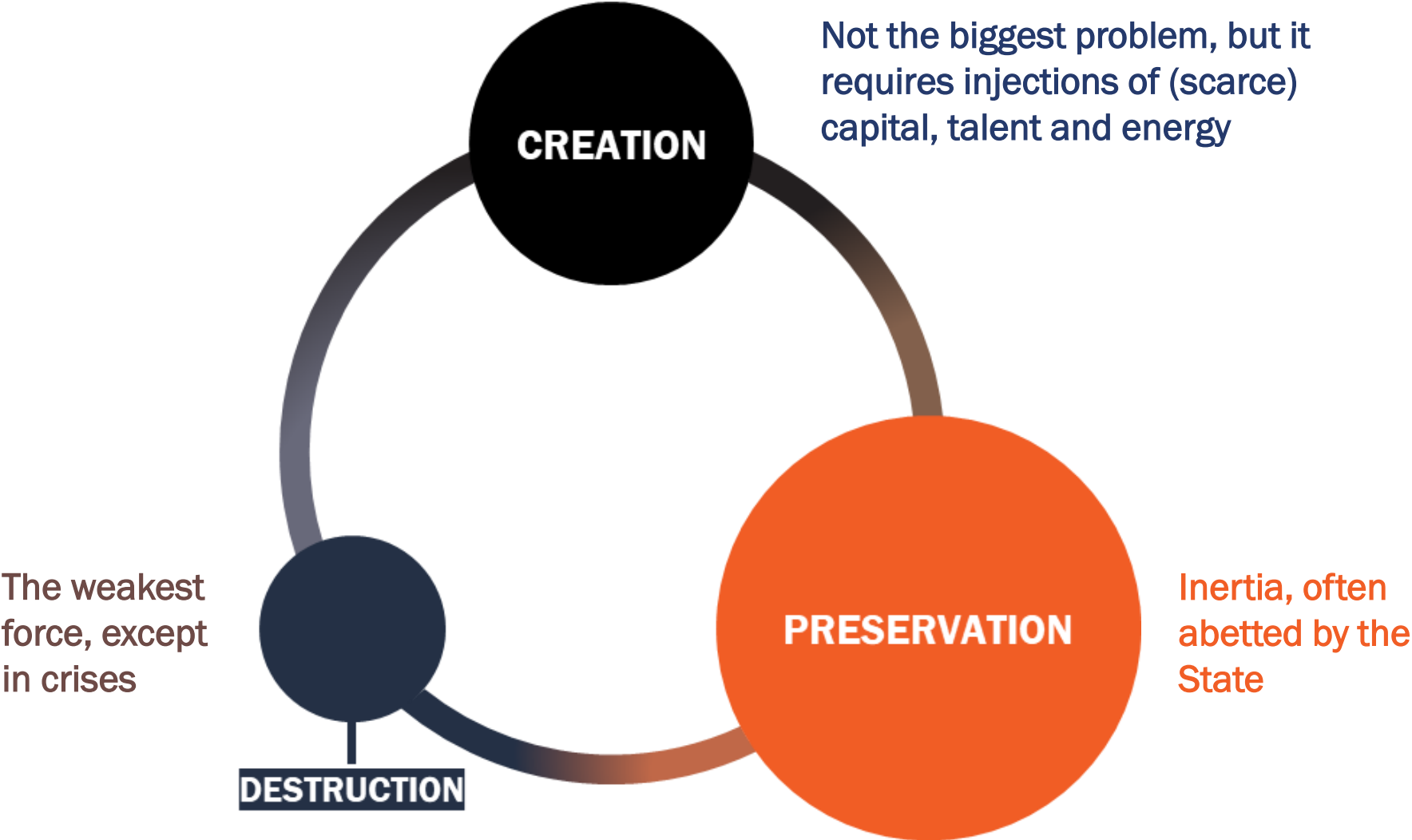


Source: WDR 2024 team using data from the Penn World Tables 10.01.

Leapfrogging prematurely into “knowledge economies” hobbles development



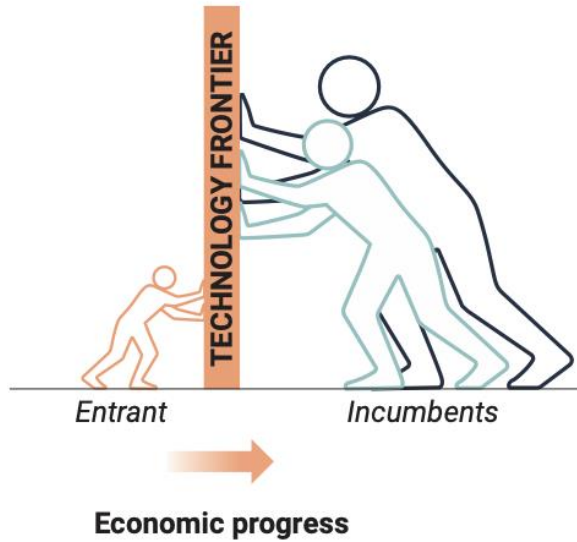
# To escape being trapped in slower growth, middle-income countries need to balance the economic forces of creation, preservation, and destruction



# Who adds value and who stiffens the status quo?

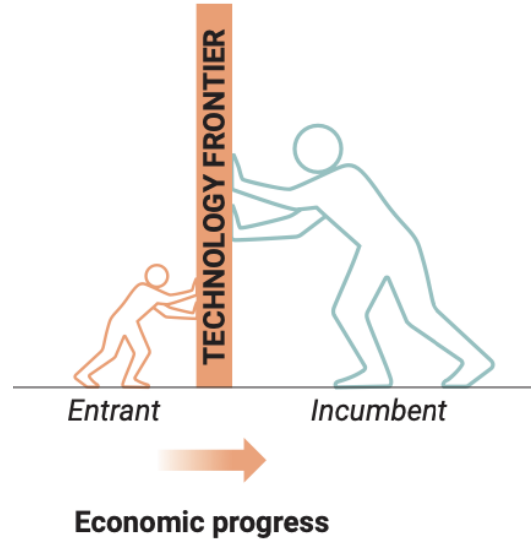


a. Energy  
(Schumpeter)



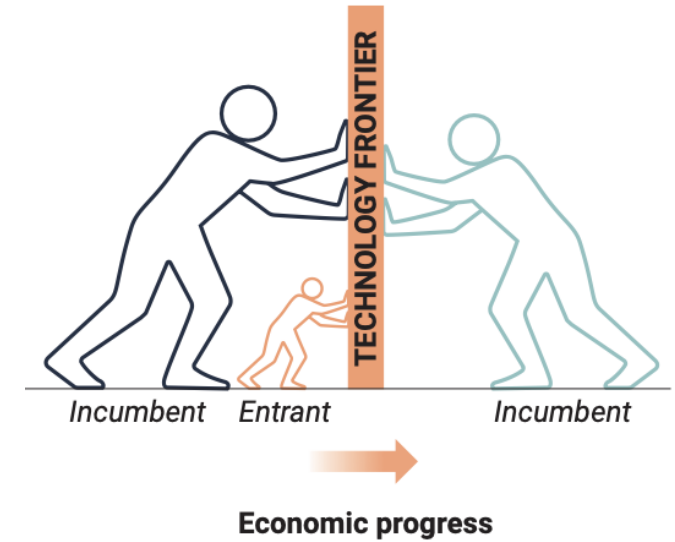
Schumpeter's view: incumbents can collude

b. Talent  
(Aghion and Howitt)



Aghion and Howitt's view: entrants create value and displace incumbents

c. Enterprise  
(Akcigit and Kerr)

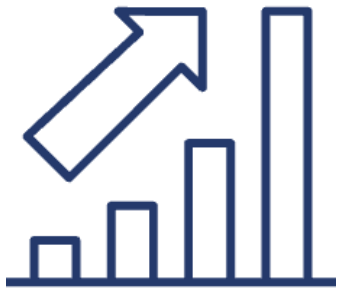


Akcigit and Kerr's view: incumbents and entrants add value

# Total efficiency – economic, social and ecological- requires serious shifts in thinking



From firm size



To value added



From inequality



To social mobility

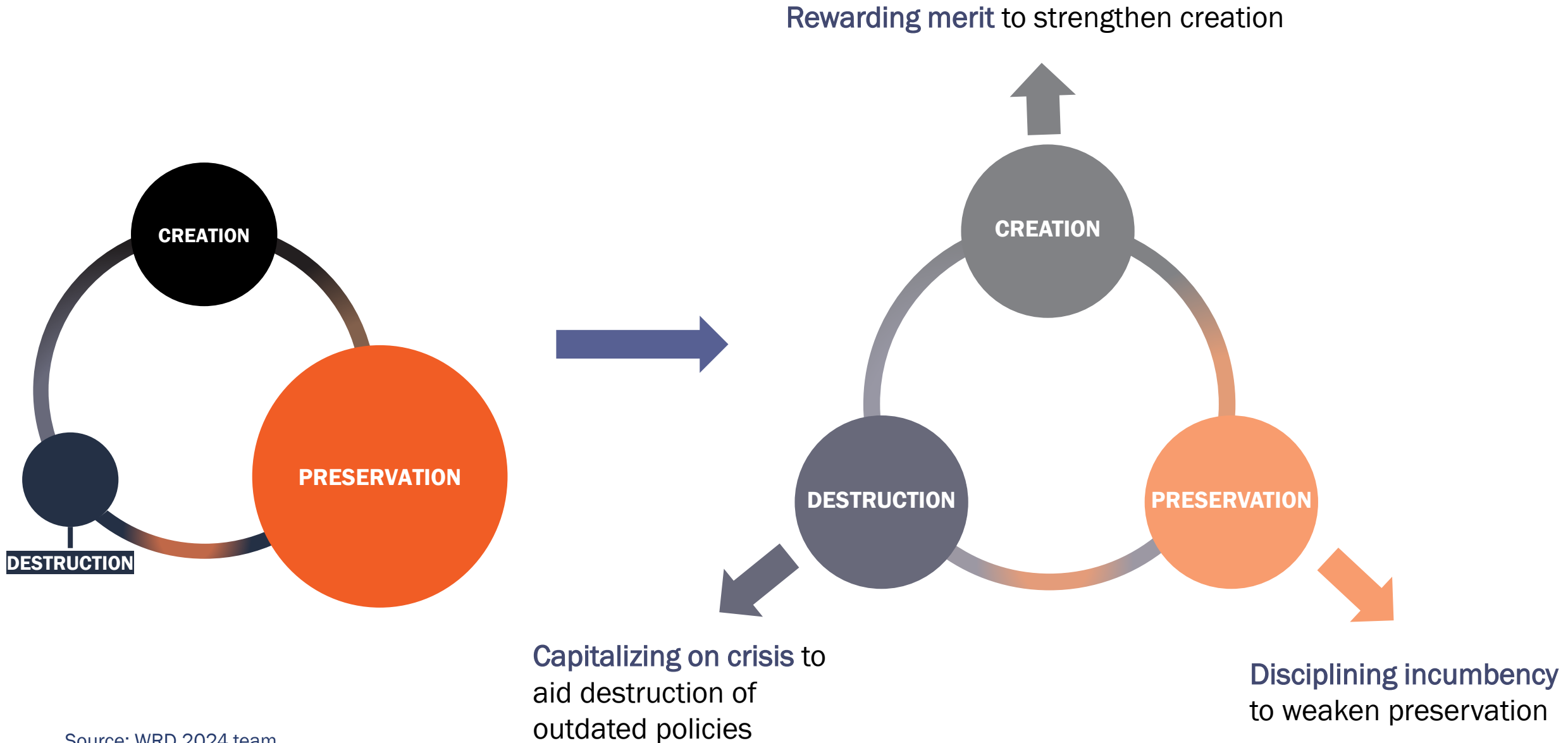


From sources of energy



To energy efficiency and emissions intensity

# Maintain a healthy balance between the three forces



# Enterprise, openness, and reforms



## 1i: Investment

Improve the investment climate to increase domestic and foreign investment.



## 2i: Investment + Infusion

Make markets contestable by opening up  
Reduce factor and product market overregulation  
Reward value-adding firms to stimulate business dynamism



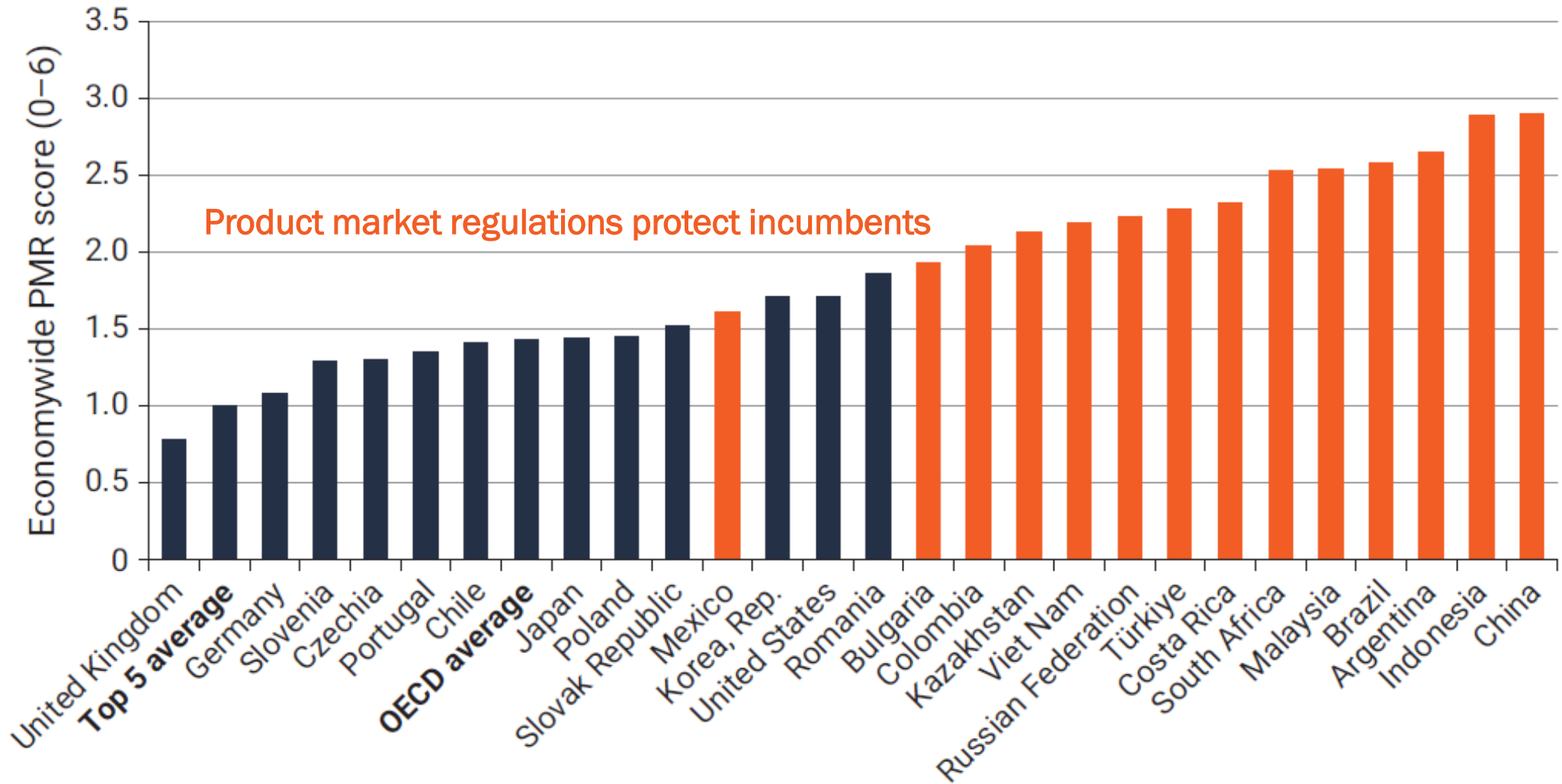
## 3i: Investment + Infusion + Innovation

Deepen capital markets and expand equity financing  
Strengthen antitrust regulation and competition agencies  
Protect intellectual property rights

# Disciplining Incumbency



- ✓ Make markets contestable by opening up
- ✓ Reduce factor and product market over-regulation





# Education, social mobility, and entrepreneurship



## 1i: Investment

Invest in human capital by broadening foundational skills and improving learning outcomes.



## 2i: Investment + Infusion

Discipline elites by providing equal opportunities for women, minorities, and disadvantaged groups

Leverage digital technologies to expand entrepreneurship and employment

Develop links among local and globally leading universities

Enable emigration of educated workers whose skills are not valued in domestic markets



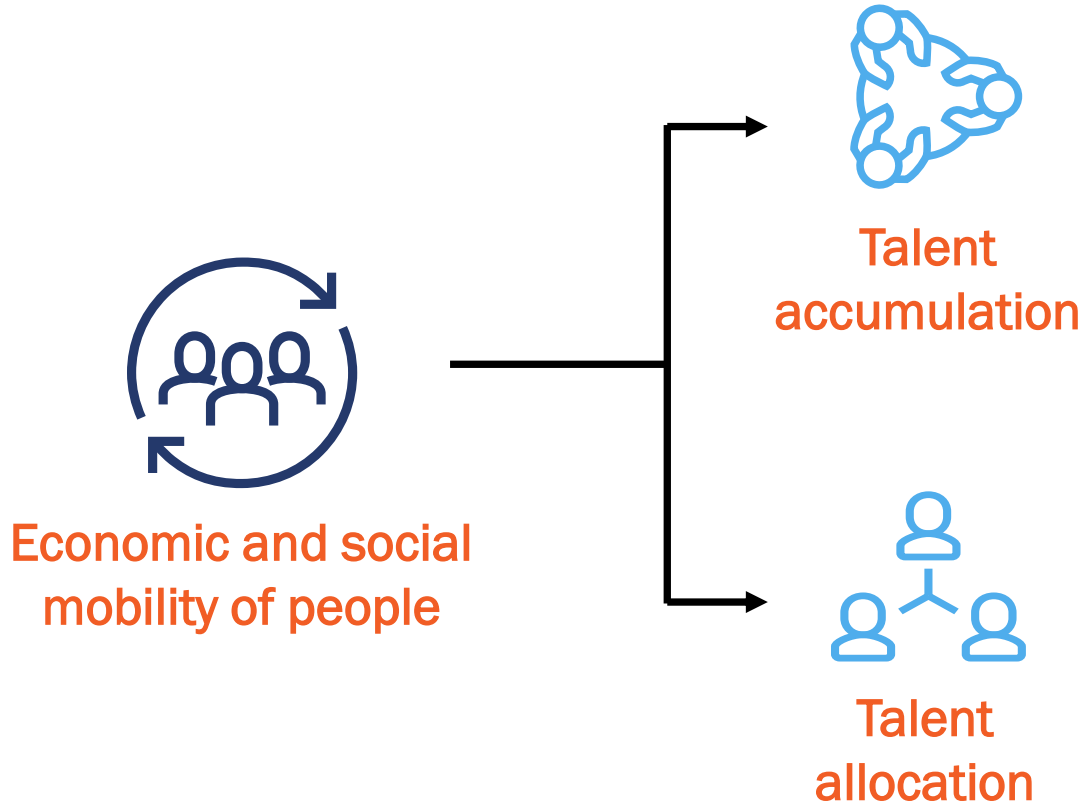
## 3i: Investment + Infusion + Innovation

Strengthen industry academia links domestically.

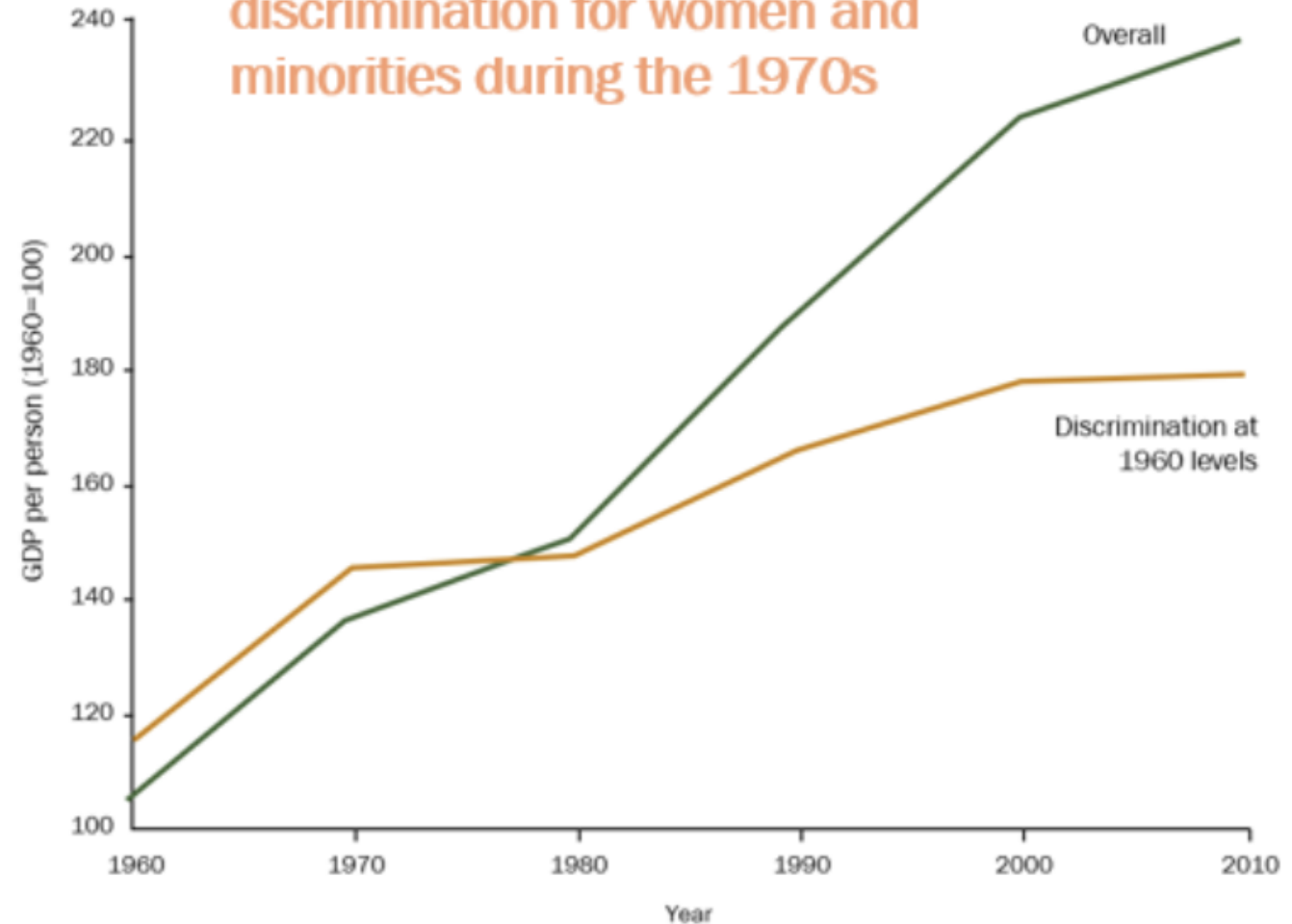
Expand programs to connect with diaspora in advanced economies.

Enhance economic and political freedoms

# Rewarding Merit



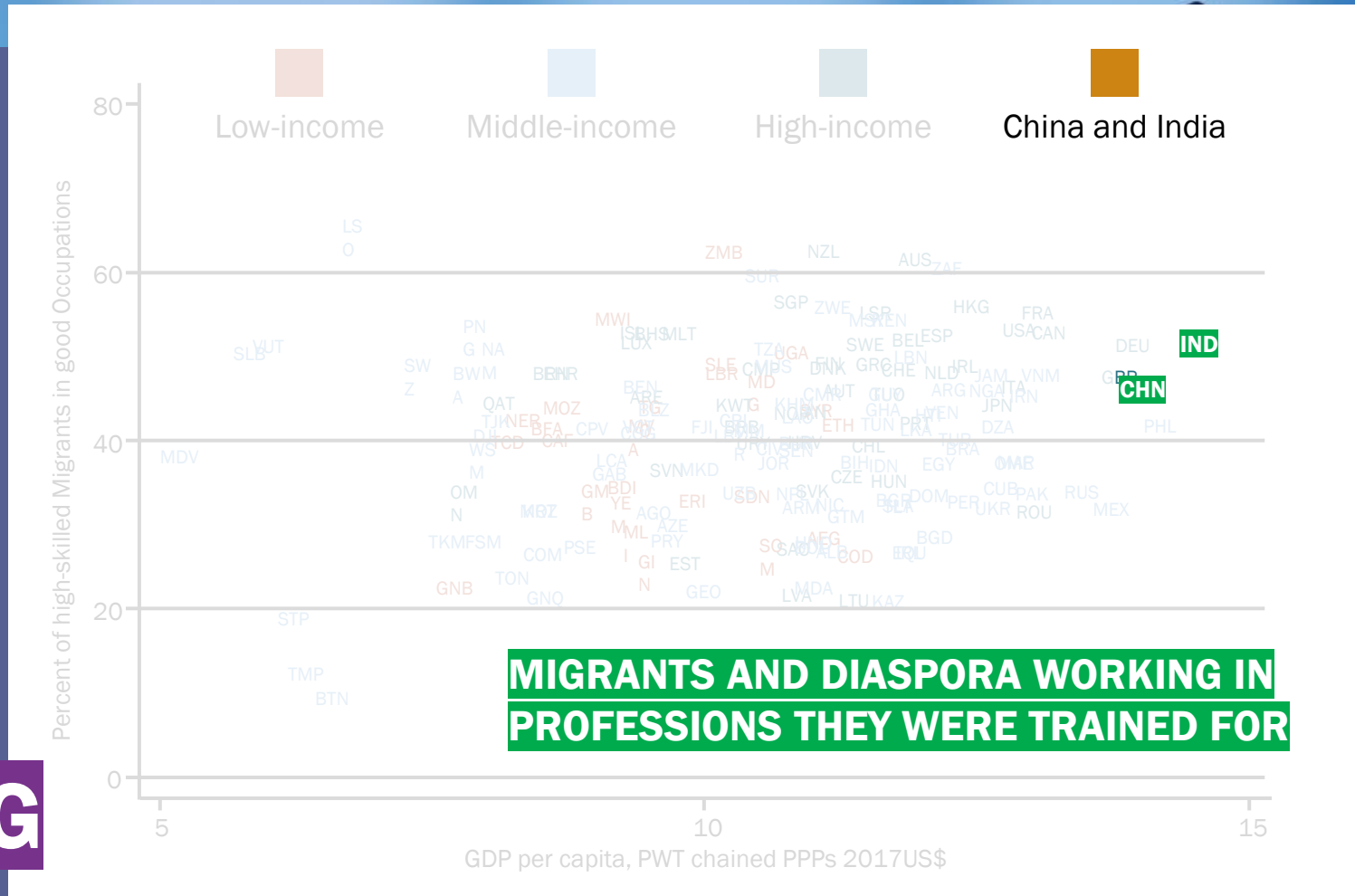
## Reductions in labor market discrimination for women and minorities during the 1970s



# China's Thousand Talent Program: Tapping into the Knowledge of the Diaspora



**NAN  
YING**



# Energy, emissions, and crisis management



## 1i: Investment

Increase investment in expanding access and grid networks.

Reform regulatory frameworks to attract private investment and ensure fair competition



## 2i: Investment + Infusion

Discipline SOEs by hardening budget constraints.  
Use international coalitions to discipline advanced economies to ease protection of domestic incumbents.

Aid adoption of energy-efficient practices.  
Enhance economic efficiency by reflecting environmental costs in energy prices



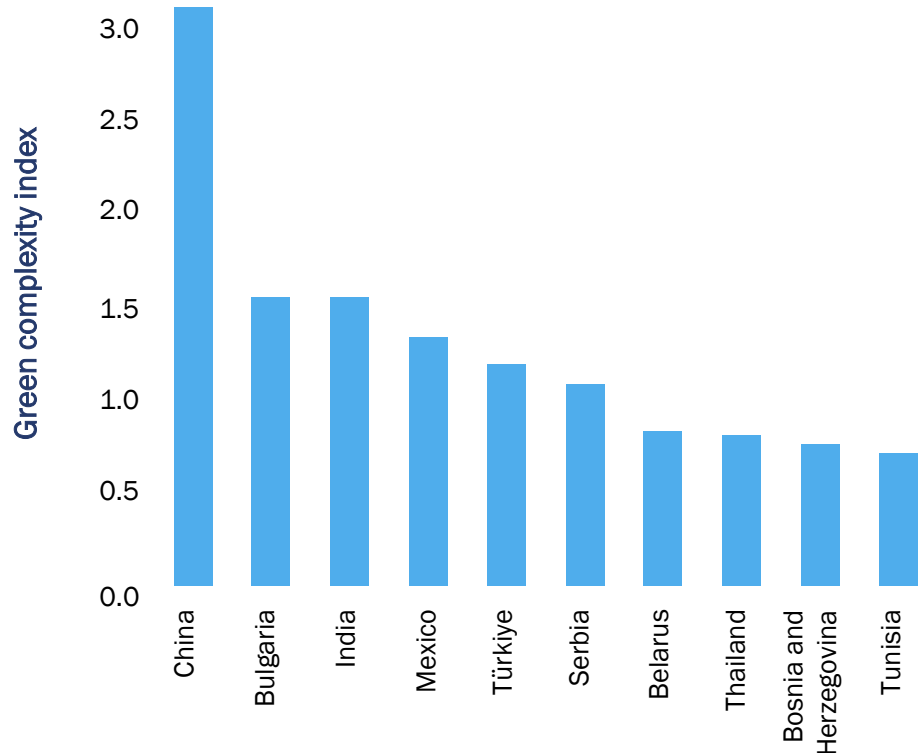
## 3i: Investment + Infusion + Innovation

Lower the cost of capital for low-carbon energy by reducing risks involving technology, markets, and policy.

# Capitalizing on crises – the global energy crunch and climate change

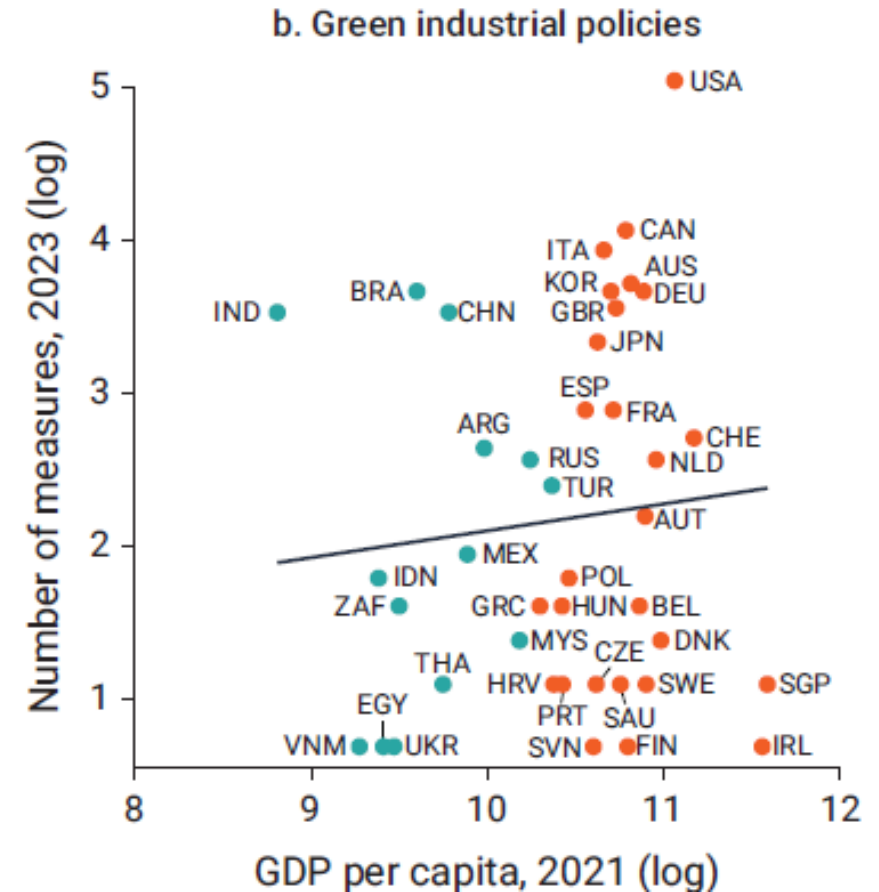


Middle-income countries can competitively export low-carbon intermediates



Source: WDR2024 team, using the Global Trade Alerts database.

The globalization of industrial policy is slowing down global decarbonization







**Making miracles**