

The Study on “Middle-Income Trap” and China’s Crossing Forecast: An International Comparative Analysis

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Abstract

The issue of “middle income trap” has been widely discussed around the world, especially whether China can cross it. This paper first outlines the background of the problem and the division of income groups related to the World Bank, and then analyzes the success and failure cases of typical countries mainly using the method of experience and case analysis. Finally, this paper indicates the challenges and favorable factors for China’s entry into high-income countries, and predicts whether China can overcome this trap according to the World Bank standards.

Keywords

Middle Income Trap, Economic Growth, International Comparative Analysis

1. Introduction

The development of society and economy is a process of gradual accumulation, changing from quantity to quality. Judging from the experience of nearly a century, many countries had escaped from poverty and low income levels after experiencing rapid development; however some had stagnated at the middle income level [1]. Therefore, the World Bank’s two economists Gill and Kharas proposed the concept of “middle-income trap” based on this phenomenon in 2007 [2]. However, they did not explain the meaning of the concept in depth. For example, what was the criterion for a country or region to fall into the “middle-income trap”, and how many years had not left the interval were considered to be locked by the “middle-income trap”. The concept is only a statistical con-

cept, and there is no in-depth explanation and research on the causes of this phenomenon.

Although there are some controversies in the “middle-income trap”, the concept has been widely discussed in the world and is often used to compare the plight of Latin America and several Asian economies [3] [4]. Especially after the global financial crisis in 2008, people had a heated discussion whether China repeated mistakes in the “Latin American trap” or continued high-speed growth [5]. Therefore, this paper will discuss the national experience of crossing the “middle-income trap” and whether China can smoothly enter the higher income country.

1.1. Absolute Standard

Since 1978, the World Bank has grouped different countries according to per capita gross national income (GNI), and adjusted the threshold value of the group annually considering the effects of inflation, exchange rate, and population. At present, all countries in the world can be divided into three categories: low-income countries (no more than \$995), middle-income countries (between \$996 and \$12,055) and high-income countries (higher than \$12,055), and medium revenue countries can be divided into lower middle-income countries and higher middle-income countries (with a \$3895 basis).

According to the 1988's standards and data (177 participating categories), there are 87 middle-income countries or regions defined by the World Bank (52 lower middle-income countries, 35 higher middle-income countries) and 45 high-income countries or regions. In 2018 (230 participating categories), there were 133 middle-income countries (61 lower middle-income countries, 72 higher middle-income countries) and 65 high-income countries or regions. Of the 87 economies classified as middle-income in 1988, 11 have entered the ranks of higher income in 2018, accounting for only 12.64%.

1.2. Relative Standard

In 2012, the World Bank and the Development Research Center of the State Council jointly released “China 2030: Building a Modern, Harmonious, and Creative Society.” The report divided all countries and regions into three categories based on GDP relative to the United States' GDP (in terms of purchasing power parity), namely low-income countries, middle-income countries, and high-income countries. Among them, middle-income countries are countries within 5% - 40% of American GDP, and low-income countries and high-income countries are outside the range.

According to the report and relative standards:

First of all, there were 101 middle-income countries and regions in the world in 1960. By 2008, only 13 of them had successfully entered the ranks of high-income, with a success rate of only 12.87%. They are: Japan, Hong Kong, Taiwan, South Korea and Singapore, Israel, Spain, Greece, Ireland, Portugal, Equatorial Guinea, Mauritius and Puerto Rico.

Second, Brazil, Argentina, Mexico and other Latin American countries and the Southeast Asian countries such as the Philippines are caught in a “middle income trap”. These countries entered the middle-income ranks in the 1960s and 1970s. However, the lack of momentum in economic growth and the widening gap between the rich and the poor, high inflation, and imbalances of payments had caused the relative per capita income levels of these countries to stagnant. Philippines even fell into low-income levels in the 1980s.

Third, countries with high-income levels in 1960 were still mostly high-income in 2008, such as the United States and Britain.

There is no clear answer to the question of what caused the “middle-income trap” [6]. Some countries have weak growth due to unfavorable economic restructuring. Some countries have too fast urbanization, some countries have severely uneven income distribution, which has led to a sharp increase in social conflicts, and some countries have been devastated by external factors (international financial crisis, etc.). The national conditions of countries are different. It can be said that all the factors that lead to the decline of economic growth rate and even cause economic recession may make a country unable to extricate itself.

The simple decline in economic growth is only an appearance. What is more essential is how to deal with a series of internal and external challenges that hindering growth in the process of economic growth. In the following article, we will use some countries including Japan, South Korea and the representative countries of Latin America as examples to summarize the experiences and lessons.

2. International Comparative Analysis

2.1. Success Experience

This paper analyzes the country experience with South Korea and Japan, which have many similarities in the East Asian economic circle, culture and economy, and briefly analyzes the “crossing road” of Singapore and Germany.

2.1.1. The case of South Korea

South Korean was dominated by agriculture, forestry, animal husbandry and fishery in the 1950s. However, South Korea had maintained a sustained and rapid development trend since the industrialization. South Korea had experienced only three times of negative growth rate due to the impact of state power, the Asian financial crisis and the global financial crisis in 1980, 1998 and 2009 alone for more than half a century [7].

South Korea’s per capita GNI reached \$11,600¹ in 1995, and the ratio of South Korea-US per capita GDP (purchasing power parity, 2011 dollar constant price) exceeded 40% for the first time, officially entering the ranks of the world’s richest countries. South Korea is the fifteenth largest country in the world and the fourth largest economy in Asia at present. The reasons why South Korea suc-

¹The data cited in the article is from the World Bank database, and the latter data is also.

successfully crossed the “middle income trap” are as follows [8].

First of all, the industrial structure is adjusted. South Korea’s top ten export products in the 1960s mainly included primary products such as iron ore, fresh fish, rice and anthracite. But the top ten export products no longer contained food, but mainly clothing, steel, shoes, ships and textiles in the 1980s. During this period, the Korean government carried out industrial restructuring and upgrading, mainly implementing investment growth strategies for emerging industries. The proportion of agriculture, forestry, animal husbandry and fishery industry declined steadily, and the proportion of capital-intensive and technology-intensive industrial industries increased significantly. Until the beginning of the 20th century, steel, ships, semiconductors and electronic information products remained the top ten export products of South Korea, which significantly boosted GDP.

Second, foreign situation was relatively favorable. From 1970 to 2000, South Korea’s per capita GDP (the US dollar constant price in 2010) maintained a high-speed economic growth of 7.38%. Especially in the late 1980s, thanks to the upgrading of industrial structure and favorable international economic environment, Korea’s economic growth rate (per capita GDP) reached 10%. South Korea’s share of GDP also continued rising, reaching a peak of 38% in 1987. This period was also often referred to as the “three big dividends” era, that is, low oil prices, low interest rates and low Korean won. The three major dividends brought about Korea’s economic prosperity, foreign trade growth and current account surplus. Therefore, the ratio of per capita GDP of South Korea to the United States increased from 20.94% in 1988 to 31.17% in 1995.

Third, South Korea increased investment in technological innovation. Ratio of South Korea’s independent R&D expenditure of GDP was about 0.3% to 0.5% in the 1970s. However, the ratio of R&D expenditure reached 4.23%, an increase of about 10 times by 2015. According to World Bank data, South Korea had become the second-highest country in R&D expenditures of GDP in the world (almost equal to the first Israel). In addition, South Korea’s spending on foreign technology had also grown rapidly. For example, overseas patent licensing expenditures accounted for only 0.2% of GDP in 1980, and it increased to 0.5% in 1990. Once again, South Korea imported a large amount of capital goods from abroad. At the beginning of the twentieth century, capital goods imports accounted for more than 30% of total Korean imports. Capital goods imported from developed countries created conditions for access to technology such as mechanical products. Therefore, South Korea had achieved rapid technological advancement by increasing its independent research and development investment, purchasing foreign technology and importing capital goods, thereby boosting industrial upgrading and stimulating economic growth.

Fourth, South Korea attached importance to income distribution and social welfare. The problem of income inequality in South Korea had not always been outstanding, and it also paid more attention to social welfare. In 1980, South Korea added a corresponding clause in the constitutional amendment. By 1990,

South Korea had basically achieved universal coverage of the health insurance and pension system. Gini coefficient of South Korean had remained 0.32 for a long time. Effectively controlling the equality of income and wealth supported South Korea to cross “middle income trap”.

2.1.2. The Case of Japan

Japan’s economic development began in the Meiji Restoration and was rebuilt after World War II. In the 1940s and 1950s, Japan became a lower middle-income country. In 1978, Japan’s per capita GNI (the current US dollar price) exceeded \$6000 and successfully entered the ranks of high income. The reasons are mainly the following two points:

First of all, the economic transformation after the war was successful. Japan established an economic structure dominated by traditional capital-intensive industries such as heavy industry, and the economy began to catch up in the 1940s and 1950s. The rise of the automobile manufacturing industry represented by Toyota, Honda, and Nissan had brought a steady stream of power to heavy industries such as steel and petrochemicals. Since then, the average annual growth rate of GDP had been around 10%. Due to the impact of two oil crises, the “Hiroshima Agreement” and the gradual disappearance of the traditional demographic dividend in the 1970s and 1980s, Japan began to transform into a technology-intensive industry represented by electrical machinery and general machinery. Japan’s electrical machinery and general machinery accounted for 30% of the manufacturing industry by the end of the 1980s. Japan tried to quickly turn to innovation-driven economy in the 1990s, but the industrial economy did not achieve accelerated upgrades, dragging down the economy and failed to maintain further high-speed growth, and subsequently entered a period of shock and recession.

Second, Japan implemented the “National Income Doubled Plan” [9]. The core problem of plan improved the income and welfare of residents by accelerating development and increasing employment. Japan increased infrastructure construction and raised the level of social welfare. In addition, Japan increased government spending and encouraged innovation and training of talent. Japan also improved the corporate structure and support the development of SMEs. Finally, Japan narrowed the gap between agriculture and non-agriculture through government-led investment and income distribution policies, between large enterprises and small-sized enterprises, and between regions, and established a sound social security and welfare system for the society.

2.1.3. Other Countries’ Success

Judging from the success cases of South Korea and Japan, their economic development has undergone a gradual industrial upgrading process. The same is true for Singapore and Germany [10]. Singapore developed rapidly with its unique comparative advantage. Germany experienced three transformations in the economic development strategy after World War II, prompting its rapid renaissance (Table 1).

Table 1. Three representative countries' industrial transformation development.

Stage	Singapore	Germany
Stage I	Labor-intensive industries such as clothing, textiles, toys, wood products and wigs (1960s)	Capital and technology-intensive industries such as electronics and chemicals (1945-1970)
Stage II	Skills and capital-intensive industries such as petroleum smelting, chemical industry, warehousing, precision engineering (1970-1980)	New economic industries such as computers and information technology (1990s)
Stage III	Emerging industries such as high-end electronic information industry, pharmaceutical, life sciences and environmental protection (1990 to present)	Renewable energy field and new energy development field (2000 to present)

In summary, with the accumulation of capital and economic development, Singapore and Germany had gradually shifted from labor-intensive to capital-intensive and technology-intensive, and even information-intensive and new energy industries [11]. The two countries or regions have seized the focus of development at different stages, achieving stable economic growth and helping them to successfully cross the “middle income trap”.

2.2. “Latin American Trap”

Brazil, Argentina, Mexico and other major Latin American countries had not significantly increased their per capita GDP to the United States GDP for nearly 50 years, leading to a long-term sequence of middle-income countries, and Argentina had even experienced a slow decline. This phenomenon was called “Latin American trap” [12].

Take Argentina as an example: in 1960, Argentina's per capita GDP (the US dollar constant price in 2010) was 5605 US dollars, and the ratio of per capita GDP to the United States' was 32.90%. However, Argentina's per capita GDP did not close to the United States between 1960 and 1990, and even the gap was growing. By 1990, Argentina's per capita GDP (constant price in 2010) was \$5939, only a slight increase from 30 years ago. According to the constant price of the US dollar in 2010, the average growth rate of per capita GDP in Argentina between 1960 and 2017 was only 1.25%. This growth rate is at a lower level in the long run.

The cause of the “Latin American Trap” is generally believed as follows.

First, the economic development strategy is wrong. Latin American countries had not seized the opportunity of post-war industrialization development, and had long implemented import substitution and primary product export-oriented policies, resulting in the import substitution of their industries while limiting the introduction of necessary technologies, equipment, and raw materials. Mainly, these countries failed to effectively adjust the industrial structure and enhanced competitive advantage [13]. At the same time, under the situation of unstable political situation in the country, the implementation of neoliberal economic policies had led to an unstable economic situation. According to World Bank

data, Argentina's average inflation rate in the 1970s was as high as 33%, and inflation further undermined the foundation of economic growth.

Second, the polarization between the rich and the poor caused by the unfair distribution of income hindered the sustainable development of the economy. This is the cause of the "middle income trap" that is most mentioned by scholars. It is believed that the social polarization formed by the unfair distribution had a negative impact on the sustainable development of the economy. According to the statistics of the World Bank, the Brazilian Gini coefficient reached a maximum of 0.63 in 1989. The disparity between the rich and the poor seriously jeopardized the healthy development of the economy.

Third, excessive urbanization. In the 1970s, Argentina's urbanization rate had exceeded 70%, and now it has reached 91%, ranking the top 10% in the world. With the advancement of urbanization, a large number of rural laborers had moved to cities, but population transfer had not been supported by industrialization, so a large number of unemployed people had formed, and a large number of "slums" had formed. The incidence of poverty in Latin America was over 40% in the 1980s and 1990s, and the highest reach 48.3%, which seriously affected the stability of society.

Fourth, the supply of social security systems is seriously inadequate, which is not conducive to improving spending power [14]. Under the tremendous pressure of excessive urbanization, the social security system and welfare system in Latin America were incapable, and the social security coverage averages about 40%. There is a huge gap between the supply of social security system and "excessive urbanization", which brought great difficulties to poverty alleviation in Latin America.

2.3. Comparative Analysis

In the empirical analysis of East Asia and Latin America, most economists regarded whether countries successfully implemented the economic structural transformation as the key to crossing the "middle income trap". Japan and the "Asian Four Little Dragons" actively changed their industries from labor-intensive to capital-intensive and technology-intensive, and even information-intensive industry, which increased the degree of economic extroversion, and had kept rapid economic growth until it entered high income ranks [15] [16]. The big data empirically found that the dynamic mechanism of economic growth in different stages of economic development was different, and the inability to switch the dynamic mechanism in time caused developing countries to fall into the "middle income trap" and so on.

Through the above comparison, the key difference between Japan, South Korea, Singapore, Germany and some countries of Latin America is whether the government could formulate a correct economic development strategy at different times and whether it can effectively adjust economic structure to drive growth, which also brought us effective inspiration.

3. Disadvantages and Advantages Facing China

In 1998, China's per capita GNI reached \$800. According to the absolute standard at that time (more than 785 US dollars for middle-income countries), China had entered the ranks of middle-income countries. At present, the driving mechanism for China's rapid economic growth is weakening. China's GDP growth rate has slowed down since the first "breaking 7%" in 2015. China's economic growth faces a series of realistic constraints such as population aging, low investment efficiency and rising labor prices [17].

3.1. The Challenges Facing China's Development

After the global financial crisis in 2008, the world economy generally weakened and China's economic development entered a new stage. The Chinese Academy of Social Sciences measured the growth of the world's major economies in the nine years before and after the crisis (1999-2007, 2008-2016): global growth rate fell from 3.5% (1999-2007) to 2.3% (2008-2016), the average economic growth rate of the United States, the United Kingdom, China and Japan decreased from 2.9%, 2.8%, 10.2% and 1.3% to 1.3%, 1.0%, 8.3% and 0.4% respectively. Any country faces challenges at any stage of development. According to the absolute standards of the World Bank, China has been a middle-income country for more than ten years and currently faces many challenges.

First of all, after the "Twelfth Five-Year Plan" period, the structural contradictions of the Chinese economy were highlighted in the overcapacity of the steel, coal and other industries and the high inventory of real estate. In addition, factors such as high leverage and high cost also constrained economic development. From the perspective of economic growth model, China relied on investment for a long time before 2013. With the reduction of the marginal utility of capital, China's economy needed to transform its economic growth model, gradually established investment-driven demand and innovation drive, and shifted from scale expansion to structural upgrading, which would contribute to stable economic development [18].

Second, with the rapid development of China's economy in previous years, the problem of declining fertility and aging population had gradually emerged. According to the United Nations (2015) forecast, China's aging process would accelerate after 2015; by 2025, the proportion of people aged 65 and over would reach 20.4%; by 2035, the indicator will rise to 32.7%. In general, a labor shortage will lead to an increase in labor costs, further weaken the profits of labor-intensive industries and have a negative effect on economic growth. In this regard, Cai Yu, deputy dean of the Chinese Academy of Social Sciences, said at the China Manufacturing Forum in 2018 that with the disappearance of the demographic dividend, it was necessary to break the shortcomings of the system and mechanism that restricted the flow of talents, created a good policy environment, and improved the efficiency of resource allocation.

Third, the current problem of large income gap is one of the main social

problems in China. According to World Bank data, China's current Gini coefficient is about 0.42, which is higher than Japan, South Korea and the United States, and belongs to countries with large income gaps. The imperfect system and the imbalance between regional and rural development (the income gap between urban and rural residents is nearly three times) are the reasons for large income gap. A large income gap will hinder the consumption of low-income people and will also affect social stability. Narrowing the income gap is a long-term and arduous task.

Finally, due to the weak international consumption and trade after 2008, China's net exports of goods and services fell rapidly, and the trade surplus narrowed significantly. The US promoted trade protectionism and launched a trade war against China, which has adversely affected economic growth in the short term.

3.2. Favorable Factors for Achieving a Successful Leap

GNI per capita in China was \$9470 in 2018, and the ratio of GDP per capita in China relative to the United States' GDP was 28.23%. Clearly, China is already a high middle-income country. It has only taken China 40 years from low income country to high middle-income country.

The middle-income trap is essentially a question of whether a country's economic growth can be sustained and maintained smoothly. Combined with existing success and failure cases, China has several advantages to help break the middle-income trap.

First, supply-side structural reform had led new development and boosted endogenous growth drivers. Structural reform focuses on the enterprises to reduce costs, improves the market system and the efficiency of state-owned enterprises, speeds up the industry and technology upgrading, expands the opening to the outside world and enhances the adaptability to changes in demand and supply structure flexibility. Taking innovation input as an example, the proportion of scientific research expenditure of GDP in China has significantly increased: from 0.56% in 1996 to 2.17% in 2015, with a growth rate of 2.67 times, far exceeding that of Britain, the United States, Japan and South Korea and other countries.

Second, consumer demand continues to grow, and the three major demand contributions occupy a dominant position. In 2017, China's final consumption reached 43.5 trillion RMB, accounting for 53.6% of GDP. After the financial crisis in 2008, with the rise of global trade protectionism and the decline of the competitiveness of China's exports, the ceiling of China's foreign exports gradually appeared, and the contribution ratio of investment and net exports to GDP tended to decline. The state had timely adjusted its development strategy, proposed to take expanding domestic demand as a long-term strategic guideline, and launched a series of policies to stimulate consumption and cut taxes. Consumption has become the main engine driving domestic economic growth, especially consumption-related industries such as culture, old-age care, health and

tourism, which will unleash greater growth potential [19].

Third, take a new path of urbanization. Rapid urbanization, if not matched by corresponding industrial development, will seriously lead to social development stagnation and social conflict. China's urbanization rate was 57 percent, slightly below the world average (59 percent) and lagging behind high-income countries (about 70 percent) in 2017. China's national new urbanization plan (2014-2020) formulated in 2014 emphasized the construction of new urbanization with "human-centered urbanization", deepening the reform of the household registration system, and improving employment, low-income housing and public services. The import substitution strategy implemented by Latin American countries broke away from the national division of labor system, resulting in higher production costs and finally falling into the "middle-income trap". In recent years, China has actively responded to various challenges, especially after the trade war between China and the United States. China has worked hard to explore other overseas markets, enhance its innovative competitiveness and participate in economic globalization in an all-round way [20].

4. Forecasting Results

According to the above-mentioned income classification method, this paper conducts scenario analysis on whether China can successfully overcome the "middle-income trap" in the future, using two methods of absolute income and relative income. Research analysis shows that China will enter high income in 2023-2026.

4.1. Absolute Standard

Every year, the World Bank adjusts the high-income threshold according to inflation, exchange rate and other factors, but the change is small. In recent ten years, the average growth rate of high-income line was only 0.15%, and the average annual growth rate from 2014 to 2017 was even -1.38%. Based on this, this paper assumes that the high-income threshold will remain unchanged in the next ten years (GNI per capita exceeds \$12,055). In the past ten years (2008-2017), the average annual growth rate of GNI per capita in China was 13.40%, but in 2015-2017, the average growth rate was only 4.93%. In this paper, we design three scenarios that the average annual growth rate of GNI per capita is 4%, 5% and 6% respectively (Table 2). The study concludes that China will be a high-income country by 2023-2025, based on absolute criteria.

Table 2. Per capita GNI forecast in China.

Year	2019	2020	2021	2022	2023	2024	2025
Scenario I (4%)	9849	10,243	10,652	11,079	11,522	11,983	12,462
Scenario II (5%)	9944	10,441	10,963	11,511	12,086	12,570	13,073
Scenario III (6%)	10,038	10,640	11,279	11,956	12,673	13,180	13,707

4.2. Relative Standard

The ratio of GDP per capita in China and the US experienced a rapid growth of 8.74% on average from 2000 to 2010, and a slow catch-up of 5.60% on average from 2011 to 2018. In particular, after 2014, the per capita GDP of China and the US grew at an average annual rate of 4.77%. Therefore, this paper sets three scenarios (relative standards), namely assuming that per capita GDP ratio of China and the United States will increase by 4%, 5% and 6% respectively from 2019 to 2026. Under the three scenarios, China would surpass 40 percent of US GDP per capita (purchasing power parity) between 2023 and 2026, putting it in the high-income group by relative standards.

5. Conclusions

The economic slowdown is the direct cause of countries such as Latin America falling into the “middle-income trap”. Economic development strategy mistakes, imbalances in industrial structure, excessive urbanization and the disparity between the rich and the poor in society are the main reasons why Latin America has fallen into a trap. Successfully realizing the high-level industrial structure, the transformation of economic growth momentum, increasing income and the expansion of middle-income class, encouraging scientific and technological innovation, properly formulating government economic policies, lowering inequality of degree is the firm support of successful leaps.

In essence, the “middle-income trap” is a sustainable issue of economic growth. The economies that enter into the middle-income stage in different periods should maintain a certain speed of development in order to achieve leapfrogging. Technological innovation, expansion and opening up to the global market, the emphasis on scientific and technological research and industrial transformation and upgrading are the keys to crossing the middle-income stage.

Accelerating supply-side structural reforms to promote industrial transformation and upgrading is the right choice for China to crossing the middle-income stage. At the same time, we should deepen the reform and explore new developmental dynamism from the level of institutional innovation rather than technological progress. We should provide positive incentives for effective market competition under the guidance of property rights protection, and reform the income distribution system to narrow the gap between the rich and the poor, adhere to opening up to the outside world, pay close attention to energy security and environmental protection.

At last, according to two different measures of absolute income and relative income, China will have a good chance of successfully crossing the middle-income trap and entering the high-income countries in the next decade, which is consistent with the predictions of many economists.

Conflicts of Interest

The authors declare no conflicts of interest regarding the publication of this paper.

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