The Way Out of the Middle-Income and Low-Productivity Trap

Mains: *GS III – Economics*

Why in News?

India faces the risk of falling into a middle-income trap—a situation in which a country exhausts the advantages of low-cost labour and rapid economic catch-up but struggles to shift towards productivity-led, innovation-driven growth.

What is the Background?

- **Rise of India** – India has emerged as one of the world's fastest-growing major economies and is widely expected to play a central role in driving global growth.
- **Challenges** – Yet, aggregate economic growth alone cannot guarantee a transition to a high-income economy.
- The challenge is not merely one of inadequate GDP growth.
- Weak job creation, stagnant wages, sluggish private investment, low productivity and unequal access to opportunities are reinforcing one another.
- Unless India addresses these structural weaknesses, rapid headline growth may coexist with inadequate employment and limited improvements in living standards.

What is the Middle-Income Trap?

- **Definition** – The middle-income trap refers to the phenomenon where rapidly growing economies stagnate at middle-income levels and fail to transition into a high-income economy.
- In the early stages of development, economies can grow rapidly by moving workers from low-productivity agriculture into manufacturing and services, adopting technologies developed elsewhere and benefiting from relatively cheap labour.
- However, this model eventually reaches its limits.
- As wages rise, countries can no longer compete merely on low costs.
- They must move towards **higher productivity, technological innovation, skilled employment and greater domestic capacity to generate and diffuse knowledge**.
- The experience of several countries demonstrates that moving from low-income to middle-income status is easier than making the subsequent transition to high-income status.
- Countries that fail to upgrade their productive capabilities can remain trapped between low-cost production and advanced innovation.

What are India's Emerging Structural Problems?

- **Low Employment** – Manufacturing has not generated sufficient employment despite policy initiatives aimed at expanding the sector.
- Less Private Investment – Private investment remains relatively subdued in several areas, while wage growth and household consumption have faced pressures.
- **Uneven Economic Recovery** – Post-pandemic economic recovery has also been uneven, with large formal enterprises and technology-intensive sectors benefiting more rapidly than much of the informal economy.
- The central problem is therefore **jobless or low-employment growth**. Productivity gains are often concentrated in capital-intensive and skill-intensive sectors that generate relatively few jobs.
- This creates a difficult cycle:

  Low-quality employment → stagnant wages → weak consumption → inadequate investment → limited job creation → continued low productivity.

- At the same time, inequality can rise because the benefits of productivity growth are concentrated among workers and firms possessing greater skills, capital and technological capabilities.
- **The Neglect of Vocational Skills –** One of India's most significant structural weaknesses is the inadequate development of vocational and technical skills.
- Formal vocational education reaches only a small proportion of India's workforce.
- The country's Industrial Training Institutes (ITIs) have substantial capacity, yet their utilisation and post-training employment outcomes remain inadequate.
- This reflects a deeper social problem: **India has historically attached greater prestige to academic degrees than to technical and vocational competence.**
- Occupations such as engineering, medicine, management and information technology are often associated with higher social status, while electricians, welders, machinists, carpenters, plumbers and other skilled workers receive considerably less recognition.
- This hierarchy is partly rooted in India's historical social and occupational structures, including the caste-based division of labour. Manual and artisanal occupations have frequently been undervalued despite their crucial contribution to economic production.
- The consequences are paradoxical. India has millions of educated young people struggling to find suitable employment while industries simultaneously face shortages of technically skilled workers.

What are the conventional debates and explanations?

- The **market-oriented approach** emphasises further structural reforms—labour-market flexibility, agricultural reforms, deregulation, infrastructure creation and a more investment-friendly business environment.
- The **Keynesian approach**, on the other hand, emphasises inadequate aggregate demand and calls for greater public expenditure, redistribution and social protection.

- Both perspectives contain important insights, but India's structural problem goes beyond the simple question of whether the State or the market should be larger.
- The deeper issue concerns the **institutions and social norms that determine how resources are allocated, which occupations receive social recognition, and who gets access to quality education and productive opportunities**.
- India's private sector has demonstrated impressive entrepreneurial capacity, but productivity and innovation remain uneven.
- The economy continues to have relatively low expenditure on research and development, while technology adoption is often concentrated in a few advanced firms and sectors.
- Similarly, the State has expanded its economic role but continues to face substantial capacity constraints in delivering high-quality public services, particularly health, education and skill development.

Therefore, the solution is not merely to create more jobs. India must also **change the social and economic valuation of productive skills**.

Joel Mokyr and the Importance of Useful Knowledge
• Economist **Joel Mokyr** has emphasised the importance of the accumulation and diffusion of "useful knowledge" in explaining modern economic growth. • Sustained economic development requires more than scientific discoveries. • Scientific knowledge must be converted into technologies, techniques and practical skills that can be widely adopted by firms and workers. • This requires an ecosystem connecting: - **Science → Technology → Skills → Industrial application → Productivity → Higher incomes.** • India has considerable scientific and technological capabilities, but their diffusion remains uneven. • Advanced technologies are often concentrated among large firms, urban clusters and highly educated workers, while smaller enterprises and informal workers remain technologically disadvantaged. • The challenge is therefore not simply to produce frontier technology but to **spread existing and emerging technologies throughout the economy**.

What are the Lessons from East Asia?

- **South Korea** – It combined industrial policy with investments in education, technological learning and export-oriented manufacturing.
- **China** – It invested heavily in basic education, health, infrastructure, technical skills and manufacturing capabilities while gradually developing domestic technological capacity.
- The crucial lesson is that these countries did not rely solely on market forces or redistribution.
- They created institutions that enabled workers and firms to acquire **productive capabilities and technological knowledge**.
- **Unsuccessful experiences** – By contrast, several middle-income economies, including Brazil and Argentina, have struggled to sustain productivity-enhancing structural transformation.
- India must therefore learn from both successful and unsuccessful experiences rather

than mechanically replicating any single country's model.

The Productivist Approach
• Economist **Dani Rodrik** has advocated an approach often described as **productivism**, which places productive employment and economic opportunity at the centre of development policy. • Productivism differs from a narrow free-market approach because it recognises a role for the State in actively shaping markets and expanding productive opportunities. • At the same time, it differs from a purely redistributive model because it focuses on enabling people to participate meaningfully in productive economic activity. • For India, this means moving beyond a framework centred only on redistribution after inequality has emerged. • The objective should be to create an economy in which individuals can obtain **decent jobs, rising wages, skills, social dignity and opportunities for advancement**.

What India should do?

- **Reform vocational education –** ITIs, polytechnics and skill-development institutions should be closely linked with local industries.
- Curricula must be updated regularly, apprenticeships expanded and training outcomes measured through employment and wage outcomes.
- **Increase the social value of skilled work –** Government campaigns alone will not be enough. Wage structures, certification, career progression and social-security systems must make skilled trades economically attractive.
- Vocational qualifications should provide genuine pathways to upward mobility.
- **Promote technology diffusion –** India should focus not only on frontier innovation but also on enabling small and medium enterprises to adopt existing technologies.
- Digital infrastructure, affordable credit, technology extension centres and industry-academia partnerships can accelerate diffusion.
- **Strengthen manufacturing and productive services –** Industrial policy should focus on sectors capable of generating large-scale employment while simultaneously increasing productivity.
- Electronics, textiles, food processing, machinery, renewable-energy equipment and other sectors can be integrated into domestic and global value chains.
- **Raise R&D intensity –** India's research ecosystem needs greater public and private investment, stronger university-industry collaboration and incentives for commercially relevant innovation.
- **Build State capacity –** Effective development requires capable institutions.
- Investments in education, healthcare, urban infrastructure and local governance are not merely welfare expenditures; they are investments in human capital and productivity.

What lies ahead?

- The ultimate objective should be an economy where technological progress is not confined to a few elite enclaves but becomes a widely shared productive force.
- India's demographic dividend will become an economic dividend only when millions of young people possess the skills, opportunities and social recognition necessary to participate productively in the economy.

- **The way out of the trap, therefore, is not merely faster growth, but more productive, employment-intensive and socially inclusive growth.**

Reference

The Hindu| Middle Income Trap of India

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