

MAIN MESSAGES

The Middle-Income Trap

Middle-income countries—home today to 6 billion people—are in a race against time.

Since the 1990s, many of them have done well enough to escape low-income levels and eradicate extreme poverty, leading to the general perception that the last three decades have been great for development. But their expectations have been abysmally low—remnants of a period when more than two-thirds of the world lived on less than a dollar a day.

Today, 108 countries are classified as middle-income. The ambition of many of them is to reach high-income status within the next two or three decades. However, when assessed against this goal, their record is dismal. Since the 1990s, only 34 middle-income economies have attained high-income status. Together, they account for less than 250 million people—the population of Pakistan. And since 1970, the median income per capita of middle-income countries has never risen above one-tenth of the US level.

To escape the “middle-income trap,” countries need to undergo two transitions

With rising debt and aging populations at home, growing protectionism in advanced economies, and escalating pressures to speed up the energy transition, today’s middle-income countries are facing growing headwinds. *World Development Report 2024* identifies pathways for these countries to avoid the middle-income trap. To do so, they will need to undergo not one but two transitions:

- The first is to transition from a “1i” strategy for accelerating *investment* to a “2i” strategy that emphasizes both *investment* and *infusion*, in which a country brings technologies from abroad and diffuses them domestically.
- Once a country has succeeded, it can switch to a “3i” strategy, in which it adds *innovation* to the mix of *investment* and *infusion*.

They need to adopt different growth strategies at different stages of development

Depending on their special circumstances and the stage of development they have reached, countries need to adopt a sequenced and progressively more sophisticated mix of policies (see table 1):

- Low-income countries can focus solely on policies designed to increase *investment*—the 1i approach.
- Once they attain lower-middle-income status, countries must shift gears and expand the policy mix to 2i, *investment* + *infusion*.
- At the upper-middle-income level, countries need to shift gears again to 3i: *investment* + *infusion* + *innovation*.

Transitions across growth strategies are not automatic

Middle-income countries will need progressively greater economic freedom, ever more open and informed debates, and—ever more frequently—the political courage to change stubborn institutions and long-standing arrangements.

The handful of economies that have made speedy transitions from middle- to high-income status have encouraged enterprise by disciplining powerful incumbents, developed talent by rewarding merit, and capitalized on crises to alter policies and institutions that are no longer suited for the purposes they were designed to serve. Today’s middle-income countries will have to do the same:

- *Discipline incumbents.* Incumbents—large corporations, state-owned enterprises, and powerful citizens—can add immense value, but they can just as easily reduce it. Governments must devise mechanisms to discipline incumbents through competition regimes that encourage new entrants without either coddling small and medium-size enterprises or vilifying big corporations.
- *Reward merit activities.* Middle-income countries have smaller reservoirs of skilled talent than advanced economies and are also less efficient at utilizing them. So they will have to become better at accumulating and allocating talent.

Table 1 The 3i strategy: What countries should do at different stages of development

| | LOW-INCOME COUNTRIES 1i: Investment | LOWER-MIDDLE-INCOME COUNTRIES 2i: Investment + Infusion | UPPER-MIDDLE-INCOME COUNTRIES 3i: Investment + Infusion + Innovation |
|------------|---|---|---|
| Enterprise | <ul style="list-style-type: none"> • Improve the investment climate to increase domestic and foreign investment. | <ul style="list-style-type: none"> • Discipline market leaders through integration into globally contestable markets. • Diffuse global technologies with fluid factor and product markets. • Reward value-adding firms to stimulate business dynamism. | <ul style="list-style-type: none"> • Deepen capital markets and expand equity financing. • Strengthen antitrust regulation and competition agencies. • Protect intellectual property rights. |
| Talent | <ul style="list-style-type: none"> • Invest in human capital by broadening foundational skills and improving learning outcomes. | <ul style="list-style-type: none"> • Discipline elites by providing equal opportunities for women, minorities, and disadvantaged groups. • Improve allocation of talent to task. • Develop links among local and globally leading universities. • Allow emigration of educated workers whose skills are not valued in domestic markets. | <ul style="list-style-type: none"> • Strengthen industry-academia links domestically. • Expand programs to connect with diaspora in advanced economies. • Enhance economic and political freedoms. |
| Energy | <ul style="list-style-type: none"> • Increase investment in expanding access and grid networks. • Reform regulatory frameworks to attract private investment and ensure fair competition. | <ul style="list-style-type: none"> • Discipline SOEs by hardening budget constraints. • Use international coalitions to encourage advanced economies to ease protection of domestic incumbents. • Aid adoption of energy-efficient practices. • Enhance economic efficiency by reflecting environmental costs in energy prices. | <ul style="list-style-type: none"> • Lower the cost of capital for low-carbon energy by reducing risks involving technology, markets, and policy. • Increase multilateral finance for very long-term investments. |

Source: WDR 2024 team.

Note: SOEs = state-owned enterprises.



- *Capitalize on crises.* Cheap, reliable energy has been a cornerstone of rapid economic development, but prospering while keeping the planet livable will now require paying more attention to energy efficiency and emissions intensity. Exigencies such as the rise of populism and climate change provide opportunities to dismantle outdated arrangements and make room for new ones. Crises are painful, but in democracies they can help forge the consensus needed for tough policy reforms.

