

# *How Can China Overcome the Middle-income Trap?*

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**Abstract:** China has experienced rapid economic development in the past few years and has become an upper-middle-income country. Becoming a high-income country is a difficult process. All middle-income countries should avoid falling into or overcome the middle-income trap. However, China inevitably fell into the middle-income trap. This work focuses on the methods of overcoming the middle-income trap in China. This work compares China and other countries that are facing or faced the same problem that China has met. Then, see if China can emulate other countries' solutions. The conclusion drawn from the work is that China needs to implement policies to overcome the middle-income trap, like enhanced technology introduction and financial support for emerging technology industries, increasing the minimum wage, etc. This work points out and analyzes some of the problems facing China today and lists some practical solutions or policies that could be feasible to help China become a high-income country.

**Keywords:** The middle-income trap, middle-income countries, China economy and society, economy growth, value-added

## 1. Introduction

The middle-income trap refers to a situation whereby a middle-income country is failing to transition to a high-income economy due to rising costs and declining competitiveness. This concept is from the World Bank [1]. At first glance, China had fast economic development in the past few years. However, in recent years, since 2020, especially in 2023, China's economic increase has apparently slowed down, and the demographic advantage is fading yearly. In this case, China needs to strengthen the introduction of technology, issue policies to encourage and support emerging industries, also reduce income inequality. Thus, to overcome the middle-income trap. In this research, this work examines other countries that have fallen into the middle-income trap and those that have crossed it. Plus the work then analyzes the policies those countries implemented.

## 2. China and South Korea

There are a few precedent countries that have already overcome the middle-income trap. One is South Korea, which could be a suitable example for China to emulate. However, here comes a problem: why South Korea but not Israel, Singapore, or other high-income countries? One reason is that Korea's economic composition is partially similar to China's economic composition. Let's take a look at the Figures.

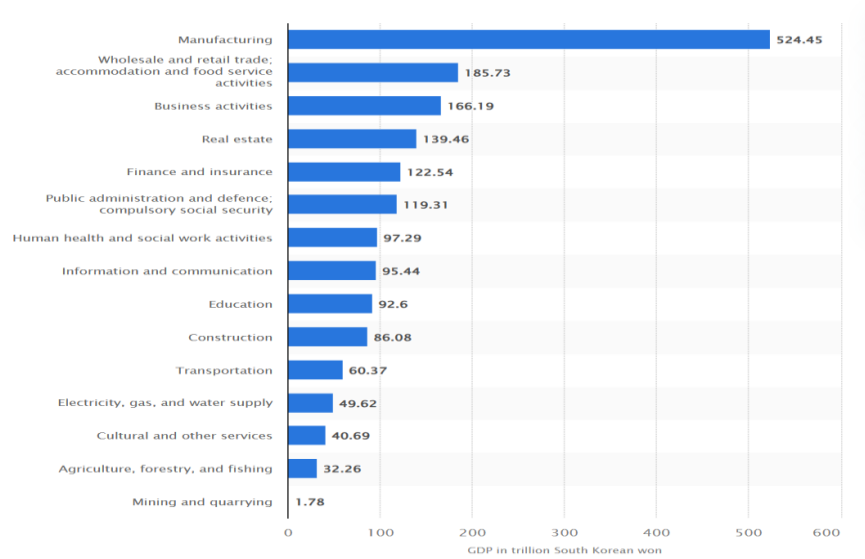


Figure 1: South Korea 2022 GDP composition [2].

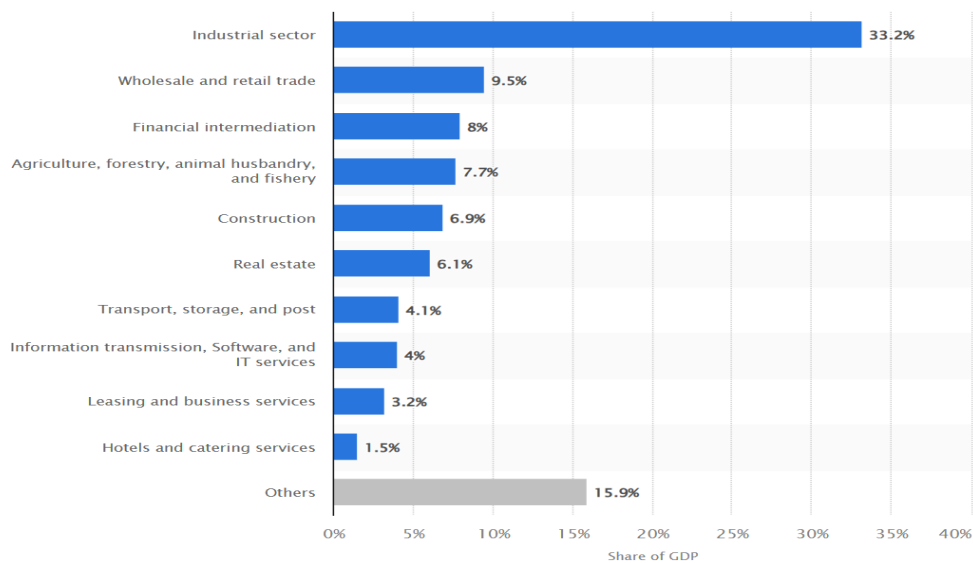


Figure 2: China 2022 GDP composition [3].

Figure 1 and 2 shows the GDP composition of South Korea and China separately. after analyzing Figures 1 and 2, this work shows that the main sources of GDP of both China and South Korea are basically the same. Which are both the industrial sector and wholesale and retail trade sector. Under this circumstance, China has similar industrial conditions to South Korea. It can be one of the conditions for China to emulate South Korea. Another reason could be that both South Korea and China are countries that have experienced post-war reconstruction. They have similar starting points in some way. However, South Korea has already become a high-income country. China, on the other hand, has fallen into the middle-income trap. Last, they both have the same geographic advantage, which is being near the sea. Finally, South Korea could be a suitable and appropriate example for China to emulate what they have done in the past few decades.

### 3. Introduction of advanced technology and re-examine state relations

In today's world, China is leading in some scientific research fields, like aerospace. Overall, the high-

tech industries are so limited in China, and China also lacks many core technologies, for instance, chip technology, numerical control machines etc. It is vital for China to have these core technologies. Because here comes another concept, value-added. The concept of value added is that value-added products or services are worth more because they have been improved or had something added. From Cambridge Advanced Learner's Dictionary & Thesaurus [4]. Thus, if China can own more parts of the product, it means more profits. What's more, the core technology of the product is the part that can give the manufacturer the most profit. However, China has very limited technology for now. Introducing advanced technology could be a practical choice. Korea can be a successful precedent. From China's Development Observation, whether it is the labor-intensive industry dominated by light industry vigorously developed in the 60s of last century or the capital-intensive industry represented by heavy chemical industries such as steel, shipbuilding, and petrochemicals in the 70s, and the capital- and technology-intensive industries such as automobiles, machinery, and electronics until the 80s, they were all developed on the basis of the introduction, imitation, absorption and digestion of advanced technologies from the United States and Japan [5]. It demonstrates the importance of introducing technology. China should increase the introduction of technology and pay attention to the countries' relations.

Under this circumstance, China should pay more attention to and improve its relations with developed countries. Back to the example of South Korea, from China's Development Observation, South Korea used economic aid and low-interest loans provided by Japan to compensate for the gap in construction funds for domestic economic development. Moreover, the normalization of relations between South Korea and Japan greatly promoted the trade exchanges between South Korea and Japan, which played a very important role in promoting the economic development and national strength of South Korea [6]. It demonstrates the importance of having a good relationship with a developed country and displays the benefits of collaboration. Re-examining relations with great powers is crucial to economic and technological development for China.

#### **4. Being the “first mover” in emerging industry fields**

As everyone knows, one of the reasons for China's rapid economic development in the past decade is its huge population. This huge population provides a large amount of cheap labor for many multinational companies. So many companies came and constructed their factories in China. It's a win-win situation. People in China have access to employment opportunities. Besides, the cost of the companies will also be reduced. With the arrival of more businesses, it also stimulates the market. However, in recent years, China's demographic advantage is shrinking. The New York Times wrote that Vietnam, which Apple had already earmarked for AirPods production in 2020, became a much-discussed option, one of the people said. Since then, Apple has started producing its watch in the country and moved some iPad manufacturing there. In Apple's most recent list of its top 200 suppliers, 20 use factories in Vietnam. By comparison, 155 companies operate factories in China [7]. So, China needs to find another way out. Back to the concept of value-added, the most profitable way is to have a brand of your own, and high-tech emerging industries are the most profitable. This work shows a very clear example, which is Tesla. Its boss, Elon Mask, is the pioneer of new energy vehicles. New energy vehicles are emerging industries in recent years, which bring huge profits. Besides, it also provides many jobs for people. According to the Figure 3:

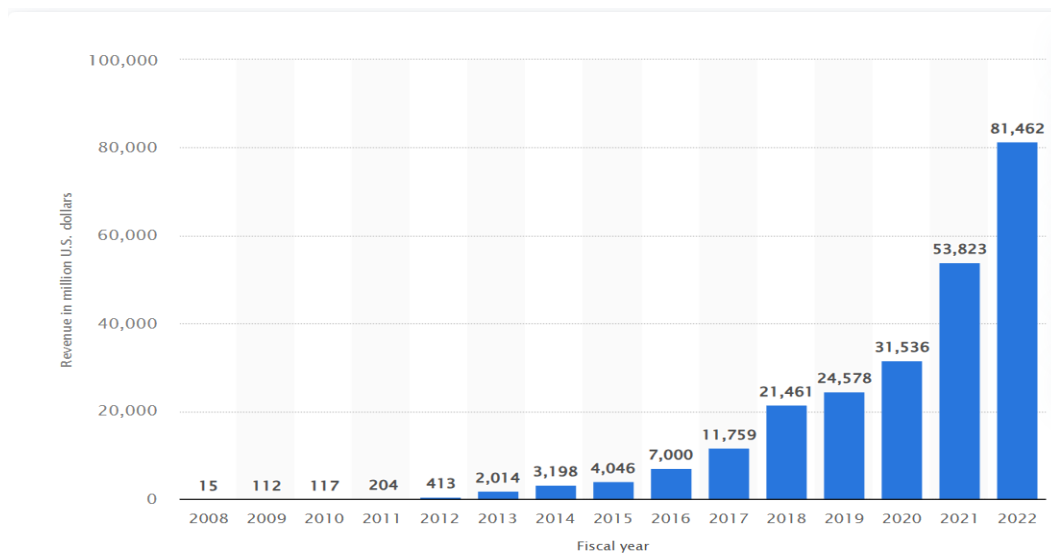


Figure 3: Tesla's annual revenue [8].

Since 2020, profits have grown significantly every year. Although at the beginning of the industry, there is no obvious profit. Once successful, it will bring huge profits. Especially the high-tech emerging industry. In today's world, many high-tech emerging industries are still developing. Thus, this would allow China to be the first mover in some specific emerging industries, like AI, genetic engineering, etc. In this case, China should Enact policies to support those emerging industries, like giving some financial support and providing top-notch technology and technical personnel. And it is better to focus on the industries that are still developing. Because there is not any monopoly and brand power impact. China can have a better chance to develop under these conditions. Another important point is to retain relevant technology talents. China should provide housing for them. Because in China, housing is a significant problem for most people. So this could be a big support for Core technicians.

## 5. Reducing the income inequality

There is a concept called the Gini coefficient, which measures the extent to which the distribution of income or consumption among individuals or households within an economy deviates from a perfectly equal distribution. A Gini index of 0 represents perfect equality, while an index of 100 implies perfect inequality [9]. When it comes to China. This work shows the Gini coefficient of China, according to the World Bank, is about 38.2 in 2019. However, compared to other countries, like South Korea, the Gini coefficient of South Korea, according to the World Bank, was about 31.4 in 2016. The result shows a huge difference between China and South Korea. The higher the Gini coefficient, the greater the wealth gap between people, which means serious income inequality. And this will cause some severe results. From the Causes and Consequences of Income Inequality, inequality dampens investment, and hence growth, by fueling economic, financial, and political instability, leading to financial crises, global imbalances, conflicts, and hampering poverty reduction [10].

The gap between the rich and the poor is too large. The rich have excess wealth, but the spending power is limited. Here is a very obvious example: three million RMB for a Bentley, 10 cars for each rich person. How many assembly lines they can run? The poor are the main force of consumption. Each family has a low-cost car of 30,000 RMB. The accumulation is millions or tens of millions of cars. Assembly lines and workers all have output and profit brought consumption, which is a positive cycle. However, if income inequality grows continuously, there will be a financial crisis. the great

depression and “pouring milk” have never been overproduction. Still, the purchasing power of the rich was limited, and the vast number of poor people were too poor to afford it, which led to the economic depression and other series problems. To reduce income inequality, the Chinese government should increase the minimum wage. In this work, people can see in other countries, like Germany and America, the wages of manual workers are not low. Besides improving workers' rights and interests, supervising the enterprise to provide five social insurance and one housing fund for workers mandatorily. As the minimum wage slowly rises, income inequality slowly falls.

## 6. Conclusion

In conclusion, although China has fallen into the middle-income trap, it is possible for China to overcome the middle-income trap in the future. China should strengthen the introduction of technology and manage diplomatic relations, strengthen the development of high-tech new industries, and reduce domestic inequality of wealth, income, and region development. This work focuses on information from figures, tables, newspapers, and some reliable academic articles, which makes this work more credible. The work also analyzes the problems facing China today and then gives some appropriate policies and suggestions for China to overcome the middle-income trap. Further research will be focused on the collapse of the real estate economy in China nowadays.

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