

Creative Destruction and the Middle-Income Trap

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The 108 economies classified as middle income by the World Bank today account for more than 40 percent of global economic activity, 50 percent of the world's poor people, 60 percent of global carbon dioxide emissions, and more than 70 percent of the world's population. A handful of countries have transitioned to high income status over the past three decades, but the median middle-income economy today has a per capita income less than one-fifth that of the US, a number that has remained the same since the 1970s. This paper addresses this syndrome—nicknamed “the middle-income trap” by economists at the World Bank—in three parts:

·The first asks whether middle-income economies are inclined to grow slower than either low-income or advanced countries, if development is structurally different at this stage and requires a different growth strategy, and whether this task is being made harder by economic, social, and environmental changes since the 2000s.

·The second distills the insights of Schumpeterian theory to better understand why middle-income economies tend to have ‘missing middles’ in their entrepreneurial structures, income distributions and energy mix: mid-sized firms, middle-class families, and mid-carbon fuels.

·The third outlines the implications of these economic anomalies for government policy, questioning conventional wisdom about large enterprises, elite echelons, and clean energy, and proposing development strategies for middle-income countries that are not self-defeating because they do not vilify big firms, rich people, and fossil fuels.

To succeed despite rising protectionism, political polarization and climate change, middle-income countries will have to institute policies that simultaneously ensure economic freedom, promote merit activities, and discipline incumbency. In Schumpeterian parlance, to grow quickly to high income over the next few decades as countries such as South Korea did during the last few, they will have to discipline a seemingly contradictory mix of forces of economic creation, preservation, and destruction. In short, they will have to make miracles.