A Political Economy of the Middle-Income Trap

Stephan Panther
Svenja Flechtner*
University of Flensburg

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Abstract

In recent years, the „middle-income trap" has been discussed by several authors. Policy advice has stressed quality of education, incentives for innovation and the quality of governance. Building on the framework of Acemoglu and Robinson, we introduce a political economy perspective to the discussion, arguing that high inequality in the access to economic resources and political power combined with low state capacity will increase the likelihood of entering a middle-income trap, since under these conditions the position of narrow elites is incompatible with the institutional changes and policies needed to avoid/overcome the middle income trap. International factors enter in an interesting non-linear fashion.

Keywords: middle-income trap, inequality, growth, income distribution, political economy

JEL Classification: D310, O110, O150, O430

1 Introduction

South Korea is a striking development success. One of the poorest countries in the world in the 1950's it was assigned middle income status for the first time in 1969 by the World Bank. In the year 1995 it was listed as a high income country, remaining a middle-income country for no more than 26 years.

The debate over the reasons for such an outstanding growth and development performance is not finished. However, it seems fair to say that the developmentalist stance of successive governments, starting with the military government in the 1960's, was decisive (Rodrik, 2003). Policies like the socialization of investment risk made it possible not only for the richest fraction of the population to invest. Wealth accumulation in the hands of a few was looked at distrustfully by the regime. This was preceded by a comprehensive land reform after the II. World War, leading to a relatively equal distribution of land. And: Growth policies in South Korea deviated significantly from Washington Consensus policies: deregulation and liberalization of trade and financial systems played as little a role as privatization or foreign direct investment (Rodrik, 2003). The level of technological sophistication of exports is high. The educational Gini is very low (Thomas et al., 2001).

*Corresponding author: panther@uni-flensburg.de. Comments welcome. We are thankful to Ben Ross Schneider and participants of the REPAL Annual Meeting 2014 in Santiago de Chile and the EAEPE Annual Conference 2013 for helpful comments on an earlier version.

Latin America is full of middle income countries. Many of them have been so for a long time. The bulk of Latin American countries have been in the middle income range since the 1950s and 1960s. But some have reached this income level much earlier. Chile became a middle income country as early as 1891, Argentina in or before 1890 and Uruguay in 1882 (Felipe et al., 2012). Sweden and Canada gained the same income level at a comparable time. In contrast to the latter, Uruguay and Chile were part of the World Bank's high income group for the first time only in 2012, and Argentina is still in the upper-middle income group.[1] None of the other Latin American countries has made the transition to high income yet. Thus Uruguay needed 130 years or almost 5 times as long as South Korea to move out of middle income status.

The cases of success-stories like that of South Korea or Taiwan have been analysed in detail, and technical policy-advice on how to overcome middle-income status is abundant. None of the papers in the literature discuss the political economy of these policies. This paper starts to fill this gap. Our key argument is that the concurrence of high inequalities - e.g. in terms of income distribution, ownership of productive capital and access to political power - and low institutional quality prevents the adoption of policies and emergence of institutional structure which would be necessary for the transition to a high-skill, high-productivity economy. This approach can explain why policies and structural changes which are quite straightforward have not been executed.

The paper is organized as follows. Section 2 characterizes the middle income trap in a more systematic fashion, Section 3 does the same for the policy suggestions contained in the literature. Section 4 then develops our theoretical argument on the political economy of the middle income trap. We take the stance that inequality of income, wealth and political power and the extractive institutions/ low state capacity associated with them, are the main underlying cause for the non-adoption of growth-enhancing policies. In section 5, we discuss international interaction and country size as intervening factors. Section 6 concludes.

2 The middle income trap

In recent years, especially under the impression that other countries, e.g. in South-East Asia, may be set for a similar growth trajectory, the Latin American experience has been discussed in a more general fashion in development research under the heading of the "middle income trap" (Griffith, 2011,Felipe et al., 2012,Agénor and Canuto, 2012,Eichengreen et al., 2013,Woo, 2012,Lin and Treichel, 2012).[2] The concept refers to the problems or failure of middle-income countries to transition to a high-income economy. While many countries have achieved to grow from a low-income to a middle-income economy since the 1950s, only few have reached high-income status (Agénor and Canuto, 2012). Caught in the middle-income trap, which may be characterized as a stable, low-growth equilibrium (ibid.), middle income countries can neither compete with low-wage countries producing standardized goods(anymore) nor with high-technology countries (yet) (Paus, 2011).

[1] Argentina is a special case. In 1914 it belonged to the richest countries of the world, starting a secular decline in its relative income level by 1929 at the latest, and hitting its lowest position so far in the years after the 2001 crisis. This has been discussed in detail by(Alston and Gallo,)

[2] See (Paus, 2014) 13-24 for a recent survey of the literature. Paus distinguishes two groups of authors, a larger group emphasizing structural change issues and a smaller group discussing the growth-slowdowns. This paper takes the structural change approach as its base.

There is a fair amount of consensus that the step from low-income to middle-income is comparatively easy as countries undergo Lewis-type structural changes, shifting labor from low-productivity sectors like traditional agriculture and informal services to sectors with higher productivity, benefiting from imported technologies. This is regularly accompanied by specializing in low-cost, low-skill activities. When these productivity gains are exhausted, countries face the challenge to further increase their per capita income - and this means: wages - without losing competitiveness.

By analysing both successes and failures to leave middle income status, the literature emphasizing structural change has reached consensus that the key for a successful transition to high income status is the diversification of economic activity into higher quality activities, where much more of the product "design", be it technological or in other areas (like marketing and branding), is undertaken inside the country, by country nationals and by firms owned by country nationals. Thus innovation and investment, especially into education, are essential to create further productivity growth and fuel the increased wage level (Griffith, 2011, Paus, 2011, Ohno, 2009, Agénor and Canuto, 2012). Policies discussed to support this include investment in high quality infrastructure (Agénor et al., 2012) and R&D (Lin and Treichel, 2012), but as well improvements regarding the efficiency and rationality of policy formation and implementation (Ohno, 2009). Rodrik (2013) places the key arguments within the context of the present state of the world economy (Rodrik, 2013).

3 Policies allowing countries to avoid a middle income trap or to overcome it

On a first level it is fairly straightforward to name the changes necessary in order that countries can overcome a middle income trap or avoid falling into it in the first place. Put very generally, it is necessary on the one hand to mobilize creative talent through education. On the other hand, it is decisive to give talent the right incentives so that it is used to assimilate best-practice technologies and organizational routines, adapt and apply them to local tasks and create cutting edge innovations in technology, management, design, marketing, etc. (Agénor and Canuto, 2012, Rodrik, 2013).

While the details of doing so will depend on the local circumstances, a few elements of how these two tasks may be achieved are undisputed. In education, this includes a clear shift from quantity to quality. Yes, higher enrolment rates in secondary and tertiary education will be necessary, but what is more important, education on all levels should be of a high quality, building up cognitive and social skills for mastering cutting edge science and unleashing creativity. In order to get there, it may be necessary to change the training of the teaching profession accordingly, to work on the prestige of school teachers, to raise their pay, to improve the teaching materials, etc. Such an argument has been modelled recently (Cantoni and Yuchtman, 2013).[3]

In some cases, a concerted drive to send people abroad for their tertiary education may be able to accelerate this process as long as the problem of a possible brain drain can be solved, as has happened in Japan after the Meiji Restauration in 1868 or is happening

[3] Hanushek and Woessmann (2012) recently found that school attainment has been relatively high in Latin America, but educational achievement has remained low. In other words, relatively high quantity of schooling has not come along with high quality of schooling. The authors argue that this lack of quality accounts for Latin America's poor overall growth performance (Hanushek and Woessmann, 2012).

in China today. Overall, maintaining a considerable amount of internationalization by both inward and outward mobility in order to keep in touch with recent developments worldwide will be part and parcel of any high quality education system.

Such policies will be able to „harvest" the larger an amount of excellent talent, the more comprehensive they will be socially. Discriminating access to high quality education along lines of gender, ethnicity or social class will inevitably reduce the pool of talent a country can draw upon.

When it comes to the incentives necessary to transform educated talent into the mastering of cutting edge technologies and the creation of innovation, it is essential that doing exactly that be the way to richness and prestige in a society. Put differently, creation of wealth must be rewarded, and gaining wealth by taking it from others must be made as difficult as possible. Robinson and Torvik (2011) provide a general model on this, Acemoglu (1995) is a classic (Robinson and Torvik, 2011,Acemoglu, 1995). Looking at the economic policy consequences of this, the profession is divided – at least it is easy to portrait two ideal types of policy recommendation. On the one hand side, liberal economists would maintain that the best way to reward wealth creation is to unleash market forces: competition and free entry. This allows the rapid introduction of innovations into the market and eliminates market power. On the other hand, many scholars emphasize the role of the state in providing complementary incentives through industrial policy of some kind including subsidization of technologies during early stages of their development(see e.g. Rodrik (2013) for the latter argument) as well as complementary infrastructures, most recently in the area of information and communication technologies (see Agenor and Canuto (2012) for an argument and model along these lines explicitly related to the middle income trap).

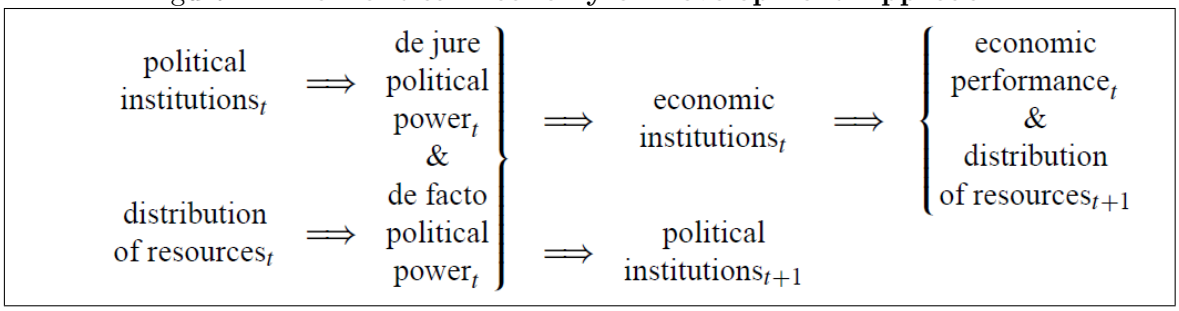
If this is a debate, we will not enter it. Both increasing competition and provision of complementary incentives and infrastructure will in general be necessary - the specific mix being determined by local circumstances. Overall the task for countries aspiring high income status is can be described as constructing their own national innovation systems ((Paus, 2014). See also (Vivarelli, 2014)). In any case, it is clear what is not beneficial for talent to be rewarded: Ample opportunities to accumulate riches by either grand or petty corruption, by using public funds or political power for private enrichment or by any other kind of rent seeking.

While the discussion on the middle income trap is relatively new, the policies described in the previous section have been discussed for a considerable time. Policy advice for Latin American countries today mentions many aspects that have been mentioned in policy advice from the 1950s already. Moreover, most of them had been applied by some governments before they were discussed and recognized in academia. What prevented other governments to try and find their own successful policy mix using the experience of others and policy advice?

4 A political economy of the middle income trap

Our political economy of the middle income trap builds on the political economy developed by Acemoglu and Robinson together with various co-authors (AR hereafter) over the last decade. A sketch of their basic framework will help to put our ideas in context.

Figure 1: **The Political Economy of Development Approach**



Source: Acemoglu et al. (2005)

4.1 The basic AR framework

In their 2005 chapter in the Handbook of Economic Growth, AR summarize their general approach using the diagram in figure 1 (Acemoglu et al., 2005).

By making the economic performance at any point in time depend on the institutions regulating the economic sphere, AR reaffirm the prevailing institutionalist orthodoxy which has been established over the last two decades. By emphasizing their distributional preconditions and consequences, they transform it into a political economy.

Any economic outcome implies a certain distribution of income and wealth. The distribution of material resources, in turn, is a key determinant of the distribution of political power in a society. This "de facto political power", as AR call it, is one key variable determining economic and political institutions. The second key determinant is the ability of a group to overcome the collective action problem. While the latter ability is a kind of shift parameter for their analysis, the distribution of resources is a cornerstone.

AR recognize the – partial – autonomy of the political sphere, the sphere of collective decision-making about the rules of the game. Hence, political power is determined also by constitutional rules – „political institutions" in the AR parlance - resulting in „de iure political power". Actors use their de iure and de facto political power to influence decisions about economic institutions and about the rules of future rule-making – that is, political institutions.

Given the recursive dynamic nature of the system, it will gravitate towards certain more or less stable configurations of the component factors. As a first approximation AR describe two such configurations, which they name inclusive and extractive institutions, respectively. Inclusive economic institutions are those that feature "secure private property, an unbiased system of law, and a provision of public services that provides a level playing field in which people can exchange and contract; it also must permit the entry of new businesses and allow people to choose their careers." (Acemoglu and Robinson, 2012, p. 74-75). Inclusive political institutions are both "sufficiently" pluralistic and centralized, where pluralism is defined as a relative broad diffusion of political power combined with considerable constraints on the use of that power, and centralisation is defined as monopoly of the legitimate use of violence (Acemoglu and Robinson, 2012, p.80-81). Extractive institutions, both economic and political, are characterized by the absence of the characteristics of inclusive institutions. AR call them "extractive", "because such institutions are designed to extract incomes and wealth from one subset of society to benefit a different subset." (Acemoglu and Robinson, 2012, p. 76). Inclusive institutions will gen-

erate and will be supported by a relatively equal distribution of income and wealth and high average income, while exclusive institutions will be associated with highly unequal distributions of income and wealth and low average income.

One essential driver of the inefficient low level equilibrium in the AR framework is due to the non-existence of a political Coase theorem: conflicts between the efficient use of resources and the maintenance of a political regime based on the political and economic privileges of a – comparatively – narrow elite may arise.[4] In other words: Certain technological or economic changes leading to an increased national income may threaten the economic or political position (or both) of the dominant group, which then has the choice between having a large share of a small pie or a smaller share of a larger pie – and may well go for the former.

Let us end this section by adding some comments on the relationship between extractive institutions and the inequality of income and wealth. First, while extractive institutions are defined as institutions which allow a more or less narrow ruling elite to extract income and wealth from the non-elite, due to the disincentive effects of redistributive institutions, this may not necessarily lead to high inequality of income and wealth. A simple, though clearly very extreme, thought experiment clarifies the intuition: If anything a member of the non-elite earns/produces is confiscated entirely, nothing will be produced by the non-elite, thus leaving the elite only with whatever it earns/produces by itself. As the degree of extractiveness of the institutions is reduced, the non-elite starts to produce and the elite adds extracted income to own income - inequality of income has increased. Thus we may see a non-linear, hump shaped relationship between the extractiveness of institutions and inequality.

Second, the distributive effects of extractive institutions may well be caught better by polarization rather than by inequality. The greater the redistribution effects of extractive institutions, the greater will be the gap in income and wealth between members of the elite and the non-elite. This contrast between relatively homogeneous subgroups of the population is exactly the feature which researchers have been trying to capture by developing measures of polarization over the last two decades.[5] While the effort has not gravitated towards a single measure - not unlike the much older and longer effort to define inequality measures - it has been able to show from the beginning, that inequality and polarization are not the same and that a given change in the income distribution may frequently cause measures of the two to change in opposite directions.

4.2 Building a political economy of the middle income trap

4.2.1 The institutional level

To create a political economy of the middle income trap against the background of the AR framework, let us first look at the institutional requirements specific to the policies needed to overcome/avoid the middle income trap sketched in 3.

Looking at the "supply side" first, providing high-quality education to as large as possible

[4]The Coase-theorem shows the independence of efficiency from distribution in the absence of transactions costs and perfectly defined and enforced property rights. A political Coase-theorem fails due to the inability of political parties to commit not to use a major shift in political power implied by a political deal to renege on it. Under these conditions distributional issues may adversely affect efficiency and therefore growth.

[5]The seminal paper is (Esteban and Ray, 1994).See (Deutsch and Silber, 2010)for a recent discussion.

section of the population will always require a highly capable bureaucracy. This is obvious in the case of public provision of education, where the state controls both the rules of the educational system and also trains and staffs it. However, regulating a system where part of the provision of education is private in order to achieve high-quality education in all parts of the system is certainly not less challenging, if not more. In both cases, the fiscal capability of the state has to be considerable, even if this is somewhat less so under mixed provision.

Turning to the "demand side", the establishment of the right incentives and opportunities for technological and market innovation, the "liberal component" of a successful national innovation system - free entry into markets, which are kept as competitive as possible - certainly is not harmed by a capable and well financed bureaucracy. Nevertheless, the focus here is on the ability of a state apparatus to institutionally commit to respect private property rights and refrain from idiosyncratically protecting political supporters from the forces of competition.[6]

When it comes to the more activist elements of an innovation policy - the establishment of technical universities, the financing of strategically important basic research, the subsidization of technologies at an early stage, the provision of key infrastructures, etc. - the picture is very similar to the one sketched when discussing education. Institutionally, a state capable to finance the necessary expenditure and to direct these finances effectively using a capable bureaucracy is the base of the necessary policies.

Overall, a fiscally potent and bureaucratically capable state which is also able to institutionally commit to self-restraint by guaranteeing competition and private property is the base for the policies required to avoid/overcome a middle income trap.

While this is certainly compatible with the concept of inclusive institutions as described by AR, the concept of "state capacity", a variety of which has been reintroduced into economic discourse prominently by Besley and Persson (2011) seems to catch the essence of the institutional prerequisites of avoiding/overcoming the middle income trap more precisely.They use the term "legal state capacity" for the institutional capability of a state to respect property rights and market forces and "fiscal capacity" for the ability to tax. To those two dimensions we would add "administrative capacity" in the sense of a "Weberian" capable bureaucracy.[7] A legally, fiscally and administratively capable state then is the institutional base for avoiding/overcoming a middle income trap.

Legal capability is incompatible with extractive institutions almost by definition. As to the determinants of a capable, "Weberian" bureaucracy, it is obvious that this needs meritocratic recruitment procedures. However,increasing the meritocratic element in the staffing of government bureaucracies in order to provide the complementary public goods needed by a thriving private sector reduces the basis of power of a clientelistic regime (see e.g. Robinson and Verdier (2013) for a recent discussion). Robinson and Verdier also suggest that the incentives to install a clientelistic regime in the first place are particularly strong in high-inequality countries (Robinson and Verdier, 2013).[8]

[6] An exception could be the protection of intellectual property rights, which is notoriously more difficult and costly than protection of the property rights of tangible goods.

[7] (Cingolani, 2013) provides an overview of the history and the present use of the concept of state capacity in the social sciences. She also provides a useful systematic of the different dimensions of state capacity.

[8] This can be connected with Greif's "administrative power": is the administration to some extent independent of the government and a real political countervailing power? This requires a certain level of preparation and education as well as a certain independence (Greif, 2008).

Finally, also Besley and Persson find that increased inequality of income and wealth will reduce the likelihood of a fiscally and legally capable state. To this they add the somewhat more general idea of the dominance of redistributive vs. common interests in a society, i.e. the degree to which all members of a society would benefit from the investment in certain public goods, something which is again more likely in an economically relatively homogeneous society (Besley and Persson, 2011).

Overall, there are good arguments to conjecture that the institutional prerequisites of the policies needed to avoid/overcome a middle income trap need an amount of commonality of interest and equality of income and wealth incompatible with extractive institutions.

4.2.2 The policy level

Leeaving the institutional level and returning to the policies to avoid/overcome a middle income trap, there are more lines of arguments strongly suggesting that the policies discussed in section 3 have a large potential to undermine a regime based on the concentration of political and economic power in the hands of a narrow elite.

Broad based education has historically been regularly associated with the demand for greater participation in political decision making, and this is likely to be true for broad based quality education with a vengeance (Glaeser et al., 2007, and others)[9]. More equitable access to educational opportunities moreover always increases the competition over, and therefore reduces scarcity rents from, whatever income opportunities education might lead to, to the disadvantage of those with formerly privileged access to education.

Some of the complementary infrastructure needed in an innovative economy may threaten the power of the privileged directly. Improved transport may threaten the hold of local monopolies on the local labour market, improved information may do so too, and the role of the internet in recent revolutionary uprisings has been documented by a lot of anecdotal evidence.

Thirdly, one obvious way to finance the necessary expenditures on education and research, reducing tax privileges for the well-to-do, closes the doors to redistribution from the poor to the rich, and again will reduce the income of a narrow elite, which will thus be reluctant to implement this policy.

Finally, the very nature of a dynamic high income economy itself, with its permanent threat to any established income and social position due to rapid technological and social change, might be perceived as a threat by those benefiting from a narrowly based regime (North et al., 2009).

4.3 Further discussion

Acemoglu and Robinson (2012) give wonderful anecdotal evidence of European monarchs consciously acting on an understanding of their situation akin to the picture described so far, consciously trying to stop growth generating policies due to the threat they would pose to their power. However, we do not claim conscious decisions of elite members are the usual channel through which the regularities conjectured above are created.

[9]Campante and Chor (2012) find that the effect is likely to be relatively strong in land-abundant countries, and weaker in human-capital abundant countries. This opens interesting perspectives when discussing differences between Latin America and Asia (Campante and Chor, 2012).

In a complex system, it might be possible that actors do not realize how they contribute to system logics. It might also be that actors desire to take actions which are costly in the short-run but which in the long run bring desired changes but are prevented from doing so due to political constraints. Also, elite interests do not have to be coordinated or not even aligned in order to produce certain outcomes. For instance, domestic elites do not have to agree on pacts with MNCs about low wages: they can as well become dependent on them and conceive of themselves as victims of the MNCs.

Finally, elites may desire economic modernization and embark on the road to it only to be confronted with the challenges to their power conjectured above. This then may lead to social unrest and repression, to coups and civil wars, thus decreasing political stability. This, however, is not unlikely to make the society regress institutionally: Already according to Mancur Olson's Logic of Collective Action (Olson, 1971), the time horizon of leadership makes a difference. If one expect one's regime or leadership to be of short notice only, it makes sense not to maximize the economy and to target growth, but to maximize one's share of the existing economy. When there is a long-term perspective, for instance one of re-election, interests look quite different.

Thus, the middle income trap is not unlikely to be associated with political violence in one form or another.Indeed, Besley and Perrson (2011) find state capacity negatively correlated with several measures of political violence.

5 Intervening factors

Although the basic mechanisms are simple, our framework allows multiple outcomes. We propose several intervening factors that bring variance into the framework at the basic level. These intervening factors are understood as exogenous to our framework for the time being.

5.1 The international economic sphere

Elite interests are not only shaped by domestic socio-economic structures, and opportunity structures are not only determined by domestic institutional qualities.Both the insertion of a country in the global system of political power and its position in the international economy influence the possibilities of national political and economic actors. Far from being able to analyse this field in its entirety we will only touch upon one factor particularly prominent in the discussion, the presence of Multinational Companies (MNCs) in a country.

Up to the beginning of the 80's MNC have increasingly been considered as problematic for the economic development of a country. Since then and up to today, their presence has been conjectured to be an important element in a process of catching up, not least in the area central to the discussion above, technological catch up. The political economy approach on the middle income trap developed above suggests that the two positions just outlined may well be both correct - conditional on the quality of the institutional environment.

Essentially, the arguments in favour of positive results of the presence of MNCs rests on the chance they offer for an economy to learn technologically (and perhaps organisationally)and to diversify its activities. For this to happen a country needs sufficient absorptive

technological capacity to transform the new ideas and potential backward and forward linkages into actual economic activity. This, as we have seen, depends on the institutional framework in place, both in the economic and by extension in the political sphere. If it is absent, MNCs tend to be isolated islands, outcompeting any actual or potential national competitors insofar they are market seeking.

This conjecture is indeed supported by the results of Hamm and King (2010) who investigate the impact of FDI on transition economies in the former soviet bloc. They find that FDI may have a positive impact on various measures of economic success if state capacity is sufficiently high, this impact being absent or even turning negative if this is not the case (Hamm and King, 2010).

Particularly interesting in the context, however, is the work of Ben Ross Schneider on Latin America, after all the region with most middle income countries - and many of them likely to be in a middle income trap.

Schneider's Latin American variety of capitalism emphasizes some distinctive structural features of Latin American economies. We argue that these features are highly compatible with our framework. According to Schneider, the Latin American variety of capitalism can be characterised as hierarchical market economy (HME). Typical of this variety are the existence of large business groups (*grupos* or *grupos económicos*), the heavy presence of MNCs, the dominance of low-skilled labour and atomistic labour relations, coming along with high degrees of informality (Schneider, 2008). We argue that these institutional features are product of the mechanisms described above.

Large business groups are diversified conglomerates, often family-owned. The existence of such groups and their dominance of many sectors reflects the high concentration of productive capital and economic power in Latin America. These groups have a high - short-term - interest in low wages and low degrees of organization of labour, and have been able to influence policy-decisions accordingly. They concentrate on the production of consumer products, which is technologically not very demanding.

Multinational companies are present in more technologically advanced sectors, both in mining and in industry. Their technological dynamism is created outside the region, where RD departments are located, and has only limited linkage effects.

This constellation - one could call it a historically grown market division - is stabilized by the MNCs depending on the cooperation of the grupos when in need to access government at various levels. Since such access tends to be highly personalized in Latin America, precise knowledge of the relevant networks is necessary, which the grupos can provide. Note, however, that this constellation does depend on influence on government being highly personalized and intransparent, and indeed government action itself being intransparent to some extent. Schneider interprets this as a stable socio-politcal constellation. It may well be at the heart of the Latin American middle income trap.

5.2 Ressource abundance

The literature on the "resource curse" has once again highlighted the negative consequences of being overly dependent on natural resources. As that discussion has shown, much of the negative effects of resource dependence is mediated by institutional quality/state capacity in the same non-linear fashion as the impact of MNCs.

Under secure property rights, increased rewards for an economic activity are a chance to

become rich. Under insecure property rights, they are a potential threat to become a target for redistributive, extractive activities, in the extreme case violent ones (a good summary of the argument is (Robinson and Torvik, 2011)). This is a theme well represented in the resource curse literature (a much cited article being (Mehlum et al., 2006)), with a clear emphasis on oil and other mineral resources. In a Marxist inspired literature this theme is echoed by work on the reappearance of "primitive accumulation" as a consequence of globalization (see e.g. (Harvey, 2005).

Here we have a mechanism potentially driving a vicious circle: Peripheral countries with a comparative advantage in natural resources and relatively weak institutions at the outset are driven down a slippery slope of deteriorating institutions, with "grabbing" becoming more profitable, approaching civil war or Hobbesian anarchy at the extreme, while core countries with strong institutions can channel the benefits of trade in natural resources into growth.

5.3 Country size

Of course, country size usually will not vary much over time and thus it can explain differences rather between countries than within a country over time. Country size can affect elite interests in important ways. First, elites are likely to me more fragmented when the area and population of a country is bigger. For instance, elites might reside in different regions, which can already result in very different interests. Coordination among elites is more difficult when they are dispersed in a large area. Furthermore, the bigger a country, the more difficult it is to centralize and control it. Monopolies are harder to maintain, competition is more likely. This can have immediate impacts on economics interets. Hirschman argued that economies with monopolistic structures of production are less likely to adopt new technologies and, in this case, to industrialize: when only few firms dominate a market, they themselves have more interest in the status quo than in buying new technologies, equipment etc. (Hirschman, 1958). Despite potential gains through technical innovation, technological adaption can be slow if that means that few producers without competitive pressure would have to renew existing production sites (Ferranti et al., 2001).

Also, FDI tends to cluster in big economies. If the institutional conditions provide for sufficient absorptive capacity this will benefit large countries. Also, if technological learning is subject to significant economies to scale this should again work towards large countries having an advantage.

6 Concluding remarks

Becoming a high income country means turning into a country which can easily assimilate technological advances in their core industries and contribute to them themselves. For this to be possible, talent has to be mobilized by high quality education and given the incentives to create the innovations needed for a high income economy to thrive. Both competition and market forces as well as the provision of high quality complementary input by the public sphere are necessary in the process.

Both these policies and their institutional prerequisites, namely legal, fiscal and administrative state capacities create tensions with extractive political regimes privileging a

narrow elite. In other words: Regimes based on the highly unequal access to income, wealth and political influence face a dilemma when trying to move beyond middle income status, a dilemma which makes a middle-income trap likely.

International interaction, which we discussed briefly looking at multinational cooperation and resource rich countries, may well impact countries in a non-linear fashion, on the one hand supporting the avoidance/overcoming of a middle income trap when institutional conditions are appropriate in the first place and on the other hand locking in insufficient institutional capacities thus reinforcing the middle income trap. Also, country size is likely to be an advantage in overcoming/avoiding a middle income trap.

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