CHINA AND THE MIDDLE-INCOME TRAP

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Executive Summary

1. China's current economic slowdown has raised the spectre of its economy potentially falling into the "middle-income trap" (MIT).

2. MIT is a fuzzy concept, widely used and also widely misinterpreted. It is simply about how a developing economy after its initial phases of easy growth has become stagnated and is unable to graduate to become a developed economy. Many Latin American countries (and the Philippines in Southeast Asia) had indeed failed to achieve a real take-off after their many decades of development.

3. According to the World Bank in 2008, of 101 or so middle-income economies in the 1960s, only 13 including Japan and other East Asian economies like South Korea and Taiwan had successfully made it to be developed economies.

4. Though much popular among journalists and policymakers, the term MIT is full of conceptual and empirical difficulties. It is particularly hard to explain why a growing economy should suddenly experience a systemic slowdown at a particular point with no further prospects of breaking out.

5. Specifically for China, whether it would fall into the MIT much depends on the internationally accepted benchmark for a "developed economy" and also the future growth potential of China's economy.

6. Extrapolating from its 2015 per capita income of US$8,300 and benchmarking a developed economy at US$16,000, China would reach the threshold of a developed economy within 10 years if it could sustain a reasonably strong growth at around 6%.

7. To sustain such stable growth in the future, the Chinese government has strived to cultivate new sources of growth associated with (i) innovation and technological progress; (ii) further market reform and institutional adaptation; and (iii) accelerating industrial restructuring.

8. While structural reform is a long-drawn process, China has already made impressive progress in its R&D efforts and stepped up industrial upgrading towards “intensive manufacturing” as contained in its “Made in China 2025” Master Plan.

9. China thus presents a sharp contrast to many emerging economies that had fallen into the MIT. If the highly industrialised China with its huge and diversified manufacturing base should still fall into the MIT, this would simply be mind-boggling, implying that no other developing country could henceforth ever make it to be a developed economy, quite an implausible supposition.

10. China may have easily crossed the MIT to become a developed economy, but its main challenge is how to continue with its per capita income growth in order to become a truly affluent society, given its huge population.

11. In the future, however, China may run into the real risk of falling into a new kind of trap, the “low-income developed-economy trap”.