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A Discussion about the Possible Effect of Middle Income Trap on Large Scale Firms' Selection of Competitive Strategy

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Abstract

Middle-income trap that is based on per capita income and measures per capita income in dollars and predominantly in relation to the Purchasing Power Parity indicates the vicious cycle a country enters at a certain income level. Thus, countries caught in the middle-income trap stay within this cycle for long periods of time and could not ascend to the next income level, the high-income group. Several ways out of this trap for countries were proposed in the literature stressing the significance of state incentives and support that state could provide for the private sector. The objective of this study is to discuss the possible changes that incentives provided by the state based on R&D innovations could initiate especially in competitive strategies of large scale firms and to present two propositions based on this discussion.

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Keywords: Middle Income Trap (MIT), Government Incentives and Supports, Competitive Strategies, Change in Strategy, Turkey.

1. Introduction

Nations, especially during the first stages of their economic growth generally have an economic structure based on agriculture. In time, productivity increases due to the mechanization, increasing capital stock and the transfer of labor into the industries. As a result, per capita income in national economies increases. Within this growth process, countries move from low-income group to lower middle-income group, from this group to upper middle-income group and finally to high-income group. However, this growth process does not have an automated impetus propelled by time. An analysis of the growth performances of nations would demonstrate that they usually stay in a

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specific income group for extended periods of time (Yaşar and Gezer, 2014). For instance, developing countries experience great difficulties in their transition from the middle-income group to the high-income group. Thus, the concept summarized as the entrapment of countries or regions with middle level per capita income in a specific income range, in other words the inability of countries to complete their transition into a higher level of income, namely "Middle Income Trap" (MIT) arises. The fact that the concept especially concerns the developing nations makes it a more interesting subject for the researchers (Kurtoğlu, 2014).

Middle-income trap basically derives from the difficulties experienced in economic growth in developing nations, which is related with the production structures of countries and sub-country regions. Thus, factors such as characteristics of production structure, businesses, labor, employment, industries, regions, technology level, foreign trade structure, product patterns, government incentives and support mechanisms, are among the concerns that should be analyzed in the definition of the problem and in the development of solution proposals (Yeldan *et al.,* 2013). Therefore, the focal point of the study is the discussion on the government incentives and support mechanisms that would be provided to break free of the middle-income trap and its effects on the strategies the private sector corporations would follow.

In the first section of the study, the meaning of middle-income trap in economics would be addressed. Then, the role of the government in middle-income trap exit strategies would be discussed. Furthermore, the concept of change in strategy would be explained and the effects of R&D based innovation incentives by the government on competitive strategies of especially large-scale companies would be discussed and finally a hypothesis would be presented as a result.

2. Literature Review

2.1. Middle Income Trap

The term "*trap*" is used to define a stable economical balance that could not be altered by any factor in the literature of economics. By the increase of a factor that helps to increase per capita income, an increase in per capita income occurs. But immediately after that fact, an increase in a factor that reduces the per capita income would cause the per capita income to decrease. Finally, income per capita would return to its initial value of equilibrium as a result of the latter detractive factor. In other words, income per capita would neither increase nor decrease, thus, would result in a state of equilibrium, which would in turn cause zero economic growth (Koçak and Bulut, 2014). Countries could experience such *income traps* in certain periods. These traps could occur in national economies in low-income levels as well as medium levels of income. Furthermore, in some cases, due to the economy-specific structural problems, blockages and declines in economic growth could be experienced even in high-income economies (MÜSİAD, 2012).

A vague area concerning middle-income trap is the uncertainty about the level of income that should be accepted as middle level income. When the concept was first discussed, national economies with 20% of per capita income in the USA were accepted as middle-income economies (Eğilmez, 2012, 2014). However, according to Eichhengren *et al.* (2001), whose work was intensively quoted in the literature, countries with a yearly per capita income of over USD 16.000 should be accepted as countries with over middle per capita income. The same study also stated that, in middle level income economies, which should have 58% of per capita income of the USA, manufacturing industry should have a share of 23% in gross national income for developing countries. According to Kharas and Kohli (2011), countries with a per capita income of USD 1,000 – 10,000 are classified as low and middle-income countries (Dalgıç *et al.,* 2014). Today, the most prevalent view is the classification made by the World Bank based on per capita income (Eğilmez, 2012, 2014). According to a calculation by the World Bank in 2013, countries with a per capita GNP of USD 1,045 are considered as "*low-income countries*," whereas countries with a per capita GNP between USD 1,045 and 12,745 were classified as "*middle-income countries*." Middle-income countries are divided into two categories as well. Those with a per capita GNP of USD 1,045 – 4,125 are considered as "*lower middle-income countries*," while those with a per capita GNP of USD 4,125 – 12,745 are considered as "*upper middle-income countries*." According to the World Bank classification, countries with a per capita income of USD 12,746 and higher are considered as "*high-income countries*" (Koçak and Bulut, 2014). The time needed for counties in middle-income group to fell into the trap for lower and upper income level countries are 28 and 14 years