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Abstract: By analyzing briefly two cases of development in 20th century Latin America, this short article tries to account for the intermediate position where the region occupied in the rank of world income. It argues that an improvement of the region's current status can be obtained through learning from the past failures, and successes as well, and through identifying the real limitations of the policy frameworks and approaches to development in the past.

What is the “middle income trap”? 

The concept of middle income trap refers to the phenomenon in the development process that an economy is detained for a long time at the middle income level and fails to further climb up the rank into a high income society. It is a descriptive concept, always relative to other economies which are either at a higher or lower level of development. It is imaginable that an economy is steadily progressing with an upward historical trajectory but still remains long a middle income society simply because some other economies do better or worse than it does. This is especially the case when we take the World Bank criteria as the main indicators where the economies with an income per capita per annum from US $ 1000 to US $ 12000 are all classified middle income ones, some of which have stayed in this middle space relative to others for decades.
Fortunately or unfortunately, Latin American countries, Brazil being the largest economy among them, are the most typical of such societies. When the word “trap” is added to the somewhat neutral term “middle income”, a new concept is formed actually to mean the particular development problems faced by those countries at this distinct historical moment. Latin American countries are chosen as typical cases for obviously simple reasons: the most concentrated area of middle income societies, early-industrializing countries in the developing world and thus earlier middle income societies than the other late comers, and remaining at this stage for so long as 3 or even 5 decades. More importantly, in the development literature dealing with Latin America, the region has long been regarded as the one losing quite a number of historical opportunities of catching-up with the advanced economies.

For our BRICS countries, according to the World Bank, each one of us is now a middle income society, with Brazil (with a per capita gross national income, or GNI of US $ 9390, and the purchasing power parity, or PPP value of US $ 10920, 2010), Russia (GNI US $ 9910, PPP US $ 19190, 2010) and South Africa (GNI US $ 6100, PPP US $ 10280, 2010) in the rank of the upper-middle income societies, China (GNI US $ 4260, PPP US $ 7570, 2010) just crossing the dividing line between the lower and upper middle income ones, and India (GNI US $ 1340, PPP US $ 3560, 2010) still approaching the line.

Some literature exists which suggests that those countries, especially perhaps Brazil and South Africa, have already fallen into or will be faced with a middle income trap, although for Brazil, again, some analysts have predicted that the country will graduate from the middle income club in a few years. It is no surprise that the “trap” as a particular development problem has drawn and should draw sufficient attention and concerns from those countries, or otherwise it will cost them potentially great prices in the future. Latin America (including Brazil) is time and again chosen as a good source of experience and lessons. I will
be careful here in attempting to present an even-handed picture about the region.

**What happened?**

Most analyses have shown tendencies towards some easily made comparison and ready acceptance of the conclusions thereof. Typically, the first case of comparison is the one between Latin America and the North Atlantic nations, which, as some analysts observed, would indicate that the income gap between the two first appeared in the 19th century and was maintained through the 20th. The second pattern of comparison suggests that Latin American economies have not only been performing unsatisfactorily when comparing to the world’s most advanced regions, but also falling behind relative to the late-industrializing Asians, e.g., Japan and South Korea, and the long-stagnant European former colonial masters, i.e., Spain and Portugal, in the latter half of the 20th century (Close, 2009. See also Kharas and Kohli, 2011). Since there has long been a sense that the early-independent Latin American countries ought to be on the same development level as the advanced economies, the unfavorable comparison mentioned here has obviously posed a big dilemma for the once comparatively wealthier Latin Americans.

No one disputes those accounts. But my view of it is that Latin America, as a whole, has not been a total failure although it is not a success story; otherwise it should have fallen into the low income group after having experimented so many strategies and approaches to development. The question is how we understand what happened by identifying the effects, both positive and negative, of the policy inputs and, specifically, the conjunctures that imposed the policy frameworks in the first place so that we will obtain a whole picture before we can hope for an improvement in the social and economic conditions in Latin America.
Take for example one of the most important endeavors in the 20th century Latin America: Import Substitution Industrialization (ISI). According to one line of analysis, prolonged existence of import substitution had brought forth four types of structural crisis in Latin America, including the international payment crisis caused by the loss of vigorous export and rigid import structure, the industrial structure crisis as a result of ignoring agriculture and overdrawning industry, the financial deficit crisis due to excessive expansion of national institutions, and the social governance crisis coming from high unemployment and unequal distribution of income (Zhang, 2012). The heyday of the import substitution industrialization in Latin America coincided with the period of the post-war reconstruction in Europe and the take-off and rapid growth in East Asia, and in the process, unfortunately, Latin American countries were gradually left behind by its European and East Asian counterparts. The choice, practice and prolongation of such development strategy, and the accompanying crises mentioned above, have since been regarded as one of the main causes which have delayed Latin America’s progress and prevented the region from ascending to the rank of the world’s wealthiest nations.

This is only part of the story. Two important points should be added to help to understand not only why things happened as they did, but also how to fix a policy framework which actually produced a mixed record of successes and failures. First, ISI was a response to the Great Depression that shutdown the global trade system and stopped the working of the laissez-faire political economy in almost all export-oriented Latin American nations. At the same time, ISI was also an approach to development that reflected the then dominant economic policy model (Keynesianism) and legitimized by the indigenous Latin American economic theory flourishing at that time (structuralism). In such circumstances, Latin American decision-makers were left little chance other than they actually did.
Second, ISI in Latin America produced good economic results at least into the 1960s, and Mexico, Brazil, Argentina and Chile did well by this policy (Close, 2009). As a growing number of industries began to produce for the domestic market, national enterprises were encouraged both in new industries and old ones, and manufacturing output increased a great deal. And MNCs were invited to set up plants to supply cars, electronics, pharmaceuticals and other products to domestic consumers.

As a consequence, Latin American economies, especially larger ones, were gradually transformed into the first group of newly-industrializing countries and later on into what we call today the middle income societies, with the following characteristics:

- More extensive use of capital-intensive technology.
- Increased training in manufacturing–related engineering and in capital-intensive techniques, but lack of development of appropriate technology.
- State intervention to encourage and protect domestic industries or to set up key industries (such as aircraft production in the case of Brazil).
- The spread of western-style consumerism to the upper, middle and lower classes, accompanying the growth of both middle sectors and an industrial proletariat (Vanden and Prevost, 2009).

Only with the advent of the age of the first oil shocks, stagflation and the first signs of the debt crisis in the 1970s, things began going bad quickly: a new crisis ended ISI just as the Great Depression buried the late 19th and early 20th century economic model in Latin America. ISI’s failures, especially its economic weaknesses have become clear since then, but most people have realized its various consequences and obtained a clearer understanding only with hindsight when they were better informed at a later date.
What recurred?

Another historical pattern is similar in dynamics to and as controversial as the ISI era, i.e., the practice of structural adjustments and neoliberal reforms since the “Lost Decade” in Latin America in the 1980s, which merits a few more words.

We have all known today that Latin America’s growth since the 1980s when reforms began has been slow, and inequality has remained persistent. The income growth during the 20 years before 1982 was 2.8 percent per capita, whereas it has been just over one percent per capita per annum since then. Even the boom period of 2003-07, when Latin America experienced a 3.6 percent annual per capita growth rate, did not alter the general trend when compared to East Asian economies, and the gap, again, becomes revealing: the growth at 4 percent (1960-82) and 7 percent (1982-2008) in East Asia depicts a familiar picture and puts Latin America on a similar trajectory as usual (World Bank, 2010. See Kevin Gallagher, 2011). We have also known that this is the result of various kinds of reforms since the 1980s, reforms advocated by economists and international institutions who have time and again failed to design and implement policies to enable growth in the developing world. Perhaps we can add something to that judgment: the Latin American economists and policymakers themselves should be more accountable for this because it was they that bear the most responsibility regarding their nations’ development.

We also know but tend to forget that the radical package of prescriptions brought to bear in the 1980s was similarly a response to a similarly pressing problem, i.e., the debt crisis. The type of production created in Latin America during the ISI era used up local sources of capital quickly and thus made it necessary to borrow money from abroad to satisfy growing capital needs. The domestic demand for imported consumer goods also meant that more external borrowing was necessary to compensate for the outflows of scarce foreign exchange. The result of both processes was the so-called “debt-led growth” and more and more external debts accumulated in Latin American nations in the
1970s. For Latin America as a whole, external debt increased rapidly from less than US $ 30 billion in 1970 to more than US $ 230 billion in 1980, and the debt service payments alone reached US $ 18 billion per year by the beginning of the 1980s. When commodity prices got down and world recession arrived, economic growth slowed and even became negative in a few countries, debt crisis began and Latin America entered its “lost decade” with a growth rate of only 1 or 2 percent for many countries.

It is important to remember that a radical approach seemed to be the only way out in the circumstances: the incredibly soaring inflation and the extremely high foreign debt burdens justified the design and implementation of policies suggested and insisted by international financial institutions, whose role became ever stronger as the Latin American nations became more dependent upon external sources to solve their financial problems. The radical approach was market orthodoxy when, not coincidentally, Keynesian economics was no longer in favor, and conservative economic thought became influential. The set of policies supposed to solve the debt crisis would work in two separate steps: stabilization and structural adjustment programs, commonly known and often referred to as the “neoliberal” reforms under the guidance of the “Washington Consensus”.

Just like ISI from the 1930s to the 1980s, the reforms of the 1980s and the 1990s have had a considerable effect upon the Latin American economies. From the early 1990s on, Latin American economies began to experience two cycles of growth and crisis: the recovery from the lost decade and a short period of growth before they were hit by the international financial turmoil in the late 1990s, and the boom period of 2003-07 and then new crisis and the Recession came to Latin America after 2008. Like all other policies ever tried in Latin America, the mixed record of reforms have caused and will cause a great deal of debate. There seemed to be two points, at the opposite end of the balance sheet, which have up to now been less controversial in the discussion: one was the area
of reasonable success in controlling inflation and reducing it to single-digit figures in most countries. Another was directly related to the time-aged problem of social conditions in Latin America: the high social costs of reforms did not help to improve the patterns of poverty and inequality. The promise of reforms to set the economy on a new foundation that ensures steady growth was far from certain, and consequently there was still much to be done for Latin America to find its way to prosperity. Hence the current state of middle income level of living for most Latin Americans.

What is different, or similar?

There was a backlash against neoliberal reforms which reminded us of what happened to ISI in the 1980s. Nonetheless, there was a difference this time. With the Pink Tide in the ascendant for more than a decade in most of Latin America, and democratic governments in power for more than a quarter of a century throughout the hemisphere, the pendulum has been swinging away from any extreme end of political and economic spectrum, permitting more compromise settlements than ever that tend to combine the characteristics of various schools of thought in political economy. All in all, no governments and no mainstream political forces can afford to ignore the “imperative” of broader sharing of the benefits from growth among the population and equal opportunities for broader segments of society, not least for their own electoral successes.

When Latin America was again in the grip of a new round of recession since 2008, the same situation seemed to take place that paralleled the historical precedents discussed earlier: no country in the region had a complete collapse despite the slowdown of economic growth and possibly some relatively serious social and political challenges as well. Although it is not easy to get out of the middle place for most Latin Americans, one remarkable achievement during this round of recession is in the financial field where the larger Latin American countries began to take matters of financial stability into their own hands in the wake of painful experience in the late 1990s. Stabilization funds and
international reserves built up during the years of high volume of exports or that of the commodity boom have made possible the countercyclical policies to protect their currencies when the crisis eventually hit. However, trade, being one of the most important driving forces behind the most remarkable income growth since the 1980s, was affected when demand for commodities slowed, and as a result growth slowed as well. According to the views critical of the boom period of 2003-2007, which express concerns over the sustainability of relying on commodity exports alone for growth, the trade deals to supply commodities to world markets may be profitable in the short term but can only serve over the long haul to place Latin America even longer where it has been for centuries, remaining vulnerable to the swings of commodity prices, failing to diversify their economies, and lacking solutions to grave social problems. At the same time, if Latin America chooses to fall back toward older models of protectionism, that does not seem to resonate well in the global economy of the 21st century.

What are the acquirements?

Latin American countries have attempted, with varying degrees of successes and failures, different development strategies and economic policies for the past two centuries, in order to make their economies more diversified and more sophisticated as well as to make their populations richer and their national income higher. As discussed earlier, the strategies and policies those countries have experimented so far have been revealing time and again their respective advantages and disadvantages. The lessons drawn from these experiences have to be rested on serious and systematic examination of the specific designs and practices which would in the end prove to be not so much incorrect policies as simply limited policies. If Latin American countries are to escape from where they have been for so long, the so-called “middle income trap”, they have a great deal to learn from their own economic history and it appears that they do have much to choose from the pool of policies of various kinds, but the key point lies in overcoming the limitations of whatever approaches they select, rather than in making the right choice in a “once-for-all” manner.
There are two points worthy of remarks here. First, it is important for one economy to maximize its advantages and at the same time try to bring out its strong characteristics to make up for its weaknesses. One illustrative case may appear if Latin American governments can make full use of their latest achievements in macroeconomic management and their current positive position in the world economy to craft policies that set to diversify their economies beyond commodity production, aiming to improve competitiveness and gain greater specialization. In the process, as efforts must be required in the areas of high-quality education, scientific and technological research, and infrastructure, in addition to the creation of decent jobs and worker training, investment in healthcare and enhancement of small and medium enterprises (Bitar, 2013), one solution comes about to the deep-seated problem of poverty and inequality. Hence one effective way to escape from the middle income trap. Second, it is important for a government to keep a balance between continuity and change and for a society to maintain a relative political consensus. More easily said than done. In the case of ISI, the adjustment of that development mode, with its limitations in the lack of experience in combining import and export effectively and the insistence of distorted industry, fiscal, and exchange rate policy, was long delayed after its momentum of growth had been depleted. Both its economic weaknesses and its political defects, i.e., the vested interests, help explain the prolongation of this particular historical experiment. It was only the arrival of a severe crisis and the application of external pressure that combined to make a transformation of the dominant development mode and the ideas underpinning it.

Nonetheless, the pendulum has been swinging too drastically. When an economic policy benefits certain vested interests, even if it harms the larger community, it is hard to make any shift; when failures of the policy happens to be amplified by a crisis, the policy tends to become the scapegoat for all the economic problems.
That's what happened to ISI: people tended to either refuse to pour the bathwater or pour it with the baby.

A similar case is the pattern of neoliberal reform era. People quickly embraced the tenets of market orthodoxy which had a sweeping impact from late 1980s to early 1990s but those policies and ideas were almost laid to rest in many countries when voices of criticism raised the political costs for the proponents at the turn of the century. Although it is more likely that people tend to throw away but not to repair the policies when those policies fail to deliver as promised, the seemingly endless fluctuations suggested the difficulties and obstacles Latin Americans have confronted and will confront in their way of finding the remedy to cure their economic ills.

The good news is that, the early years of the new century witnessed the accumulation of knowledge such that almost all ideas of development are extremely easy to obtain. One principle, either as a historical lesson or as a common sense, is simple and clear both in form and in content: do what needs doing when it needs to be done. With the consolidation of democracy in Latin America and the accompanying institutional structures conducive to extensive and all-sided discussion and debate, a range of common ground is also more likely to form, especially in regard to the fundamentals in both economic and social terms, which no political actors can afford to ignore.

REFERENCES


