



Trapped In The Semi-Periphery

Understanding The Middle-Income Trap From a World-Systems Theory Perspective

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Abstract

This paper attempts to explain the middle-income trap from the lens of an amended world-systems theory, in which capitalists within the semi-periphery are taken into account. It rejects that developing countries should pursue an import-substitution industrialization strategy, and instead argues developing countries should pursue a strategy similar to South Korea's. An export-oriented industrialization strategy, with tight limits on foreign direct investment (FDI) and multinational corporations (MNCs) operating within the economy, building up state capacity in order to form a close collaborative, not corrupting relationship between private businesses and the state, and calls for heavy investments in human capital and industrial upgrading. This would ensure that surplus value does not leave the country nor does it lay idle in the hands of domestic capitalists. It also calls for changes to the global economic governance regime, such as common rules for FDI and taxes on MNCs, on the part of developing countries in order to create a more development friendly international economic system.

Keywords: Middle-Income Trap, World-Systems Theory, Developmental State, Foreign Direct Investment, Global Economic Governance Regime



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Since 1960, there have only been a handful of economies, 13 as of 2008, that have been able to cross over into the high-income group, although the number has exceeded 13 since this report (The World Bank and Development Research Center of the State Council, the People's Republic of China 2013). While there has only been a few to cross over into the realm of high-income, there have been a whole host of countries that have been stagnating in terms of GDP per capita. This phenomenon has been dubbed the “middle-income trap,” a term first introduced by Indermit S. Gill and Homi Kharas (World Bank Group 2007). Since its conception, it has gotten a notable amount of attention. According to the World Bank, as of 2015, Google Scholar has over 3,000 papers with the term and about 300 with the term in its title (Gill and Kharas 2015).

As one of the leading political economy theories attempting to explain development and underdevelopment, world-systems theory has been used to explain why some countries fail to develop. It seems as a natural fit to explain the middle-income trap, yet unfortunately, aside from Fang and Zeng (2014), scholars have thus far failed to tie the two together. This paper seeks to do as such. This paper will attempt to explain the middle-income trap using world-systems theory as a theoretical framework. To do this, I will attempt to amend world-systems theory by adding capitalist within middle income countries, as doing so should enrich world-systems theory to a degree that enables it to offer a satisfactory explanation to the middle-income trap. After that, this paper will turn to Mexico and South Korea as a case study of this “amended” world-systems theory. It will close with proposed changes to the global economic governance regime, in order to make it more development friendly and suggests countries to increase their own state capacity.

The Middle-Income Trap

As discussed above, the middle-income trap is a term that is over 15 years old. To define it, a country that is in the low middle-income range for 28 years, high middle-income range for 14 years, or middle-income (MI) range in general for 42 years is labeled as “trapped” (Felipe et al. 2021). Most of the scholarship looking at the middle-income trap comes from economics, yet some political economy and political science scholars have offered their own take on it (Fang and Zeng 2014; Doner and Schneider 2016; Wang 2016; Kang and Paus 2019; Paus 2020).

Doner and Schneider (2016) take a rather interesting look at the middle-income trap coming from political science. They state that the economic impediments leading to the middle-income trap mostly come from productivity slow downs as they “exhaust the gains from moving into MI status.” MI countries, on the aggregate, grow slower than low-income (LI) and high-income (HI) ones, as they can no longer compete with LI countries in low value added industries (since their wages are too high) and HI countries in high-value added industries (as they are not technologically advanced enough yet).

Doner and Schneider's main argument is that the middle-income trap has more to do with politics than economics. To upgrade industries and make improvements in human capital, a country needs more and better education (especially higher and technical), greater savings and better investment, better infrastructure, more innovation, more R&D spending, and industrial

policy.¹ To pursue these policies, a state needs better institutions, yet there are social cleavages that exist in MI countries that make the coalition building for these institutional upgrades very difficult. These cleavages include economic inequality, informal workers versus formal workers, and home-grown businesses versus multinational corporations (MNCs). They warn against too much foreign direct investment (FDI). MNCs do not have vested interests in upgrading the host countries institutions or industries and most of their R&D spending is in their home country. MNCs are most interested in profiting from developing countries' resources, such as cheap labor, and taking benefits back to their home country, trapping the host country in their place in the global supply chain.

To make matters worse, today's MI countries have a much tougher task advancing towards HI status when compared to already developed countries. Their education levels have to exceed those of the already developed countries when they were developing (Doner and Schneider 2016). This is because the industries of yesterday's MI countries were much more simple, requiring a less advanced workforce, infrastructure, and so on. Also the introduction of China in the global economy has made it more difficult. China's domination of global manufacturing has increased competition and placed pressure onto MI countries to develop and innovate faster and faster. Paus (2020) dubs this new challenge the "Red Queen Effect."² Just as the Red Queen must run faster and faster in order to stay in the same place, MI countries must move towards innovation-led growth more quickly in order to stay in the same place. Though Paus does note there are more factors than just China causing the Red Queen effect, yet China plays an outsized role.

Where a majority (but not all) of the political economy scholarship looking at the middle-income trap falls short, is that they overweigh domestic factors, and undervalue international factors (Ohno 2009; Doner and Schneider 2016; Wang 2016). While domestic factors are critical and should not be taken for granted, viewing the middle-income trap through the lens of world-systems theory should add more clarity to this issue, rendering a fuller picture.

Explaining the Middle-Income Trap from a World-Systems Theory Perspective

Building on theories from Hobson (1907), Lenin (1917), and Presbich (1950), American sociologist Immanuel Maurice Wallerstein published *The Modern World-System, Vol. I: Capitalist Agriculture and the Origins of the European World-Economy in the Sixteenth Century* (1975). His work laid out world-systems theory, which divides the world into three sections: the core (or the center), the semi-periphery, and the periphery. The core consists of developed countries, while the periphery and semi-periphery are made up by underdeveloped countries. Through exploitation, core countries became rich and the periphery became dependent. Semi-periphery countries are still

¹ Doner and Schneider (2016) listed these as areas of agreement of economists that sought to make suggestions for country to avoid the middle income trap. Yet they note that industrial policy is one area that is rather controversial.

² The Red Queen is a character in the Disney movie *Alice In Wonderland*.

being exploited by the core countries, yet not to the same extent as the periphery proper, and they are also exploiting the periphery countries, yet not to the same extent as the core countries.

The crux of the argument world-systems theory lays out is that because of the global division of labor that global capitalism brings, countries far down the supply chain cannot advance from the periphery (and semi-periphery) to the core. Industries in the periphery and semi-periphery create “peripheral-like products” while industries in the core create “core-like products.” This puts core countries and core-like products in a much stronger position relative to countries in the periphery and semi-periphery and industries that make peripheral-like products. This is because the industries in the periphery are much more competitive when compared to industries in the core, since there is a much smaller amount of countries that can compete in core industries, which can be labeled as “quasi-monopolised” (Zeng and Fang 2014). There are very few companies and countries that can design high-quality smartphones, semi conductors, and so on, yet there are many companies and countries that can produce shirts, agriculture goods, simple light-manufacturing goods, and so on. This allows core countries to make a large amount of profit from their economic activities, while countries in the periphery and semi-periphery make very little profit from their economic activities. When core countries trade with peripheral or semi-peripheral countries, they are able to extract much more profits out of their products due to the lack of competition. It also makes them dependent on products from the core, as peripheral or semi-peripheral countries need both finished products from the core (for consumption) and high-tech capital and intermediate goods from the core (for production). This leads to surplus value flowing from the peripheral and semi-peripheral countries to the core.

Not only does trade between the core, periphery, and semi-periphery create conditions that make development difficult (if not near impossible), yet FDI also creates barriers to development. When MNCs go from the core into the periphery and semi-periphery, they do it to reduce costs. MNCs use the periphery and semi-periphery for cheap labor and natural resources. As Doner and Schneider (2016) show, this creates domestic political problems that lead to economic problems, yet it also causes some direct economic problems in two interconnected ways; first, the lack of research and development (R&D) spending on the part of MNCs in the host country and second, surplus value flows from the periphery and semi-periphery to the core through the exploitation of the local labor force. The first is that MNCs do not spend a significant amount of money on R&D in the host country, as they mostly save those types of investments for their home countries (Doner and Schneider 2016). Additionally, there is evidence that FDI inflows and indigenous R&D spending are negatively correlated within the developing world (Anastasi 2022; Azman-Saini et al. 2018). This makes industrial upgrading quite difficult, as R&D spending is quite important to developing new industrial capabilities. The second is that these MNCs go into the periphery and semi-periphery to save costs and maximize profits, meaning that workers are paid lower wages when compared to the same job in the MNC’s home country. MNCs can out bid local firms for workers, yet they are far from fully compensated for their labor. This allows surplus value to flow from the periphery and semi-periphery into the core. With surplus value escaping the developing world, they cannot use the profits of their labor and resources to reinvest in R&D spending, raising

human capital, upgrading infrastructure etc etc. making further development and industrial upgrading very difficult.

The Semi-Periphery Trap

World-systems theory helps explain why some countries suffer from underdevelopment, when used to explain the middle-income trap, the two are quite complementary. As discussed above, LI countries can grow to become MI countries by using their comparative advantage of having an abundance of cheap labor, yet once their wages rise to a certain point, they lose this comparative advantage. After losing this comparative advantage, they must have companies able to move up the international division of labor and innovate and compete in core-like industries. This is obviously not an easy task. As stated above, countries need investments in areas such as R&D, human capital, infrastructure, education, and more in order to advance towards HI status. Looking at the middle-income trap from a world-systems theory perspective, the explanation can be summed up in one sentence; due to the nature of the global economy, middle-income countries that fully involve themselves in the global economy cannot hold on to enough of their surplus value in order to make the investments needed to advance towards high-income status.

There has been relatively little scholarship published on the “low-income trap” (Federal Reserve Bank of St. Louis 2015). Consequently, this is because fewer countries get caught in the “low income trap” (The World Bank and Development Research Center of the State Council, the People’s Republic of China 2013). Through the lens of world-systems theory, we can explain why countries can advance from LI to MI status, yet have a much harder time moving from MI to HI status. This is because having countries move from LI to MI status suits the needs of the global capitalist elites. LI countries’ economies are dominated by agriculture. Introducing light-manufacturing and export growth usually helps grow the economy to MI status. Some of the investments needed to make the transitions to MI from LI relate towards ensuring the products can make it to the market. After these investments are made, core countries and companies are able to use said developing country as a base to produce cheap manufactured goods by exploiting the local labor force. These are easier investments to make when compared to the investments needed to make an economy innovative enough to advance from MI to HI status, and they have the support from international institutions such as the World Bank. Though support for the investments needed by high MI countries to advance toward HI status does not exist to the same degree (Independent Evaluation Group 2017). Obviously, those investments are much more expensive and harder to execute, needing stronger, more complex institutions to carry them out (Doner and Schneider 2016). Though if high MI countries could make these investments and are able to produce innovative companies that could compete with HI countries’ companies, core countries’ products could lose their quasi-monopolised status, making them less profitable (Zeng and Fang 2014). In short, if developing countries move from LI to MI status, this suits the wishes of the global capitalist elites, yet moving from MI to HI status goes against their wishes.

If most MI countries had the ability to make these investments, the global capitalist elites would be against it, yet most do not have this ability. This is because of the nature of their economic

activities. We can see this in the difference in profits between manufacturing Apple products and designing them. For example, as of 2012, Foxconn, a manufacturer of Apple products operating in mainland China, has a profit margin of 1.5 percent, while Apple's operating margin is more than 30 percent (Culpan 2012). Though as of 2020, Apple's profit margins have rose to over 40 percent, and while Foxconn's profit margins have increased since 2012, it remains in the single digits as of 2020 (Ma 2020). These profits allow Apple to continue to innovate and have a leg up over their competition, yet it leaves relatively little profit for Foxconn. In order to keep Apple as a client, Foxconn must keep its cost low, making their wages and working conditions inside of mainland China unheard of in the developed world (Condliffe 2018).

Despite playing an important role in the economy, the Mexican auto-making industry primarily focuses on the low-value adding parts of the production process, while the high-value adding parts of the production process are done outside of the country. The auto-making industry in Mexico is currently dominated by MNCs (Audi, Baic Group, BMW, Stellantis, Ford, General Motors, Honda, Kia, Mazda, Nissan, Toyota, and Volkswagen) using their cheap labor to complete cars or make parts, and then sell them elsewhere (ITA 2021). Eighty percent of all cars made in Mexico are exported to the United States, nine percent are exported elsewhere in the world, and 11 percent are for domestic consumption (ITA 2021). U.S. companies design car models in the United States, build them in Mexico, and then sell them in the United States, leaving very little profit in Mexico.

While the system is stacked against countries from advancing towards HI status, as is observed in a handful of cases, it is possible. To put it abstractly, advancing towards high-income status requires a different type of relationship between the state and capitalism. Some historical materialists, such as the creator of dependency theory, Raul Prebisch (1959), argue that a state must cut itself off from global capitalism and pursue an import substitution industrialization (ISI) strategy in order to develop. This should be rejected, as the internal contradictions of the ISI strategy of needing to import capital and intermediary goods, while having no clear strategy of acquiring foreign currency, led to the Latin American debt crisis. To showcase this failure and to amend world-systems theory to accurately reflect the realities of the middle-income trap and the global economy at large, the next section will compare South Korea to Mexico, and then introduce an updated world-systems theory.

Case Study

Mexico is a high MI country in the semi-periphery. Mexico meets the definition of a country trapped in the MIT laid out by Felipe and colleagues (2021). South Korea is a HI country and would be considered a core country.³ South Korea was able to advance from LI status to HI status within about a lifetime. Mexico saw robust growth for a few decades after the Second World War, yet faced tough economic problems in the late 1970s and early 1980s. Mexican leaders bought into

³ Some scholars, such as Kang (2016), would still label South Korea as a semi-peripheral country.

neoliberalism as the savior to their problems. Despite their wishes, neoliberalism trapped Mexico in the middle-income trap, and hampered further development.

The Case of Mexico

After the Mexican revolution and consolidation of political power, the Partido Revolucionario Institucional (PSI), or the Institutional Revolutionary Party, sought to industrialize the Mexican economy. It could be argued that Mexico had a developmental state under the rule of the PSI from the years of 1946 to 1982 (Knight 2019). Yet this developmental state was not as comprehensive as the ones found in Japan, Taiwan, and South Korea; and for the purposes of this paper, will be labeled as a “limited developmental state.” The state primarily relied on the private sector for development, yet was ready to act as a backstop when the private sector was unwilling or unable to act (Bennett and Sharpe 1980). The state’s primary tool to direct the economy was the Nacional Financiera (NAFIN), a public sector investment bank, which between 1950–1980 accounted for one third to one half of bank financing of industry, which created state-owned enterprises (SOEs) (Bennett and Sharpe 1980). Yet despite heavy public financing, private capital and FDI played a large role in Mexico during this time. The state pursued an ISI strategy, so businesses were offered protection with tariffs and import quotas, yet were dependent on foreign technology and sometimes, foreign investment (Soederberg 2001). Capitalist could profit, and were not disciplined to reinvest those profits into industrial upgrading. Yet growth was fast during this period, which was dubbed the “Mexican Miracle” (Aguilar Camín and Meyer 2021).

During Mexico’s limited developmental state period, workers were offered some job protection and a social security system, but only for those in the formal sector, which left out a sizable amount of the working population (Knight 2019). This coupled with low tax rates made inequality rise dramatically. From 1950 to 1960, the GINI index rose from .50 to .58 (Knight 2019). This hurt domestic demand, weakening the ISI system. Additionally, due to Mexico’s ISI strategy, concerns about the balance of trade were always present, as Mexico imported more, mostly capital goods, than it exported. This made the Mexican state fund its trade deficit from foreign, U.S. dollar denominated loans (Unger 1991). The 1970s were marked by global economic problems, such as high oil prices and the devaluation of the U.S. dollar, and domestic political problems for Mexico.

Mexico’s one-party rule was being challenged by “radical students, regional opposition movements, and insurgent trade unions” (Knight 2019). The state opted for “populist” solutions to hold onto power, dramatically expanding the state, its involvement in the economy, and its payroll (Schneider 2019). This was funded by an oil boom and foreign lending. During this time, economic growth happened faster and inequality came down, yet this growth was unsustainable. In the early 1980s, debt repayment costs soared and oil prices came down. In 1982, Mexico nationalized the banking system, which was “the last straw” for Mexico’s unruly private businesses (Kleinberg 1999). Mexico was in crisis and needed a bailout from the IMF, and with that came their neoliberal period.

Following the bailout, the IMF urged the Mexican government to “allocate resources in accordance with global market signals.” The state took measures such as re-privatizing the banks, deregulating the labor market, and liberalizing trade laws in order to try to attract foreign capital. The state moved from a “regulator” and a “competitor” to a “facilitator” (Kleinberg 1999). This dismantled the limited developmental state, exacerbated inequality, and put the state in a more subservient position to foreign capital. The state focused its attention on paying back its debts. Between 1982 and 1988, 60 percent of public spending went towards debt servicing (Laurell 2015). This coupled with trade liberalization policies, (imports rose faster than exports, 84 percent versus 247 percent between 1987 and 1993 [Soederberg 2001]), effectively was a transfer of wealth and resources from Mexico to the developed world. The Mexican economy still saw growth, yet it was much slower. It became a high MI country in 1999, yet is still classified as such more than 20 years later.

After enacting neoliberal policies, the limited amount of surplus value left in Mexico after the production process makes reinvesting in its industrial capabilities quite difficult. Cypher and Delgado (2010) argue that after the shift in their development strategy, Mexico’s development capabilities were severely damaged, as now they shifted to an export model that is based on cheap labor and attracting FDI, namely after the signing of the North American Free Trade Agreement (NAFTA).⁴ This new model has proved to be unsustainable as its ability to increase wages, promote innovation, and “incorporate national suppliers into production relationships” is almost nonexistent (Arevalo 2021). Cypher and Delgado (2010) continue to argue that this new model has greatly benefited the United States, yet has made the Mexican economy more dependent. As world-systems theory would suggest, Mexico retains low-value added parts of the production process, in which they retain a small amount of benefit, and most of the profits are retained by the United States.

As discussed below, the division of labor regarding the North American auto-making industry leaves very little profit left in Mexico, and acts as a good example for Mexico’s larger economic problems. Mexico lacks indigenous companies able to compete in the higher value adding parts of the North American auto-making industry’s production process, such as designing and marketing, instead Mexico specializes in manufacturing and assembling, which generates relatively little profit (Debrand 2014). World-systems theory can explain why Mexico has not advanced since liberalization, yet fails to explain why Mexico’s ISI strategy failed. It overlooks the damage capitalists within the country did to the economy, during its “limited-developmental state” period. Of course at that time, the economy still saw growth, yet the internal contradictions of an ISI strategy and wildly high economic inequality led to its demise. If the Mexican state had a better way of ensuring reinvestment in industrial upgrading and human capital from the profits of domestic capitalists, their economic growth should have been relatively more sustainable.

⁴ NAFTA was renegotiated and renamed the United States-Mexico-Canada Agreement (USMCA)

The Case of South Korea

After the Korean War, South Korea was one of the poorest countries in the world, yet it grew to be one of the richest within a lifetime. This is thanks to the state's ability to ensure constant reinvestment in industrial upgrading and human capital. In 1961, Major General Park Chung Hee carried out a coup and took control of the South Korean state. After taking control, Park oversaw the creation of a comprehensive developmental state, with a close working partnership with business. This partnership between the state and business created a quasi-internal organization (Kwon and Yi 2015). Park established a "super-ministry" to oversee other government agencies regarding the economy called the Economic Planning Board (EPB). The goal of development was placed above all else, and was carried out using "five-year economic development plans" (FYEDPs). Banks were nationalized, ensuring that the only supplier of capital was the state. This along with other forms of support acted as "carrots," while disciplining measures such as taxes, audits, and licensing requirements acted as "sticks." The state carried out its development goals through big businesses (small and medium sized firms, MNCs, and SOEs were excluded), which later came to be known as the *chaebols*. *Chaebols* are primary family run, as their name literally translates to "rich family." Shortly after coming into power, Park jailed all but one of the heads of South Korea's *chaebols*, showcasing the power-dynamics of this state-business relation (Kim 2015). These *chaebols* turned into huge conglomerates, with arms in many different industries, that were given very detailed directions and goals, such as growth rates, manufacturing and export volumes, and even which industries to go into.

The first FYEDP focused on transforming the agrarian economy into one focused on manufacturing using an ISI strategy. The next FYEDP turned its attention towards exports, shifting towards an Export Oriented Industrialization (EOI) strategy. The first two were great successes. The third focused on Heavy and Chemical Industries (HCIs). Despite the first two solely focusing on development, the third cited national security as a reason for getting into HCIs. Additionally, despite shying away from SOEs in the first two plans, an SOE was chosen for iron and steel production (yet the rest of the five HCIs selected were given to private businesses). The choice to nurture domestic industries was key to South Korea's sustained development (Diebold and Amsden 1990). Additionally, in 1972, South Korea went through a regime change in which many legal constraints on the state were removed and Park was allowed to rule indefinitely. With the new, Fourth Republic of Korea came a dramatic increase in its state capacity, which helped it protect and support its domestic companies more effectively and was key to getting some HCIs, such as the auto making industry, up and running (Kim and Vogel 2013).

Park was later assassinated in 1979, and President Chun soon came into power. President Chun did not have the legitimacy that President Park had, and because of this, the state did not have the same level of autonomy, meaning the state could cave from pressure more easily (Hamilton and Kim 1993). Under both domestic pressure (the *chaebols* wanted economic liberalization and students and labor wanted political liberalization) and international pressure (core countries, headed by the United States, wanted to trade with South Korea on more favorable terms), the comprehensive developmental state turned into a democratic, limited developmental

state; banks were privatized, the state started to support and regulate the economy more and lead it less, and welfare started to become a goal of the state. At this point, it did not make sense for the *chaebols* to be dependent on the state for resources, as they were mature and large enough to compete in international markets (Kim 2015). South Korea later became a HI country in 1995, and liberalized further after an IMF bailout following the 1997 Asian Financial crisis.

During South Korea's developmental state (early 1960s to the late 1970s), both business and workers benefited greatly (Campbell and Cho 2014). The government forced all workers to join a public union, where wages were suppressed, in order to supply the *chaebols* with a constant flow of cheap labor (Campbell and Cho 2014). At the same time, the government carried out labor policy through the *chaebols* by expanding employment and making it nearly impossible for them to lay off or fire workers. Job expansion and protection combined with policies to encourage high-saving rates among workers and increase their human capital created what Campbell and Cho (2014) called the "two face of government." South Korea's development state helped create inclusive development by extending "developmental citizenship" to its population (Chang 2007). This is important as Acemoglu and colleagues (2004) argue that inclusive institutions are necessary for long-term, sustained development. Also, through South Korea's developmental state, the state was able to control inequality and extended formal employment to most of its population. Though this system broke down after the IMF bailout in 1997, South Korea was a HI country at the time.

While the country did shift to more neoliberal policies after the IMF bailout, they still retained parts of their developmental state, which Lee (2019) labels *neoliberal developmentalism*. Despite becoming a HI country and moving to the core (Uttam 2019), South Korea's post-developmental state model produced slower growth and more inequality (Lee 2019), and shifted power from the state to the *chaebols*, which has undoubtedly led to corruption and poses a threat to the South Korean economy (Albert 2018). Undeterred by these flaws in their growth model, South Korea remains one of the richest and most technologically advanced countries, even becoming the first country to develop 5G (Li and Park 2019).

Doner and Schneider's (2016) argument that low levels of inequality, informal work, and FDI are needed for countries to advance towards HI status holds true in the case of South Korea. Zeng and Fang's (2014) argument also helps explain South Korea, as they competed in global capitalism, yet they did it their own way without allowing MNCs to exploit them. This allowed South Korea to continue to reinvest in its productive capacity and upgrade its industries and successfully saw the development of their economy.

Due to South Korea's tight limits on FDI and MNCs within the country, they were able to ensure their surplus value did not escape the country. Uttam (2019) credits South Korea's developmental state for moving the country from the periphery to the core. As well as ensuring surplus value did not escape the country, thanks to controls over the banking system and pressure placed on the *chaebols* to continue to venture into new industries, South Korea ensured that it did not just set idle in the hands of capitalist, it was constantly reinvested in itself. This allowed South Korea to move into the ranks of the HI countries fairly quickly.

Expanding World-Systems Theory

The comparison between Mexico and South Korea shows that in order to improve world-systems theory, we must open the “black box” and look at of the inter workings of the state. Of course some might argue that it does not or should not serve that purpose, it should just look at the interactions between states, and not the inter-workings of them. That is wrong if we wish it to be a comprehensive theory of development and underdevelopment.

As we saw above, world-systems theory helps us understand that surplus value flows from the periphery and semi-periphery into the core. Yet with an ISI strategy, that flow could be stopped, yet it would not stop surplus value from being held on to by domestic capitalists. So to expand world-systems theory to better describe the middle-income trap, it should state: *due to the nature of both domestic and global capitalism, middle-income countries have difficulties making the investments needed to advance towards high-income status, due to domestic capitalists’ tendency to hold on to surplus value and international capitalists’ tendency to extract it and bring it outside of the host country.*

This proposed new way of viewing world-systems theory can help us understand why some countries, such as Mexico, failed to advance towards HI status. Before their neoliberal turn, they followed the playbook laid out by some historical materialist scholars, pursuing an ISI strategy which led them to having minimal interaction with the global capitalist economic system. There is no argument about if Mexico saw growth during this period, yet they failed to develop into the ranks of a HI country, while South Korea succeeded too around the same time. Some questions linger, why did Mexico’s limited developmental state system break down? Why did they not develop further? To answer these questions, this paper proposes an amended world-systems theory to deal with capitalist inside of the semi-periphery.

The capitalist’s main goal is the maximization of profit. When the economy is at LI status, capital deepening is essential to furthering development, yet when at MI status growth in total factor production matters considerably more (Wang 2016). In short, when out of poverty, the economy must change from the accumulation of productive factors to improving them (Wang 2016). Advancing to HI status requires innovation, which in turns creates “creative destruction,” which can harm already existing industries. Policy makers and business leaders would choose not to advance to the next stage of development since it would harm their existing comfortable, favorable position in the economy and society at large. If we assume the state’s main goal is development, this is in conflict with the capitalists’ main goal: profit. There would be some situations, such as the one observed in Mexico, in which capitalists choose not to upgrade industries since that could upset their profits. Due to this, it is not just capitalists in the core countries which could harm development, its capitalists within periphery and semi-periphery countries as well.

There has been a handful of East Asian economies that have developed and advanced towards HI status. There has been a whole host of research into why many East Asian states developed rapidly (Johnson 1982; Amsden 1989; Wade 1990; Evans 1995). This started what would become the developmental state literature, which was summarized by Haggard (2018). The scope of this

literature is vast, yet its relevance to this research is by helping us answer the question of why did domestic capitalists continuously agreed to upgrade industries, and not just hold onto surplus value in the East Asian developmental states. The answer lays within the relationship between the state and business and the effect state capacity had on economic development. Advancing state capacity could aid economic development by effectively caring out industrial policy and upgrading industries. In these cases, industrial policy had mostly avoided rent seeking and was used to advance the development goals of the state, due to these state's embedded autonomy (Evans 1995). This means the state, or the bureaucracy is close enough to business to understand the needs of a particular business or particular industry and thus is able to effectively craft industrial policy and carry it out, yet the state also has a level of autonomy that makes it difficult for businesses to corrupt the state or bureaucracy. Evans (1995) explains, in the case of South Korea, that the sense of brotherhood the bureaucrats had (since a large plurality went to the same university and came from similar backgrounds), the difficulties becoming a bureaucrat (due to the civil service exam), and the relatively high pay, benefits, and job stability, led to the bureaucracy's autonomy and ability to fend off rent-seeking activities from private business.⁵

This embedded autonomy seemed to be a key reason why the South Korean state was able to have a close relationship with business without becoming corrupted by it.

Policy Implications

Understanding the middle-income trap from the lens of this amended world-systems theory can lead us to some policy conclusions. Like most scholars that have looked at the middle-income trap have said before, to escape or avoid the middle income trap a country must invest in its ability to innovate. This translates to investments in human capital and industrial capability. To do this the state must oversee that surplus value is used for these proposals. There are two main threats to this: international and domestic capitalists. As shown in the case of South Korea, sedating these two threats and advancing towards HI status is possible within the current system. Yet it is not clear if every country can build the state capacity and the embedded autonomy necessary to achieve this,⁶ so changes to the global economic governance regime should be desired.

Changing The Global Economic Governance Regime

The first is the threat from traditional world-systems theory, the core countries. To address this challenge, there need to be changes to the global norms surrounding FDI. As discussed, FDI could posed a threat to development, as it would make it harder for new, higher-valued added industries to materialize; yet, FDI should not be completely rejected because of this, though the international

⁵ Johnson (1982) came to a similar conclusion about the Japanese bureaucracy.

⁶ As noted in the developmental state literature, there were many historical and culture factors that played into why these East Asian states were able to build up state capacity and their embedded autonomy. It is unclear if countries in different regions could achieve the same results without the same factors being present.

norms surrounding it should change. It is necessary for MI countries to ensure that their surplus value does not flow outside of the country and into the core, while at the same time, the developing world needs technologies that exist in the developed world. If FDI is set up to create a fully foreign-owned business, there is little evidence that this will lead to improvements to industrial upgrading (Javorcik 2004). This is not to say that every single case of FDI in a MI country is negative, though it should be constructed in a manner in which industrial upgrading and technological transfers are more likely to occur.

The developing world should band together and bring their laws and regulations surrounding FDI into agreement, much like we saw a “Global Minimum Corporate Tax” (GMCT) come into force (Partington 2021). These should be common rules about ensuring that a greater share of surplus value stays within the host country and there is some level of technology transfer. To ensure the larger share of surplus value staying put domestically, the developing world should also come up with their own GMCT, yet only for MNCs within their borders. This tax would essentially work as a tax on FDI, that would sit on top of normal corporate taxes. So say if a company, that was set up by FDI from a rich country in a developing country, would normally face a tax bill of ten percent on their final profits, would be hit with an additional tax of, say two percent. This would bring their tax bill to 12 percent of their final profits, while a fully-domestic company that has a comparable amount of final profit would only pay the original ten percent. This paper will not try to guess what the optimal percentage for this tax is, yet it should be above zero.

This surplus value should be invested in a manner that could create and increase developing countries’ indigenous innovation capacity. FDI should be a learning experience for the developing world. The developing world should essentially banned the creation of fully foreign-owned businesses by the means of FDI. Instead they should opt for a “China Model” of FDI, in which MNCs must set up a joint venture with a local firm. During the joint venture, the intellectual property rights of the joint venture should be respected, yet after the joint venture expires (at a standardized time agreed upon by the developing world), the local firm can use their technology and any other practices they learned to create their own products. There are other obstacles for these developing countries to produce these products, such as the necessary infrastructure, yet due to the tax on FDI proposed above, their would be extra funds within the developing world to attempt to overcome these infrastructure deficiencies.

Of course this would make investment from the developed world into the developing world much less attractive, which is why a common agreement involving most major economies in the developing world is required to prevent a race to the bottom. There would be plenty of hurdles to achieve the level of goodwill and trust to be able to make an agreement of this type possible, yet that does not mean it should be forgone. The preferable international institution that could coordinate this effort would be the BRICS (Brazil, Russia, India, China, and South Africa). The BRICS would be by no means the perfect candidate for coordinating this effort, yet in our current world, it stands as the best. The largest foreseeable hurdle to this would be China, as if there is industrial upgrading in the developing world, Chinese products will face more competition.

Though stronger economic growth and rising incomes in the developing world would lead to stronger demand for Chinese exports, which should make this agreement in China's interest.

Domestic Reforms For Developing Countries

The second threat comes from the capitalist within the semi-periphery. There are cases in which capitalists would choose not to advance towards the next stage of development. This is because industry leaders are currently in a favorable position in society (Wang 2016). Advancing towards the next stage of development implies "creative destruction," which could harm that favorable position. If light manufacturing gives way to higher-value added industries, there is no guarantee that the business leaders of today will be able to compete in the new industries. Due to this, capitalists in the semi-periphery might choose to hold on to profits and not reinvest that money. This would lead to under-investments in areas needed to increase human capital and upgrade industries, trapping said country in its current stage of development.

To overcome this, the state must form a close working relationship with businesses. Until home-grown companies and domestic industries are able to compete in global markets, the state must discipline businesses to continuously reinvest profits into industrial upgrading and venture into newer, higher tech industries (Amsden 1989). The state must also support (through access to capital and technology transfers) and protect (through tariffs and other means) their own domestic businesses in order to achieve this feat. This paper does not argue that this is the only model of development, yet the developmental states found in East Asia worked out very well, and should be a serious consideration for any LI or MI country seeking to develop (Hoogvelt 2001).

Of course, such a close relationship between the state and business could lead to corruption. As written about in below, to overcome this the state must have ample capacity and have a degree of "embedded autonomy," a collaborative yet independent state-business relation in which the state is autonomist enough to where it will not be corrupted by actors looking for rents and turn into a "predatory" state, yet embedded enough to where political and government leaders are not insulated from society (Evans 1995). Some have even called embedded autonomy a necessary condition for development (Kanchoochat, Aivara, and Ngamarunchot 2021). Evans (1995) said this is the reason for South Korea's success in the information-technology sector, as the government worked closely with South Korean businesses to develop the industry to the point in which it could compete in global markets. Reforms aimed at increasing state capacity and improving governance would be a necessary condition before a close relationship between the state and business can be properly formed. Left alone, the market will not be enough to move a country into HI status, yet without proper incentives for private businesses to move to high-value added industries and become globally competitive, state-led growth would also not be enough (Paus 2020). Which is why a developmental state, with a close, yet not corrupting, relationship between the state and private businesses is the preferable method to achieve development.

Conclusion

World-systems theory, when it includes capitalists within the developing world, does a satisfactory job of explaining the middle-income trap. When developing countries move from LI to MI status, it does not hurt the core, in fact it helps it. Because the improvements surrounding advancing from LI to MI status usually results in moving farmers into factories, and producing manufacturing products for low wages. Yet when a MI country transitions to HI status, this would create more competition for the core. Additionally, this transition needs large amounts of investment in human capital and industrial upgrading. Due to the current global economic system, developing countries have a very difficult time holding on to enough surplus value to make these investments. This results in some countries being stuck at having the ability to manufacture simple goods, yet are not able to innovate. This specialization in low-value added economic activities makes advancing towards HI status nearly impossible. As observed in the case of South Korea, it is possible to advance to HI status in the current system, yet it is quite difficult, as only a small amount of countries have been able to do it. To overcome this, the developing world should band together and agree on a common GMCT for MNCs and a common framework for dealing with FDI. This would change the global economic governance regime to make it far more development friendly. Though changes to the global economic governance regime will not push every developing country into HI status. There must be domestic reforms as well. Constructing a developmental state, in which the businesses place the goal of development over the goal of profit and the state protects, supports, and guides the economy through market conforming interventions, would be the most preferable development strategy (Kanchoochat et al. 2021).

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