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SUBJECT: What do Brazil, Thailand, Mexico, Turkey, and South Africa have in common? They're all so-called middle income countries, but they seem to be stuck with that label. Since the mid 2000s economists have been paying increasing attention to this category and what's now known as the middle income trap, especially in Southeast Asia and Latin America.

With globalization and open markets, we just assume that all middle income countries are going to become high income countries. Richard Doner from Emory University, Ben Ross Schneider from MIT, and the Watson Institute's Richard Snyder, all of them political scientists, are here today to look at divisions in societies that undermine this push toward development.

INTERVIEWER: Well, it's a pleasure to have both of you back here at the Watson Institute with us, Ben and Rick. And I just wanted to ask, could you tell us what is the middle income trap and why is it something we should be concerned about? Ben, would you like to take a shot at that?

BEN ROSS SCHNEIDER: Sure. The term actually-- I guess they celebrated the 10 year anniversary this year. It came-- some economists at the World Bank used it in late 2000s. And it derives from, I mean, basically the World Bank started to classify countries as low income, middle income, and high income. And then some econometricians started looking at the data for middle income countries and noted that not many of them were graduating or moving up into high income. Therefore, they were stuck in some kind of trap.

INTERVIEWER: And why is that something that we should be concerned about?

BEN ROSS SCHNEIDER: I think it goes against the basic idea that many people have and many economists have that all countries can grow to high income, and that with globalization, open markets, movement of capital we should eventually see a convergence of all countries towards high income. So the shock was to discover the basic number that is useful is to look at 101 middle income countries in 1960. Of those 101, only 13 by 2008 were high income. So the rest are stuck in the trap.

INTERVIEWER: Rick, would you like to add to that?

RICHARD DONER: Sure. And Ben's point about the assumption about convergence, I mean, this has been a very prominent theme in the development literature. In the late '90s and early 2000s, one prominent development economist came out with an article saying divergence, entitled, "Divergence Big Time," that this wasn't happening. So that went against expectations, that basically technologies in the world, all you have to do is downloaded essentially, and everybody can-- lesser developed countries can grow more quickly than the developed countries.

The other reason that it's important or one reason it's important is the assumption that if you don't grow, if there's stagnation, that can have important political repercussions.

INTERVIEWER: For example?

RICHARD DONER: For example, as the rise of populism, the rise of clientelism, and an inability, essentially, to sustain and provide for the public welfare.

BEN ROSS SCHNEIDER: I think we should add here that some economists particularly associate with the IMF and the World Bank sort of discovered and first started analyzing the middle income trap. But it's not a complete consensus across economists. Some of them dispute the actual existence of this trap and say there-- if you run the numbers differently, you don't find the same kind of growth slowdown.

That said, I think it's important to look at these countries as a group and consider what are the challenges that they face if they're going to try to make this leap to high income.

INTERVIEWER: What countries are we talking about here? Let's put some names out here. I think you've mentioned Brazil, Mexico, Thailand. What are some of the other countries that you classify as being in the middle income trap?

BEN ROSS SCHNEIDER: The ones we look at in our research are sort of the nine largest, which are Argentina, Brazil, Mexico, Colombia, Peru.

RICHARD DONER: And Peru, right. So it's five there, and then Thailand and Malaysia, Turkey, and--

BEN ROSS SCHNEIDER: South Africa.

RICHARD DONER: And South Africa.

BEN ROSS SCHNEIDER: And those are the ones that account for two thirds of the people living in countries in the

SCHNEIDER: middle income trap. But beyond that, there are a total of 53 countries in upper middle income by the World Bank.

INTERVIEWER: But these are not all of the so-called BRIC countries, Brazil, Russia, India, China. Only Brazil would be in the category of middle income trap, is that correct?

RICHARD DONER: And if you include South Africa in a BRIC.

INTERVIEWER: The BRIC South Africa.

RICHARD DONER: Right.

INTERVIEWER: Or the [INAUDIBLE], which was another formulation. Remember that?

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So both of you are political scientists, and you you've mentioned economists a number of times. And my question is as political scientists, what do political scientists have to contribute to this debate? What is it that the economists, in your opinion, are missing? And why do we need political scientists thinking about this problem?

RICHARD DONER: I think that the key thing is that political scientists typically have perhaps a comparative advantage in looking at the origins of institutions. And so that's, in some ways, where economists stop. And so we were inspired to address this because there was-- the economists typically said, oh, there needs to be political will. You need to have consensus. But they never grappled with a question of where political will came from, where would a consensus come from.

And so that was the kind of launching point for us to try to engage that question and to look at some of the divisions within society that would undermine broad coalitions that would encourage the growth of these institutions.

BEN ROSS SCHNEIDER: Yeah, because we looked at the recommendations of economists writing on the middle income trap, and they would all mention things like, you need to invest in human capital, in innovation, in R&D, in a good judicial and legal system, in financial intermediation. And you know, the list went on. But at the top of the list were always pretty much the same human capital and innovation.

And so we started to think, well, if there is such a consensus there, then why don't countries just grab this consensus and run with it? So we started-- well, are there obstacles to really improving education and innovation? And that's where we got into looking at these countries more closely to see what were the obstacles.

INTERVIEWER: So what are the obstacles, and how do countries surmount them possibly? Why did they get stuck and how do they get out?

RICHARD DONER: Let me emphasize here that I think a little bit more than in Latin American countries, but you go round to Thailand, Malaysia, China, this is an issue that people grapple with publicly. And so it's on the radar. It's very much on the radar. And so this came out as a puzzle for us. And for me, one of the things that helped me think through this is looking at Ben's earlier work on the kinds of institutions that exist in Latin American countries and thinking how does that relate to the kinds of puzzles that we're dealing with.

And one of the things I think that it pointed to was divisions within society. So the argument, our core argument is that there are divisions within business, within society, and within labor that undermines some kind of broad push for the kinds of policies and institutions that the economists say we need.

INTERVIEWER: So you both bring very different regional expertise to the table. So Ben is a Latin Americanist primarily, although you've done work on other regions. And Rick, your focus has been Southeast Asia. And what I've heard Rick just say is that combining different kinds of area expertise to get a cross-regional view of a problem proved fruitful. Could you say something about that, Ben?

BEN ROSS SCHNEIDER: No, exactly. We started talking about this and relating it to various studies we've seen in our respective regions and discovering a great deal of commonality across those regions. So in a way, the middle income debate sort of forces you to think beyond just regions and to think, you know, what could be common across countries in these different regions that would give them the same problems to sort of surmounting the obstacles to get to high income.

RICHARD DONER: So informality is a big question. The nature of domestic big business groups, diversified groups that are maybe in natural resources and autos and motorcycles and textiles. Why would they invest in skills or research and development if they are simply leveraging different-- if they are speculating and playing essentially a cheap labor game in different sectors? There's not a lot of effort to develop core competence in a particular area.

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INTERVIEWER: So if you have to boil it down to a set of actionable pieces of policy advice, you were advising a country that seems to be stuck in the middle income trap, what would you advise that country to do? What policies and recommendations would your research suggest should be implemented?

BEN ROSS SCHNEIDER: Build long-term coalitions. I think part of what we saw in the beginning was the-- as I mentioned, the long series of policy recommendations that came from the economists, so that the policies, I don't think are really a point of contention. So governments know what those are and can act on them. But what we think they need to do more importantly is to find the kinds of coalitions with potential business partners with groups and labor, other groups in society that could sustain long-term investment in the institutions required to produce human capital innovation.

INTERVIEWER: Those institutions are educational institutions primarily? What kind of institutions are we talking about here?

RICHARD DONER: Both-- I mean they're education institutions, they're research, and I mean, and then there are institutions that focus more on research and development, and then there are institutions that straddle those different kinds of activities. So there are a lot of institutions that do both. For example, standards. How do you get local firms to be able to meet production and process standards at global standards? You can build presumably a coalition through that by building these kinds of institutions.

So part of it is A, looking at trying to build out learning lessons from successes in particular sectors that may not dominate an economy, or looking at particular groups of firms.

INTERVIEWER: Are there any successful cases that stand out in both of your minds as models of how to do this?

BEN ROSS SCHNEIDER: But first, I want to emphasize this point about the long term and the issue of building institutions and organizations, because if you take something like R&D spending, which are the nine largest middle income countries is one third of our R&D spending in the rich countries. So there's a lot to do to increase that investment. But you say, when I want to increase investment, it's not a question just of spending more money, because spending more on R&D

means that you're hiring more people to work in the labs, technicians to work on research. So you have to train those people. So that requires the whole educational system behind it.

RICHARD DONER: I mean, I always come back to looking at medium sized domestic firms who are scared for their existence and who have political heft more broadly and building work and building institutions that basically reward them. And we see this in a number of different areas. I've looked at rubber producers in Malaya and electronics producers in different parts.

There are puzzles along these lines. You know, how did Brazil develop an avionics industry?

BEN ROSS SCHNEIDER: It goes to the more general point is that what we see is we don't see yet the kinds of coalitions in middle income countries at a national level that would really make this big push to create the institutions. But we do see more sectoral and local successes, so the sectors like aviation or the whole sugar cane complex in Brazil, the soy production there, wine in Argentina.

INTERVIEWER: So breaking open countries and disaggregating them into regions, sectors, and thinking about them inside countries seems to be a useful way to think about this, about the middle income dilemma.

BEN ROSS SCHNEIDER: Precisely.

INTERVIEWER: What are some examples of successful sectors? You mentioned some, the wine region of Argentina, rubber in Malaysia. Some others and what makes them--

RICHARD DONER: There's electronics in Malaysia in certain parts of Malaysia. There is also, as I've looked more deeply, there are-- in Southeast Asia, certain countries have fairly good petrochemical industries, where it is important-- the petrochemical industry is important for broad national revenues, and they recognize that they have to be somewhat autonomous, and they've invested more than I would have thought in sector specific training institutions.

BEN ROSS SCHNEIDER: I mean, you could include Peruvian cuisine on the list. But more generally, you could put a lot of smaller and medium sized manufacturing firms in Turkey. We've seen--

INTERVIEWER: Making what kinds of items?

BEN ROSS SCHNEIDER: A lot of it just basic products, nothing very high tech, and a lot of it sort of for export to the European Union.

INTERVIEWER: So I asked you what policy recommendations you would be able to offer a country. What about in the middle income trap? What kinds of policy recommendations could you offer to multilateral organizations, like the World Bank or the Inter-American Development Bank, and also to the US government for foreign policy, if this is an issue that US foreign policy should be concerned about. Is there anything that US policy, as well as multilateral development institution policy can do to help nudge countries out of the middle income trap?

RICHARD DONER: As I've been thinking about this, and you and I've never talked about this, but you know there is an area where external actors really are investing in training. And it turns out it's Japanese aid organizations. As I've thought back on this, they have been heavily engaged in training in things like mold and die and things like that. And the question is why? And part of it is the need to make sure that their skilled manpower personnel for Japanese firms who are moving--

INTERVIEWER: Moving--

RICHARD DONER: To Southeast Asia, who are moving out, whose owners have died or getting old, and they want to move this stuff. And the Japanese are very aware that if you're going to have an assembly firm, you need to have good suppliers. You're going to have good suppliers. And so organizations like JETRO have really been engaged in this, much more I think than the Americans.

BEN ROSS SCHNEIDER: Yeah, I mean, I think-- I mean, I think there are two things that multilaterals and other foreign governments can do. I would not recommend that they get involved in coalition building. And I don't think that's promising. But I think that they can get involved on one side, you know, making-- bringing this analysis and debate to the fore, so they can-- now, particularly, World Bank and other regional development banks invest a great deal in research and have a lot of influence through that. Then short of that, they can watch for promising policy experiments in their countries and then support them as they arise.

INTERVIEWER: Well, you've been with us today at the Watson Institute, here at Brown University. My last question is what have you learned about your own project from your visit?

RICHARD DONER: There are a number of questions that came up for me that I thought were really useful. One is what's the difference between building a coalition for mass primary and secondary education and for more technical education? How do those two differ? That's one issue. A second issue that was raised is to what degree is this just a case of regulatory capture, and seems to me that story is consistent with what we are talking about.

INTERVIEWER: What does regulatory capture mean briefly?

RICHARD DONER: Essentially that private interests are able to control for their own reasons, for their own purposes and interests, the public sector agencies that are essentially-- it's essentially a kind of fox in the hen house or something kind of argument.

BEN ROSS SCHNEIDER: I mean, for me the discussion was very useful at the seminar, two things in particular that I think will keep us thinking for a while. One is we say you have to bring politics back into the analysis. But we haven't gone as far as you can with that, in particular looking at things like how do parties form coalitions, how do they generate programs that might be able to address some of the issues we see as obstacles in the way of middle income countries.

And then the second thing was to think more generally about inequality, because in all of these middle income countries, inequality is just very high, among the highest in the world. So that should, we think, have some consequence, mostly negative on politics and on coalition building. But there's still much more to do to figure out exactly how inequality affects politics in middle income countries.

INTERVIEWER: Terrific. Well, thank you very much, Ben Schneider and Rick Doner for being with us today.

RICHARD DONER: Thanks for having us.

BEN ROSS SCHNEIDER: Thank you.

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