Title: Inequality and the Middle Income Trap

Many countries are concerned about the possibility of falling into the middle income trap (MIT), not only those that have been experiencing stagnant growth, but also emerging economies such as China. This concern is becoming more serious as the current de-globalization wave proceeds. On the other hand, appropriate indicators for rigorously analyzing the MIT issue are lacking or largely absent. Built on works of Woo et al. (2012), Agenor et al. (2012), Bulman et al. (2017), and the World Bank (2012), this paper contributes to the literature and policy debate by proposing a simple but intuitively appealing framework which will then be used to estimate the probability of an economy escaping the MIT. Finally, this probability is modeled as a function of inequality, along with control variables, to explore the role of income distribution in the MIT context.

Our cross-country data analyses reveal that before 1950 (in the 1950s, in the 1960s, in the 1970s, and after 1970s), some 24 (30, 15, 21, 27) countries climbed into the middle income status. However, 59 countries have fallen into the MIT and Africa homes most of them. Only seven economies, namely Cyprus, Hong Kong, Korea, Malta, Puerto Rico, Slovenia and Singapore did manage to escape the MIT.

Also, income distribution plays a critical role as inequality is found to be negatively and significantly correlated with the MIT. This finding is robust to different sources of data on inequality. The negative effect of inequality on the probability of escaping MIT attenuated in economies where expenditure on public health quality of human capital are relatively higher. On the contrary, the negative effect became stronger in economies with more capital formation and trade openness.