Middle-Income Trap: A Review of the Conceptual Framework

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ABSTRACT

This study aims to review and synthesize the existing conceptual frameworks on Middle-Income Trap highlighting key dimensions such as structural transformation, innovation, governance, and human capital. It adopts a qualitative conceptual review approach, analyzing major theoretical contributions from World Bank, Asian Development Bank, and academic scholars. It compares models and frameworks across regions and critically assesses their strengths, weaknesses, and applicability, particularly for economies like Malaysia. The review shows that existing frameworks provide valuable insights into the causes of the Middle-Income Trap, particularly the roles of innovation, institutional quality and structural transformation.

However, most frameworks rely mainly on GDP per capita as a measure of the trap, and pay less attention to political economy, environmental sustainability, and digital transformation. As a conceptual paper, the study does not include new empirical data or case studies. Future research should validate the proposed frameworks through quantitative analysis or comparative case studies. In addition, this study relies on published literature and may not fully reflect the latest policy developments in all regions. This paper provides a clearer understanding of the multidimensional nature of the middle-income trap. It offers guidance for designing policies that integrate institutional reform, innovation systems, education, and inclusive growth.

Keywords: Middle-Income Trap, Structural Transformation, Innovation, Development Policy, Emerging Economies

INTRODUCTION

The Middle-Income Trap (MIT) described a situation in which countries that have progressed from low-income to middle-income levels struggle to achieve high-income status. The concept was first introduced by Gill and Kharas (2007), and explains that countries often experience slower economic growth due to structural challenges, such as week innovation, rising labour costs without matching productivity improvements, and weak institutions (Eichengreen, Park, & Shin, 2013: World Bank, 2020). To overcome the Middle-Income Trap, countries need more than economic growth. They must strengthen innovation, upgrade industries, improve institutional quality and implement inclusive policies that support long-term development (Lee, 2022; Felipe, Abdon, & Kumar, 2020).

Many developing countries in Asia and Latin America, such as Malaysia, Thailand, Brazil and Mexico face the challenges of the MIT. These countries often depend on low-cost manufacturing or natural resources exports and have made slow progress in technological innovation, human capital development, and governance (OECD, 2023; ECLAC, 2022). As a result, despite years of economic growth, they have struggled to develop innovation-driven, high-value economies, making them more vulnerable too economic stagnation and inequality (UNESCAP, 2022).

This paper aims to review and synthesize existing conceptual frameworks on the MIT by examining its key dimensions. It also identifies gaps in the literature, particularly the limited attention given to political economy, environmental sustainability, and regional perspectives including Islamic development models. The findings will provide a basis for futre research and better policy development, especially for countries like Malaysia.

Evolution of the Middle-Income Trap

Concept Origin and Early Definitions: Introduced by the World Bank, ADB, and Gill & Kharas (2007)

The concept of **Middle-Income Trap (MIT)** was first introduced by Gill and Kharas (2007) in a World Bank report on East Asia's growth trajectory. It describes a condition in which countries that have transitioned from low- to middle-income status experience prolonged stagnation and fail to adapt into high-income economies. These economies initially benefit from low-wage advantages and export-led growth, but eventually lose competitiveness when wages rise and productivity fails to keep pace. Subsequently, The Asian Development Bank (ADB) and World Bank later expanded the definition, and describing MIT as a structural challenge arising from weak innovation capacity, limited value-added production, and inadequate institutional development (World Bank, 2020; Felipe, Abdon, & Kumar, 2020). Rather than simply a phase of slowed growth, the MIT has come to represent a development "dead zone" requiring deep economic transformation. Over the time, the MIT has evolved into a key conceptual tool to understand why some countries struggle to sustain momentum toward advanced economy status, although experience early success.

Criteria and Thresholds: World Bank Income Classifications and Economic Indicators

Scholars and institutions have proposed various thresholds, primarily based on income levels and growth performance to identify countries caught in the MIT. The World Bank (2023) classifies countries into four income groups based on gross national income (GNI) per capita: low-income, lower-middle-income, upper-middle-income, and high-income. The trap is believed to occur when a country remains within the middle-income bracket, between USD 1,136 and USD 13,845 GNI per capita, for an extended period without significant upward mobility. In empirical studies, MIT is often marked by GDP per capita stagnation, slowing total factor productivity, and a failure to transition into innovation-driven growth models (Eichengreen, Park, & Shin, 2013). These stagnation trends often occur when countries have fully utilized the benefit of low-cost labour and early-stage industrialization but lack the innovation capability and institutional capacity necessary for higher value economic activities (Lee, 2022). Therefore, the MIT should be understood as both a quantitative and qualitative challenges, characterized by prolonged developmental stagnation rather than short-term cyclical changes.

Key Characteristics of Trapped Economies: Rising Wages, Weak Innovation, and Institutional Bottlenecks

Countries trapped in the MIT commonly exhibit structural constraints that limit their transition to high-income levels. One key feature is the increase in labour costs without matching productivity improvements, reducing competitiveness in manufacturing industries that once supported economic expansion (OECD, 2023). Without moving up the value chain or generating knowledge-based outputs, countries find it difficult to differentiate their economies in a globalized environment. Second, many countries have weak innovation capacity, reflected in low investment in research and development (R&D), limited pattern creation and weak collaboration between universities and industry (Felipe, Abdon, & Kumar, 2020). Third, institutional bottlenecks—including inefficient bureaucracies, inconsistent policy implementation, and weak rule of law—undermine investor confidence and policy effectiveness (UNESCAP, 2022). These governance weaknesses limit a country's ability to carry out long-term development plans and adapt to evolving global economic conditions. Collectively, these factors create a complex set of interconnected constrains that make escaping the MIT particularly difficult without comprehensive and sustained reforms.

REVIEW OF CONCEPTUAL FRAMEWORKS

Previous Frameworks and Models on the Middle-Income Trap

A range of conceptual and analytical models has been developed over the past two decades to understand the causes and conditions of the Middle-Income Trap (MIT), each contributing unique insights into its structural and institutional roots.

Gill and Kharas (2007) – World Bank East Asia Study

Gill and Kharas (2007) were among the first scholars to introduce the concept of the MIT in the World Bank's East Asian Renaissance report. They argued that middle-income countries cannot rely on low-cost labour and capital investment as their main sources of economic growth forever. Instead, sustained growth requires a shift toward an innovation-driven economy supported by quality education, research and development, strong institutions, good governance, and an efficient financial system. Without these structural changes, economic growth is likely to slow, causing countries to remain in the middle-income category for a prolonged period. Their framework has become the foundation for many subsequent studies on the causes of the MIT and the strategies needed to achieve high-income status.

ADB Framework

The Asian Development Bank (ADB) expanded the framework proposed by Gill and Kharas by presenting the MIT as a multidimensional challenge. According to the ADB, countries can escape the MIT by upgrading their industries, improving technological capability, and responding effectively to demographic changes such as population ageing and urbanization (Felipe, Abdon, & Kumar, 2020). The framework also identifies structural, institutional, and policy-related factors as the main barriers to economic progress. To achieve high-income status, middle-income countries need to strengthen human capital, promote high value-added industries, and increase investment in research, innovation, and technology. Unlike earlier frameworks that focus mainly on economic growth, the ADB model also considers the influence of social and demographic changes on long-term development, providing a more comprehensive understanding of the MIT.

Eichengreen, Park & Shin (2011, 2013)

Eichengreen, Park, and Shin (2013) examined economic growth patterns in a large sample of countries and found that growth tends to slow when economies reach middle-income levels, particularly at GDP per capita around USD 10000-15000. They suggest that countries can avoid this slowdown by improving productivity through innovation, technological progress, and structural reforms. Their findings provide empirical support for the MIT concept and demonstrate that growth slowdowns are a common challenge among middle-income economies across different regions.

Rodrik's Structural Change Model

Rodrik (2014) argues that escaping the MIT requires structural transformation that increases productivity and supports long-term economic growth. He introduced the concept of premature deindustrialization, where developing countries experience a decline in manufacturing before reaching advanced levels of development. This reduces their ability to gain the productivity benefits typically generated by the manufacturing sector. Rodrik further highlights the importance of strong institutions, export diversification, and a shift toward high-productivity industries. According to his framework, countries that fail to diversify their economies and maintain a competitive manufacturing sector are more likely to remain trapped in middle-income status.

Comparative Frameworks: Latin America vs East Asia

Comparative studies of East Asian and Latin America show that countries have taken different paths in responding to the MIT. East Asian economies, such as South Korea and Taiwan, successfully achieved high-income status by promoting export-oriented industrialization, investing in research and development., and implementing consistent government policies (Paus, 2017). These strategies helped strengthen innovation and improve global competitiveness. In contrast, many Latin American countries, including Brazil and Mexico, continued to rely heavily on commodity exports and natural resources, with less emphasis on productivity improvement and economic diversification (Doner & Schneider, 2016). As a result, they experienced slower and more unstable economic growth and were more vulnerable to external economic shocks. These different experiences suggest that although the MIT is a common challenge, a country's success in overcoming it depends largely on effective policies, strong institutions, and its ability to diversify and upgrade the economy.

Key Components of the Mit Conceptual Framework

The Middle-Income Trap (MIT) is widely recognized as a multi-dimensional challenge that cannot be addressed through singular policy interventions. Scholars have identified several key components that shape a country's ability to either remain in or escape the trap, highlighting the complex interplay between economic structure, innovation, human capital, governance, and social inclusivity.

Structural Transformation

Structural transformation is widely recognized as a key factor in helping countries escape the MIT. It requires a shift from low-productivity sectors, such as agriculture and basic manufacturing to high-productivity industries and knowledge-based service. Rodrik (2014) argues that middle-income countries must diversify into higher value-added industries to remain competitive in the global economy. Without this shift, economic growth may slow as the benefits of low-cost labor decline. The experience of many Latin American countries shows that reliance on commodity exports can limit innovation and economic diversification (Doner & Schneider, 2016). In contrast, East Asian economies, particularly South Korea, successfully upgraded their industrial structure, which supported their transition to high-income status.

Innovation and Technological Capability

Innovation and technological capability play a critical role in helping countries overcome the MIT. Although many middle-income economies successfully adopt foreign technologies, they often struggle to develop their own innovations, limiting their long-term competitiveness. Lee (2022) argues that strengthening national innovation systems through greater investment in R&D, closer university-industry collaboration, and support for technology-intensive firms is essential for sustained growth. Weak technological capability also limits a country's ability to move into higher value-added industries and participate more effectively in the global value chain. Likewise, the ADB (Felipe, Abdon, & Kumar, 2020) emphasizes that developing domestic technological capabilities, rather than relying heavily on imported technologies, is crucial for building a more resilient and competitive economy.

Human Capital Development

Human capital development is an important factor in helping countries escape the MIT. Quality education and adaptable skills are essential for improving productivity, encouraging innovation, and supporting economic transformation. Despite improvements in educational access, many middle-income countries continue to face skills mismatches, where graduates' knowledge and skills do not meet labour market requirements, particularly in STEM-related fields. UNESCAP (2022) emphasizes the importance of investing in TVET, lifelong learning, and digital literacy to develop a workforce that meets the needs of future industries. Without stronger alignment between education and labour market demand, countries are likely to experience low productivity, underemployment, and high youth unemployment, which can slow economic progress and increase the risk of remaining in the MIT.

The quality of education and the adaptability of skills are crucial for enabling innovation, entrepreneurship, and economic transformation. While access to basic education has improved in many middle-income countries, challenges persist in ensuring that skills match labor market demands, particularly in science, technology, engineering, and mathematics (STEM) fields. According to UNESCAP (2022), investment in technical and vocational education and training (TVET), lifelong learning, and digital literacy are necessary to prepare the workforce for future industries. A mismatch between educational output and employment needs often leads to underemployment, low productivity, and rising youth unemployment—factors that perpetuate the MIT.

Institutional Quality and Governance

Strong institutions and good governance are essential for supporting economic reforms and attracting investment. Many countries trapped in the MIT face challenges such as inefficient bureaucracy, inconsistent

policies, and weak legal systems, which reduce innovation discourage entrepreneurship and slow the implementation of long-term development plans (Doner & Schneider, 2016; Eichengreen, Park, & Shin, 2013). Effective governance involves more than administrative efficiency. It also requires clear policies, long-term planning and strong anti-corruption measures. The success of Singapore and South Korea in escaping the MIT shows that well-functioning and adaptbale institutions play an important role in coordinating economic and social policies to achieve sustainable growth (Gill & Karas, 2007).

Demographic Dynamics and Inequality

Many middle-income countries are facing ageing populations, lower fertility rates, and a growing number of older people, which increase government spending and reduce the size of the workforce (OECD, 2023). At the same time high levels of income and regional inequality can reduce social mobility, weaken domestic demand, and create social and political challenges. Therefore, countries need inclusive development policies that promote equal opportunities, gender equality, and social protection to ensure that the benefits of economic growth are shared by all (UNESCAP, 2022). Without addressing these demographic and social issues, reforms aimed at improving productivity and innovation may not achieve sustainable and inclusive economic growth.

Critical Gaps in the Literature

Despite the growing body of research on the MIT, several gaps remain in the existing literature. Most studies identify the MIT using GDP per capita thresholds, making income the primary measure of development. Although this approach is useful for comparing countries, it pays less attention to qualitative factors such as innovation, institutional quality, and social inclusion, which also influence a country's ability to achieve high-income status (Eichengreen, Park, & Shin, 2013; Felipe, Abdon, & Kumar, 2020). Therefore, a broader framework that combines both economic and structural factors is needed to better explain why some countries remain trapped while others successfully progress to high-income economies.

Another limitation of the existing literature is its limited focus on political economy factors. Most MIT studies emphasize economic policies and structural reforms while giving less attention to the political and institutional conditions that shape policy implementation. Political interest, weak governance, and fragmented political systems can reduce the effectiveness of reform efforts. Doner and Schneider (2016) suggest that political constraints, such as patronage networks and unstable coalitions, often delay productivity-enhancing reforms despite favourable economic conditions. This indicates that successful strategies for escaping the MIT require not only sound economic policies but also strong political commitment and effective governance.

Existing MIT frameworks also pay limited attention to environmental sustainability and the digital economy, despite their growing importance in economic transformation. Environmental issues, including climate change and resource depletion, can reduce long-term growth, particularly in resource-dependent economies. Meanwhile, digital technologies offer opportunities to increase productivity, encourage innovation, and accelerate development, but they also require countries to strengthen digital infrastructure and capabilities (UNESCAP, 2022). Therefore, future MIT frameworks should integrate environmental sustainability and digital transformation as essential components of long-term development rather than treating them as supporting factors.

Another gap in the MIT literature is the limited consideration of Islamic economic priciples and regional development approaches, particularly in countries such as Malaysia. Islamic institutions, including zakat and waqf, can support income redistribution, social welfare and inclusive economic development. However, most existing MIT frameworks are based mainly on conventional development approaches and give less attention to the influence of local values and institutions (Kuran, 2018). Incorporating Islamic economic principles, such as equity, social responsibility, and risk-sharing, may provide additional perspectives for developing more inclusive and locally relevant strategies to address the MIT.

Overall, these gaps suggest that the MIT should be examined through a broader and more context-sensitive framework. Future frameworks should move beyond income-based measures and traditional economic factors

by incorporating political economy, environmental sustainability, digital transformation, and region-specific institutional factors. Such an integrated approach could provide a more comprehensive understanding of why countries experience the MIT and help develop policies that better reflect their different economic, social, and institutional conditions.

IMPLICATIONS FOR POLICY AND FUTURE RESEARCH

The growing understanding of the MIT highlights the need for a more comprehensive and interdisciplinary framework to guide future research and policy development. Traditional approaches mainly focus on economic factors such as GDP per capita, productivity growth, and industrial upgrading. However, these factors alone cannot fully explain why some middle-income countries experience long-term economic stagnation. A broader approach should therefore consider political, social, technological, environmental, and cultural factors that also influence economic development (Felipe, Abdon, & Kumar, 2020; Rodrik, 2014). Integrating these dimensions can provide a better understanding of the different challenges faces by middle-income countries, including week governance, climate-related risks, demographic changes, and technological transformation.

Another important policy implication is the need to adapt the MIT framework to different regional contexts, as countries face different development challenges. For example, ASEAN countries such as Malaysia and Thailand commonly face issues related to productivity and innovation, while Sub-Saharan African countries may experience greater challenges in infrastructure, population growth, and governance (UNESCAP, 2022; Lee, 2022). Therefore, a single approach may not be suitable for all middle-income countries because their economic, social, cultural, and institutional conditions differ. Region-specific frameworks are needed to develop policies that better reflect the particular challenges and opportunities of each country or region.

Future research should also give greater attention to adaptive governance, environmental sustainability, and social development. Governments need strong institutions as well as the ability to respond effectively to changing domestic and global economic conditions. Environmental sustainability is increasingly important, particularly for economies that depend heavily on natural resources and are vulnerable to climate-related risks (OECD, 2023). At the same time, economic policies should be supported by social policies that address inequality, access to quality education, and social well-being (Doner & Schneider, 2016). Integrating these areas into the MIT framework can support economic transformation that is more inclusive, sustainable, and resilient. Future research should therefore examine how these factors interact and contribute to a country's ability to move form middle-income to high-income status.

CONCLUSION

This paper reviewed the main concepts and frameworks of the MIT and identified several keys factors that influence a country's transition from middle- to high-income status. The literature highlights structural transformation, innovation and technological capability, human capital development, institutional quality and demographic and social conditions as important elements in overcoming the MIT. However, existing frameworks often focus strongly on income and productivity while giving less attention to political economy, digital transformation, environmental sustainability, social inclusion and regional differences. Therefore, a more comprehensive and context-sensitive framework is needed to better explain the different development experiences of middle-income countries.

Future research should focus on developing and empirically testing integrated MIT frameworks across different countries and regions. These frameworks should examine how structural transformation, innovation, human capital, governance, digitalization, sustainability and social inclusion interact in influencing a country's development path. Comparative studies across regions such as ASEAN, Latin America, and Africa could provide a better understanding of how the causes and solutions of the MIT differ according to economic and institutional conditions. Such research can strengthen the theoretical understanding of the MIT and provide more practical and locally relevant policy strategies from middle-income countries seeking to achieve sustainable and inclusive high-income development.

It is suggested that in order to exit the MIT, the country must encourage the transition from assembly and low-cost manufacturing to high-value-added industries through targeted R@D funding and university – industry research partnership.

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