The new middle classes in emerging markets

For the first time in history more than half the world is middle-class—thanks to rapid growth in emerging countries. John Parker (interviewed here) reports

Financial Times

THE crowd surges back and forth, hands above heads, mobile-phone cameras snapping one of Brazil's best-known samba bands. It could be almost anywhere in Latin America's largest city on a Saturday night. But this is Paraisopolis, one of São Paulo's notorious crime-infested *favelas* (slums). Casas Bahia, the country's largest retailer, is celebrating the opening there of its first ever store in a *favela* (pictured above). It is selling television sets and refrigerators in a place that, at first glance, has no running water or electricity.

Among the shacks, though, rise three-storey brick structures with satellite dishes on their tin roofs. In the new shop, Brazilians without bank accounts—plumbers, salesmen, maids—flock to buy on instalment credit. In a country with no credit histories, the system is cumbersome: the staff interview customers about their qualifications and get them to sign stacks of promissory notes, like post-dated cheques, before allowing them to take their purchases home. But it works, more or less. According to Maria, a cleaner, "Everything I have comes from Casas Bahia. Things are very expensive but the means of payment are better for people like us, without any money." This is the emerging markets' new middle class out shopping.

Eduardo Giannetti da Fonseca, one of Brazil's most distinguished economists, describes members of the middle class as "people who are not resigned to a life of poverty, who are prepared to make sacrifices to create a better life for themselves but who have not started with life's material problems solved because they have material assets to make their lives easy." That covers a broad range of ambitions, as two other examples will show.

Back in 1992 Lu Jian was a dissatisfied mid-level bureaucrat at China's department of transport and communications who became surplus to requirements. Taking advantage of government measures that encouraged such officials to go into business, he went off for a stint at China's first commodity-futures trading company. Soon afterwards he found himself designing the country's first ski resort, near the northern city of Harbin. Now, as chairman of the Nanshan Ski Village, in the desert hills near Beijing, he presides over the capital's main winter-sports recreation ground.

This season 3m Chinese will take up a sport that was unavailable in the country only 15 years ago. China has around 300 ski runs, including some in the subtropical south where skiing is done indoors. Even in freezing Nanshan, snow is manufactured from wells deep underground.

“When the Chinese first got rich,” says Mr Lu, “they wanted to go to Thailand and South Korea. Now they want to go skiing.” Every weekend the resort is packed with IT executives, bankers and media glitterati. This is the emerging markets’ new middle class at play.

In December 2008, a week after the terrorist attacks in Mumbai, thousands of young, English-speaking professionals gathered in Mumbai, New Delhi, Bangalore and Hyderabad. They were demanding a new security law and a ban on criminals holding parliamentary seats, as well as urging people to vote. India’s professional classes have long been considered indifferent to politics and less inclined to vote than the poor. Yet suddenly social-networking sites were full of memorials to the victims and proposals for further action: vote, don’t vote, withhold taxes, join a new party. “Those laid-back, lethargic, indolent middle classes—they’ve been galvanised,” says a former advertising executive.” This is the emerging markets’ middle class engaged in politics.

So much to do

“We expect a lot from the middle classes,” say Abhijit Banerjee and Esther Duflo, of the Poverty Action Laboratory at the Massachusetts Institute of Technology. Following the historical examples of Britain and America, they are expected to be the dominant force in establishing or consolidating democracy. As a group, they are meant to be the backbone of the market economy. And now the world looks to them to save it from depression. With the global economy facing the biggest slump since the 1930s, the World Bank says that “a new engine of private demand growth will be needed, and we see a likely candidate in the still largely untapped consumption potential of the rapidly expanding middle classes in the large emerging-market countries.”

This special report will assess these expectations. It will argue that many of them are broadly justified; that there is indeed something special about the contribution the middle classes make to economic development that goes beyond providing a market for Western consumer goods. The middle classes can, and sometimes do, play an important role in creating and sustaining democracy, though on their own they are not sufficient to create it, nor do they make it inevitable. On balance, the report is optimistic about the prospects of countries where the middle classes are growing. But they are not a homogeneous group, so their impact varies. A middle class that has grown largely to tend to the state will behave differently from one that is based on the private sector.

The one-third rule

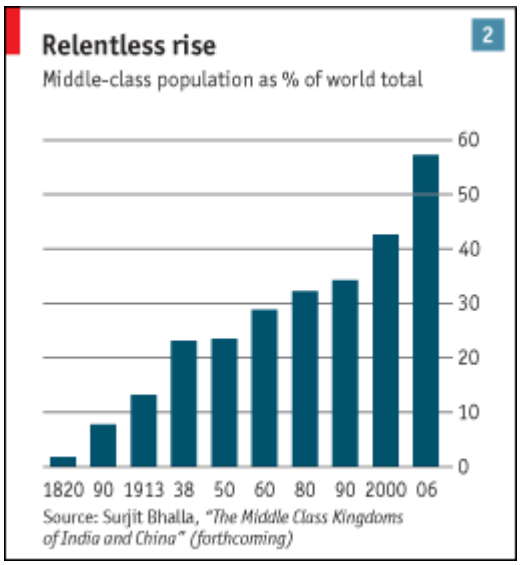
But who, as a patrician British prime minister, Harold Macmillan, once loftily asked, are these middle classes? Their members are neither rich nor poor but somewhere in-between. In countries long divided between lord and peasant, that has large consequences. “Middle-class” describes an income category but also a set of attitudes. In the words of Shashi Tharoor, an Indian commentator, it is a category “more sociological than logical”.

An essential characteristic is the possession of a reasonable amount of discretionary income. Middle-class people do not live from hand to mouth, job to job, season to season, as the poor do. Diana Farrell, who is now a member of America’s National Economic Council but until recently worked for McKinsey, a consultancy that has spent a lot of time studying the middle classes, reckons they begin at roughly the point where people have a third of their income left for discretionary spending after providing for basic food and shelter. This allows them not just to buy things like fridges or cars but to improve their health care or plan for their children’s education.

Usually, an income of that size requires regular, formal employment, with a salary and some benefits, that is, a steady job—another key middle-class characteristic. The income needed to have a third of it left over after meeting basic needs also varies from place to place. In China, for example, $3,000 a year may be enough in Chongqing or Chengdu, big cities in the west,

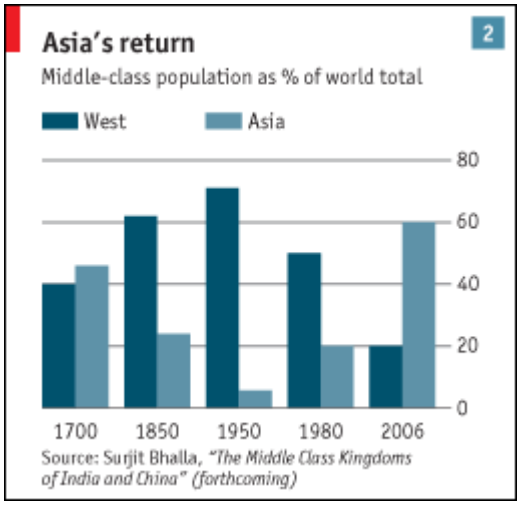
but not in Beijing or Shanghai. So defining the middle class in absolute terms is hard (see article).

In practice, emerging markets may be said to have two middle classes. One consists of those who are middle class by any standard—ie, with an income between the average Brazilian and Italian. This group has the makings of a global class whose members have as much in common with each other as with the poor in their own countries. It is growing fast, but still makes up only a tenth of the developing world. You could call it the global middle class.



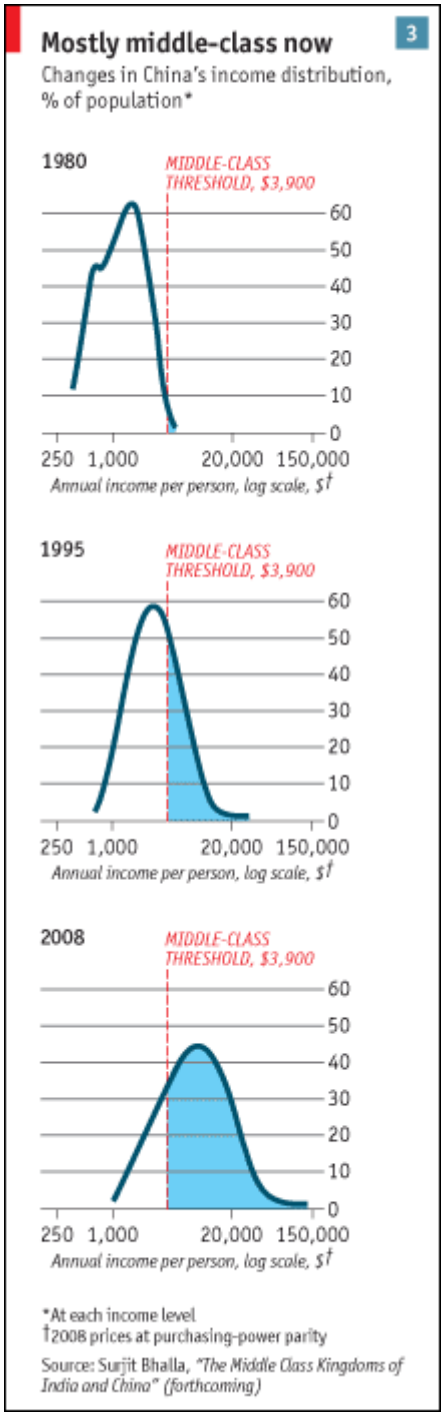
The other, more numerous, group consists of those who are middle-class by the standards of the developing world but not the rich one. Some time in the past year or two, for the first time in history, they became a majority of the developing world's population: their share of the total rose from one-third in 1990 to 49% in 2005. Call it the developing middle class.

Using a somewhat different definition—those earning $10-100 a day, including in rich countries—an Indian economist, Surjit Bhalla, also found that the middle class's share of the whole world's population rose from one-third to over half (57%) between 1990 and 2006. He argues that this is the third middle-class surge since 1800. The first occurred in the 19th century with the creation of the first mass middle class in western Europe (see chart 1). The second, mainly in Western countries, occurred during the baby boom (1950-1980). The current, third one is happening almost entirely in emerging countries. According to Mr Bhalla's calculations, the number of middle-class people in Asia has overtaken the number in the West for the first time since 1700 (see chart 2).



In many emerging markets the middle class does not grow incrementally, in line with, say, economic growth. It surges. Chart 3 below shows why. The vertical line represents an income of $10 a day, which is where Mr Bhalla considers the middle class to start. In 1980 there was hardly anyone beyond that line. The lop-sided bell shape represents the distribution of income in a country (in this case, China) with a tail of poor people on the left, a longer tail of rich ones on the right and a bulge of people on average incomes in the middle.

As the economy grows, the bell moves to the right and as it meets the threshold, a great whoosh of people cross into the middle class. In reality, growth may be even faster because the shape of the bell has been changing. According to new research by Martin Ravallion, the director of the World Bank's development research group, income distribution in developing countries started to shift between 1990 and 2005. The bulge in the middle of the range got bigger, making the bell taller, so the middle class is growing even faster.



At a certain stage it starts to boom. That stage was reached in China some time between 1990 and 2005, during which period the middle-class share of the population soared from 15% to 62%. It is just being reached in India now. In 2005, says the reputable National Council for Applied Economic Research, the middle-class share of the population was only about 5%. By 2015, it forecasts, it will have risen to 20%; by 2025, to over 40%.

Sweet spot

Homi Kharas, of the Brookings Institution, a think-tank in Washington, DC, argues that the point at which the poor start entering the middle class in their millions is the “sweet spot of growth”. It is the moment when poor countries can get the maximum benefit from their cheap labour through international trade, before they price themselves out of world markets for cheap goods or are able to compete with rich countries in making high-value ones. It is also almost always a period of fast urbanisation, when formerly underemployed farmers abandon what Marx called “the idiocy of rural life” for the cities to work in manufacturing, boosting their productivity many times over. Eventually this results in a lessening of income inequalities because the new middle class sits somewhere between the rich elite and the rural poor.

The surge across the poverty line is a period of accelerating growth both for the new middle class and for the country it inhabits. That should continue for a couple of decades. By most estimates, the global middle class will more than double in number between now and 2030. This will have profound social consequences, as happened in previous middle-class surges.

Close to the creation of the world’s first mass middle class in early 19th-century England, Thomas Malthus (the political economist who scared the world with his forecasts of overpopulation and food shortages) wrote that “it is probable that extreme poverty or too great riches may be alike unfavourable [to furthering the progress of mankind]. The middle regions of society seem to be best suited to intellectual improvement.”

Marx, who admired Malthus, was equally astonished by the emergence of the middle class. As he wrote in the “Communist Manifesto”:

Historically it has played a most revolutionary part. The bourgeoisie, wherever it has got the upper hand, has put an end to all feudal, patriarchal, idyllic relations…It has accomplished wonders far surpassing Egyptian pyramids, Roman aqueducts and Gothic cathedrals…The bourgeoisie has through its exploitation of the world market given a cosmopolitan character to production and consumption in every country…All old-established national industries have been destroyed or are daily being destroyed. They are dislodged by new industries, whose introduction becomes a life-and-death question for all civilised nations…In place of the old wants, satisfied by the production of the country, we find new wants, requiring for their satisfaction the products of distant lands and climes…National one-sidedness and narrow-mindedness become more and more impossible, and from the numerous national and local literatures there arises a world literature. The bourgeoisie, by the rapid improvement of all instruments of production, by the immensely facilitated means of communication, draws all, even the most barbarian, nations into civilisation.

Who's in the middle?

It's a matter of definition

THERE are two main ways to define a middle class: in relative terms, as the middle income range of each country; or in absolute terms, using a fixed band for all countries. An influential exponent of the first approach was Lester Thurow of the MIT's Sloan School of Management, who took as his reference point the median income in America—where there is an equal number of people above and below the line—and defined the American middle class as the group with incomes lying between 75% and 125% of the median. Nancy Birdsall of the Centre for Global Development applied the same idea to developing countries. Bill Easterly of New York University selected those who were in the three middle quintiles of income (leaving out the poorest 20% and the richest 20%). The problem with this approach is that each country has a different median income, so the definition of what is middle class shifts from place to place.

An absolute definition avoids that problem. The question is what level to choose. In a paper in 2002, Branko Milanovic and Shlomo Yitzaki used the average incomes of Brazil and Italy as the respective floor and ceiling. That translates into roughly $12-50 a day per person, using household-survey data at 2000 purchasing-power parities (PPP).

On that definition, the middle-class population of emerging markets was about 250m in 2000 and 400m in 2005. The World Bank says it will be 1.2 billion by 2030. But despite that rapid growth, in 2005 this global middle class accounted for only 6% of the world's population and in 2030 it will still make up only 15%.

The main objection to this definition is that it excludes many people in China and India who are recognisably middle-class but earn less than $12 a day. India's National Council for Applied Economic Research found that between 1995 and 2005 the number of Indians earning $12-60 a day rose from 2% to only 5% of the country's population, but the number of those earning $6-12 a day rose from 18% to 41%.

An unpublished paper by Martin Ravallion at the World Bank uses a range of $2 to $13 at 2005 PPP prices. Two dollars a day is a commonly accepted definition of the poverty line in developing countries; people above this line are middle-class in the sense that they have moved out of poverty. Thirteen dollars a day is the poverty line in America, so this category might be described as people who are middle-class by developing-country standards but not by American ones. It is the developing world's own middle class.

Half the world 4

Population living on $2–13* a day, m

	1990	2005
East Asia and Pacific	315.5	1,117.1
of which China	*173.7*	*806.0*
Eastern Europe and Central Asia	355.3	347.8
Latin America and Caribbean	276.7	362.1
Middle East and North Africa	170.2	240.1
South Asia	192.7	380.2
of which India	*146.8*	*263.7*
Sub-Saharan Africa	117.7	197.1
Total	**1,428.1**	**2,644.3**

Source: Martin Ravallion

*2005 prices at purchasing-power parity

Mr Ravallion's range captures the staggering growth of the emerging-market middle class. Between 1990 and 2005 the total almost doubled, from 1.4 billion to 2.6 billion, rising from one-third of the developing world's population to half. It also gives due weight to China, where the numbers living on $2-13 a day rose from 174m to a jaw-dropping 806m in just 15 years. In India the numbers rose from 147m to 264m, impressive in any other context. But Mr Ravallion's definition excludes people living on slightly above-average incomes in Brazil, who would generally be considered middle-class too.

John Hewko of the Millennium Challenge Corporation, part of America's aid-giving system, points out that there is no single best definition; it all depends on what you want it for. If you need to know whether America's middle class is declining, for example, you use Mr Thurow's relative approach. To find out how many people in emerging markets might be, or become, customers for Western brands—the global middle class—you need something like the Milanovic-Yitzaki range: this is what McKinsey and Goldman Sachs use. And if you want to measure how many people in developing countries have moved out of poverty and into the middle class recently, the Ravallion/Banerjee-Duflo range is just the job.

Scott Fitzgerald was wrong. It is not the rich who are different but the middle classes

IN 1943 Abraham Maslow, an American behavioural scientist, published an article entitled “A Theory of Human Motivation” in which he argued that people everywhere are subject to what he called a “hierarchy of needs”. At the bottom are food and shelter, sex and sleep: elementary physiological needs. Next come the basic needs for safety and security. As long as these things are lacking—as they are for billions of the world’s poor—the search for them dominates every aspect of life.

But once basic needs are met, people move up “Maslow’s pyramid” to look for other things: what he called “belonging needs” (love, acceptance, affiliation), “esteem needs” (self-respect, social status, the approval of others) and at the top “self-actualisation” (as he put it, “a musician must make music, an artist must paint, a poet must write if he is to be ultimately at peace with himself”).

Maslow was talking about individuals, but groups of people climb Maslow’s pyramid too, argues Brink Lindsey of the Cato Institute, a think-tank in Washington, DC. In America, says Mr Lindsey, material abundance has made people more self-absorbed, changing the character of culture and politics. This is what happens when people reach the top of the pyramid. Developing countries have yet to get there. Once they have solved the problems of food and security, suggests Mr Lindsey, the middle classes in those countries too start to turn to “belonging” and “esteem” needs.

Suburban revolution

Sociological research has confirmed that improvements in material circumstances change the behaviour and the thinking of whole groups. In 1967, within a generation of Maslow’s article, Herbert Gans wrote a classic book, “The Levittowners”, which described the changing mindset of America’s new middle class. Levittown was the original suburbia: a place of identical detached single-family houses with white picket fences. Lampooned for its uniformity (“Ant-like conformity now affordable”, joked a satirical newspaper, *The Onion*), it nevertheless influenced suburbs the world over.

In “The Levittowners”, Gans claimed that America’s new middle classes were thinking and acting very differently from the working-class communities in which most of them had grown up. Those traditional communities had been (to use terms popular at the time) “peer-group-directed”, taking their values and their outlook from people in their immediate circle, such as family and co-workers. By contrast, Gans argued, the middle classes were “other-directed”, taking their cues not only from family and friends but from managers in distant offices or from contemporaries they had heard about through other means, such as the mass media.

Peer-group people live by rigid codes set by their village or trade union. “Other-directed” folk are more flexible in their thinking. Mr Lindsey explains: “Middle-class life is built on abstract relations based on shared values…We are used to dealing with people we don’t know in order to get something done and do it by abstracting away from the particular details of our background or personality.” To use a famous metaphor, the mind of the peer-group-directed person is a gyroscope, pivoting on a single point; that of the other-directed person works like radar, taking in signals from near and far.

Research based on opinion polls documents the differences between middle-class and working-class attitudes. The best-known work of this kind is the World Values Survey run by Ronald Inglehart of the University of Michigan. It tracks attitudes to public institutions—such as the government or the church—and to broader social matters, such as the role of women or children. As countries get richer (and, by implication, more middle-class), the influence of traditional and religious authorities tends to fall away, though “Western” attitudes to personal and individual well-being are slower to develop. Just as people move up Maslow’s pyramid from “safety” to “esteem”, so countries rid themselves of some traditional attitudes without adopting individualistic Western notions about broader social *mores*. For this special report,

The Economist asked the Pew Research Center to document the opinions of the global middle class: the results, which confirm the distinctiveness of middle-class attitudes, are summarised in this article.

Mr Inglehart identifies three kinds of society. The first is dominated by traditional attitudes to authority and holds inherited religious and communal norms in great esteem. The next is "modern society", which covers the majority of middle-income countries. The last is what he calls "post-modern society", which values individual and subjective well-being above all else and downplays authority of any kind.

"Modern society" stresses the importance of economic growth and upward mobility. It is shifting away from traditional acceptance of established authority and putting more emphasis on law and rights. It engages in a wider debate of policy and politics. It is the kind of society in which people hope their children will do better than they have done themselves; which believes in merit, not privilege; competition, not inheritance; thrift, not conspicuous consumption; and which applauds personal effort rather than collective endeavour. It is a society summed up by the words of Margaret Thatcher, a former British prime minister: "We were taught to work jolly hard. We were taught self-reliance. We were taught to live within our income." Lastly, it is a society whose critical characteristic, according to Justin Yifu Lin, the World Bank's chief economist, is "aspiration, and the means to pursue it". It is a society of the new middle classes.

The muddle classes

So far, this report has looked at what the new middle classes have in common, treating them as a homogeneous group. But, as Lawrence James says about the British variety in his book, "The Middle Class: A History", they are "a sprawling, untidy organism in a perpetual state of evolution".

Getty Images

Thatcher set the tone

For example, Kellee Tsai, a professor at Johns Hopkins University, argues that there is no such thing as a coherent middle class in China. Her research shows that two-fifths of Chinese private-sector entrepreneurs were born to farming families; one-fifth come from families of ordinary workers; and about 15% are children of government officials or enterprise managers. Their attitudes to China's Communist party vary widely, from enthusiastic support to overt opposition, with the majority accepting the status quo. She also points out that private-sector

entrepreneurship takes different forms in different regions of the country. So the term “middle class” covers a multitude of differences.

Pavan Varma, the director-general of the Indian Council for Cultural Relations, also thinks that in at least one respect the middle class of his own country behaves more like members of its elite than as a distinctive group of its own. Both, he says, have similar attitudes to the poor. Traditionally, the middle class has supported meritocracy and upward mobility, more than the elite has done. Yet, according to Mr Varma, the Indian middle class shows little inclination to fight the corruption, bad governance and incompetence that hold back the poor and block upward mobility through education. Unlike its peers in other emerging countries, it has largely given up on public education, paying for private schools for its own children.

The most important division, however, is probably between the middle class created by the actions of the state and its equivalent created by its own efforts in the private sector. The first group contains managers and white-collar employees of state-owned enterprises, accountants and civil servants, and teachers and doctors in the public education and health systems. The second group covers private entrepreneurs, their employees and archetypal small shopkeepers.

To see how much these groups differ, consider economies in which oil plays a large part. Here the middle class is often puny or distorted. A 2003 survey by Tatyana Maleva of the Independent Institute for Social Policy in Moscow found that only just over 20% of Russians were middle-class by income or occupation. Depressingly, this was a smaller share than on the eve of the October revolution of 1917, when a quarter of the population was estimated to have been middle-class. In most countries with Russia’s income levels the middle class accounts for half the population or more.

The distortions in the Gulf states are even more conspicuous. Kuwait has both a public-sector and a private-sector middle class, but they are totally separate. Over 95% of adult Kuwaitis work for the government, usually in white-collar civil-service jobs. The emirate also has a thriving private-sector middle class, but it consists almost entirely of foreigners.

Considered as a group of consumers, a middle class created by the state is unlikely to behave any differently from a private-sector middle class. Its members will buy the same branded goods, save up for the same houses, sign up for the same credit cards and aspire to put their children into the same schools. But there are question marks over whether the public-sector sort has the same entrepreneurial drive, political impact or capacity to sustain high economic growth over time.

Brazil offers a case study in the differences between a middle class created by the state and one that owes more to the private sector. In 2008 Brazil became a middle-class country by its own reckoning. In April of that year Brazilians with household incomes ranging from 1,064 reais to 4,561 reais a year, which is the middle of the country’s income range, were found to make up nearly 52% of the population, up from 44% in 2002 and only one-third in 1993. Marcelo Neri of the Getulio Vargas Foundation, which carried out the research, says it shows Brazil has at last become a middle-class country after decades of effort.

The first big growth spurt took place in the 1960s behind high tariff walls. The middle class expanded fast thanks to jobs in state-owned companies, the public education system and the bloated civil service. “We grew the middle class faster than would have been possible with pure market forces,” says Marcelo Giugale, the World Bank’s chief economist for Latin America. “But it was the result of state policy, not growth.” Income inequality also rose dramatically. By the 1980s Brazil had become the world’s most unequal society.

Moreover, the economy was prone to slumps and episodes of hyperinflation. That made the middle class poorer (not least by destroying its savings) and caused it to rebel. “Our middle class was no longer willing to live in a closed society,” says Mr Giugale. “People have become more outgoing and technologically savvy. They don’t want their kids left behind by what the

rest of the world knows. This is the middle class of satellite dishes and political activity. If you want to be middle-class now, you have to earn it; you can't have a state that creates a middle class as you could 40 years ago."

Panos

Where's the file with the entrepreneurial drive?

Private-sector growth and openness to trade has so far proved a more reliable engine of growth for the middle class than the old state-directed version. Between 2001 and mid-2008 Brazil experienced a long period of growth with low inflation, something it never managed in its earlier stop-start period.

By squeezing inflation out of the economy, argues Santiago Levy of the Inter-American Development Bank, Brazil has enabled people to expand their planning horizons and take out credit, which has soared. This has allowed a new middle class—a younger generation, mostly in their 30s and 40s—to start building up assets. By encouraging growth and improving the labour market, Brazil has greatly expanded the number of jobs in the formal economy (which matters because its informal sector is unusually large). Formal jobs, with health and pensions benefits, are a middle-class preserve. In the first quarter of 2008 Brazil's six largest cities created a record number of new jobs. Mr Neri talks of "the return of the *carteira de trabalho*" (the employment registration book that comes with a formal-sector job).

Moreover, thanks partly to a government cash-transfer scheme called Bolsa Familia, aimed at the poor, Brazil has reversed the vast rise in income inequality that accompanied the earlier period of state-led middle-class expansion. The Gini coefficient, a measure of income inequality, fell from 0.628 in 2003 to 0.584 in early 2008, which by the standards of this index amounted to a social revolution. Vinod Thomas, the World Bank's former country director in Brazil, reckons the lessening of income inequality has come in roughly equal measure from cash transfers to the poor, better education and jobs growth. Brazil's poorest provinces are growing faster than its richer ones, helping to narrow the gap between its rich and its poor regions (whereas the opposite is true in India and China).

The emergence of a new middle class in Brazil has gone hand in hand with an increase in political stability. If the next presidential election is held in 2010, as planned, it will be the fourth one in a row to be conducted under the same rules. The last time that happened was in the 19th century.

Brazil's economic record is not all jam. As Marcelo Carvalho of Morgan Stanley argues, the country owes more of its recent growth to the commodity boom than its policymakers realise, which suggests that it is more vulnerable to the downturn in raw-material prices than its leaders think. Even so, seen through the eyes of the middle class, recent times compare favourably with the period of economic take-off in the 1960s. In Brazil, the middle class is at last delivering on its long-standing promise of growth, stability and equality.

THE NEW middle classes in emerging markets. The Economist. 12 fev. 2009. Disponível em: <www.economist.com>. Acesso em: 5 mar. 2009.