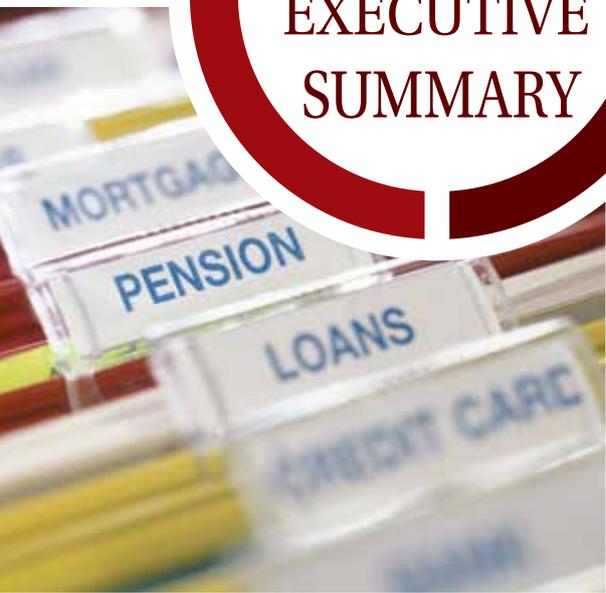


CDE

EXECUTIVE SUMMARY

September 2014



THE MIDDLE CLASSES OF INDIA, KENYA AND SOUTH AFRICA



THE MIDDLE CLASSES OF INDIA, KENYA AND SOUTH AFRICA

Beginning in 2013, governments in several democracies across the emerging world were shaken by angry protests which were unprecedented in their size and suddenness. What shook the ruling parties most however was that the people driving the protests were mainly the new middle classes, the beneficiaries of the economic growth and government policies that had lifted them out of poverty.

Far from passively and gratefully enjoying their new status however, citizens in Brazil, India, South Africa and elsewhere took to the streets to express their frustration with corruption, rising prices, poor services and other grievances, and to demand more accountable government. This was a wakeup call to governments in several countries – most of whom had been in power for multiple terms – not to take this constituency of upwardly mobile, mainly urban voters for granted. Successful democratic societies of the future will be those that achieve sustained economic growth which consolidates and improves the hard-won status of this demanding and newly empowered constituency. Governments can best achieve this through market reform, policies that encourage labour intensive and faster growth as well as a better educated and skilled workforce. At the same time they have to hold on to and deepen democracy and accountability.

In numerous developing countries economic growth has lifted very large numbers of people from poverty to a status that can broadly be defined as 'middle class'. However the term middle class can mean many things. What is clear is that these 'new' or 'rising' middle classes are different in many respects from the middle classes of early-industrialising countries in Europe and North America. They also differ from the traditional conception of working class: unionised, often manual workers in large industrial concerns.

The new middle class in emerging societies is more likely to be in low-level public sector, or service sector employment or in self-employment. Under contemporary conditions much of this sort of employment can be precarious and new middle classes can be uncomfortably poised between upward and downward mobility.

As a consequence definitions and discussions of the middle class in emerging societies need to be carefully interrogated. One useful approach is to distinguish between a 'local' and a 'global' middle class. The global middle class consists of people – often a relatively small group in developing countries – who have incomes and aspirations comparable to middle classes in wealthy, industrialised countries.

By contrast the local middle class is defined as those who earn incomes that place them between the very poor on the one hand and the global, or 'upper' middle class and the rich on the other. Such people, although middle class in terms of their place in income distribution, do not enjoy more than modest affluence and are vulnerable to regressing into poverty. This vulnerability is captured in the label 'floating' classes which is sometimes used to describe them.

Definitions of the middle class vary from country to country and from study to study, making cross country comparisons difficult. Different definitions are used depending on the issue or question being discussed. This makes for a very loose and often confusing public conversation about 'the middle class'.

For the purposes of this study, CDE used an African Development Bank summary of the middle class in Africa which estimated the 'floating class' in Kenya (in 2008) at 28 per cent of the population, the lower middle class at 15.2 per cent and the upper middle at a mere 1.59 per cent.

In South Africa two different definitions have been proposed, which encompass very different income groups. The 'literal middle' – that is, households in the middle of the income distribution – is made up of households with monthly per capita incomes between US\$190 and US\$570. They constituted 31 per cent of the population in 2008. By comparison the 'relatively affluent middle' find themselves in higher, more typically middle class income brackets by global standards between US\$700 and US\$5,000. They constituted 30 per cent of the population in 2008.

With respect to India, our expert cites an estimate that puts the local middle class in that country at about 40 per cent of the urban population and the global middle class at about 12.5 per cent of urban Indians. The proportions for the whole population



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are of course much lower. Nevertheless, although the global middle class accounts for just over 4 per cent of all Indians, this is still about 50 million people.

To advance understanding of this vital, but hard to define phenomenon, CDE commissioned research papers on India, Kenya and South Africa and hosted a round table discussion in Nairobi, Kenya in 2014 with our partner think tank, the Kenyan Institute for Economic Affairs.

Four expert speakers assessed whether and how the middle classes of India, Kenya and South Africa strengthened democracy, promoted growth and improved the effectiveness of the state. We decided to refer to middle classes as a plural phenomenon to illustrate the many different groups and categories contained within this term and concept.

Middle Classes and Democracy

Members of the middle classes who feel economically secure and can draw on savings and family support when they run into trouble are likely to espouse the values and demand the civil and economic freedoms of constitutional democracy. However, this may not be the case for those who recently achieved middle class status, have few support systems but many obligations, and are vulnerable to falling back down the income ladder. In fact, economically vulnerable lower middle classes can become a source of instability and, from either the political right or the left, demand greater state protection and restrictions on freedom if they feel that it will keep them from sliding back into poverty.

These factors may be behind the performance in South Africa's May 2014 general election of the populist Economic Freedom Fighters (EFF) – which has been branded both as the extreme right and the extreme left by its various opponents. Although the EFF gained a smaller share of the vote than the ANC break-away party, COPE in the previous election, it did win a 10 per cent share in South Africa's richest and most urbanised province, Gauteng. According to some political commentators the EFF nationally picked up votes from the poor and marginalised as well as some disaffected people in the lower (and some higher) rungs of the middle class.

In addition, ethnicity, race and caste continue to shape attitudes and influence electoral behaviour amongst middle classes in India, Kenya and South Africa. It is clear in all three countries that ethnicity and other historically-determined loyalties do not always or quickly disappear as people earn higher incomes.

This reality emerges particularly strongly from Kenya, where a survey of young middle class voters in the run up to the 2013 elections revealed that, despite initially expressing a preference for candidates who stood for better governance and the fight against corruption, they ultimately voted for the party led by Uhuru Kenyatta. As members of the Kikuyu ethnic group they worried that voting against Kenyatta's broad but Kikuyu dominated ethnic coalition would allow a non-Kikuyu to win the Presidency.

In the 2014 Indian national elections, the Bharatiya Janata Party (BJP) won enough seats to govern on its own, the first time since 1984 that any party has done so. While some commentators have focussed on the Hindu nationalist appeal of the BJP and its candidate for Prime Minister, Narendra Modi, the party's election manifesto spoke to Indian voters concerned about the seeping corruption and anaemic economic growth that marked the past five years of Congress Party rule. In stark contrast to Congress's focus on expanding entitlements, the BJP emphasised economic growth, employment, infrastructure and improving the business environment, while Modi stressed his record as an effective leader of the state government in Gujarat.

In South Africa, the results of the 2014 national elections suggest that the black middle class remains broadly loyal to the ANC, but the ANC's vote share nevertheless fell to 62.15 per cent (from 65.9 per cent in 2009). At the same time, support for the largest opposition party, the Democratic Alliance, grew from 16.66 per cent to 22.23 per cent.

The ANC fared worst in the metropolitan areas, falling from above 60 per cent to unprecedentedly low figures in the two most important cities in Gauteng: Johannesburg (54 per cent) and Tshwane (51 per cent). Its support fell below 50 per cent (49.17 per



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cent) in the Nelson Mandela Bay metropolitan municipality (Port Elizabeth) in the Eastern Cape. While it is not clear at this point what exactly accounts for these shifts, it is likely that many urban, mainly middle class voters are shifting their support as a result of the less-than satisfactory performance of the ruling ANC.

Middle Classes and Economic Growth

Apart from their substantial human capital and entrepreneurial contributions, the middle classes can be expected to contribute to economic growth either by increasing their consumption or by raising their savings rates. Rises in consumption can generate bursts of growth in the short run, but a rise in savings is more important for long run growth as it finances the investments necessary for improvements in productivity. Increased consumption by new members of the middle class has been an important element in the economic performance of all three countries. If consumption rises in response to a realistic expectation that lifetime incomes will rise then it can be both rational and desirable. If, on the other hand, rising consumption is based on the conviction that tomorrow does not matter, or if the rising consumption is based on overly-optimistic assessments of future income, then both the individual household and the national economy can run into serious trouble.

There is growing concern about how sustainable rising consumption levels are, as rising indebtedness, especially in Kenya and South Africa, threatens to push many back down the income ladder while also undermining any hope for a savings boost.

Kenya has experienced a consumer boom over the past few years, largely driven by the middle class and accompanied by rising levels of debt, much of it for consumption items

In South Africa levels of debt are high and rising. The lion's share has been incurred by, mainly black, middle-income South Africans earning between R8,200 and R22,800 a month, who account for R600 billion worth of household debt. Only 40 per cent of this debt consists of mortgage bonds. The rest is owed on cars, credit cards, personal loans and overdrafts. These growing levels of debt have been encouraged by the low interest rate regime of recent years, which, in the face of rising interest rates, may reduce people's incomes and even squeeze them out of the middle class.

Emerging middle classes should have access to credit and have aspirations as consumers, but there can be a downside when debt levels rise too quickly. The increase in consumption debt in the three countries in the past few years could – unless modified by market-related interest rates – reduce their potential for long run growth and lead to severe disruption in the expansion of the rising middle classes.

Middle Classes and Politics

A commonplace assumption is that middle class people have more ability than poorer people to focus on issues that go beyond basic survival, to mobilise effectively against bad policies and to demand more say in decisions made by the state. These assumptions are predicated to some extent on middle classes enjoying a certain level of independence from the state.

In all three countries the state has been heavily involved in the growth of middle classes. Large-scale public sector employment and dependent 'entrepreneurs' who rely on state tenders have been features of this. India made a decisive break with this, through the dramatic liberalisation policies of 1991 which swept away many aspects of the 'Licence Raj', with its central planning, protectionism and state control. At first, Indian middle classes responded to the rising incomes and greater social mobility which were the results of liberalisation by disengaging from politics and operating outside the state rather than demanding better services from it. However there is a growing sense that this is changing. Middle class involvement has been particularly evident in recent protests against corruption and crime as well as the 2013 Delhi region and 2014 national elections.



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Despite continuing dependence of middle classes on the state in Kenya and South Africa, things may be changing there too. In Kenya, during the time of the Kibaki administration (2002-2007), middle class citizens had a strong influence on policy making and the liberal 2010 constitution is seen as fundamentally shaped by middle class influence. Young members of the Kenyan middle class are today leading Twitter and other social media campaigns against poor service delivery

In South Africa middle classes are participants in policy issues at all levels of society. Middle class citizens of all races engage with national and local politics as taxpayers, professionals, trade unionists, civil society activists, residents and parents and with corporate power as both employees and consumers. Within this context the black middle class is becoming increasingly vocal and critical, contributing energetically to the public discourse as editors, print and broadcast journalists, commentators, letter writers, bloggers and enthusiastic users of social media. Many are as sharply critical of the ANC as the opposition parties (and critical of the opposition too). Increasingly they are playing a leadership role in civil society organisations and making their way forward in professions such as law, engineering and accountancy.

As well as democratic participation, a further contribution that middle classes are expected to make to public purposes lies in paying their taxes and thereby providing the revenue the state needs to provide services, pay salaries and hire competent bureaucrats. In all three societies the middle classes make up the bulk of taxpayers but a number of factors are creating growing disenchantment.

In India only 33.2 million individuals pay tax, between 2 and 3 per cent of a population consisting of 1.3 billion people and 250 million households. Only 0.38 per cent of these taxpaying individuals (fewer than 100,000 people) declare an income above US\$35,000 per annum. This almost certainly means that many thousands of Indians are either under reporting their income or not reporting their income at all. Most individual tax in India is therefore paid by a few honest high earners and the small minority of the workforce (approximately ten per cent) working in the formal sector, whose tax contributions are automatically deducted from their payrolls. This, along with the fact that many taxpayers feel that they receive little or no benefits from the taxes they pay, is creating growing unhappiness that may have political repercussions.

Kenya currently collects the equivalent of 22 per cent of GDP in taxes, with the burden falling heavily on the lower middle class income brackets. This trend has been reinforced since a widening budget deficit pushed Kenya's government into finding additional sources of revenue, principally through Value Added Tax (VAT) on previously exempt staple goods. The introduction of these new taxes led to widespread protests in 2013/14, sharpened by the knowledge that richer Kenyans have – through aggressive tax planning – frequently found ways to avoid paying their full due.

In South Africa, direct taxation on individuals and businesses accounts for the bulk of state income (56.5 per cent in 2012/13), largely drawn from individual income tax (34 per cent of tax revenues), and that paid by corporations (20 per cent). Indirect taxes, principally VAT, contribute 26 per cent and are paid by all, regardless of income.

In 2013 only 5.1 million individuals (about ten percent of the population) were required to submit tax returns with over 95 per cent doing so. These are the individuals on whom the direct tax burden, in the form of income tax, most immediately falls. Their relatively small number contrasts sharply with the rising number of recipients of social grants (15.3 million in 2013), with social protection accounting for 16 per cent of the national budget.

This skewed tax structure has resulted in what is often described as a heavy squeeze on middle class taxpayers. Financial commentators argue that the tax environment for lower and mid-level earners (the vast majority) has worsened considerably as income tax brackets have not been adjusted adequately to reflect the combination of higher local inflation and the depreciation of the rand. The effect of this 'fiscal creep' is that personal income tax rates for anyone earning below R1,5 million are now reported to be 'hopelessly uncompetitive by international standards'. At the same time, middle class tax payers are getting less back from the state, in terms of the quality of public goods and service delivery.



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Widening the tax net, ensuring compliance and simplifying and rationalising tax structures have been among the most striking successes of post-apartheid governments. It has been this more than relentless tax rises that has so far financed a very high social expenditure for an economy the size of South Africa's. However the number of income tax payers is still very small and in an environment of low growth and high unemployment the government's options for future tax revenue are limited. Tax increases may incur a heavy political cost, and protests (involving middle classes from the trade unions to the professions) have emerged over the (badly managed and communicated) imposition of highway tolls in the Gauteng province.

Concluding Thoughts

Middle classes in India, Kenya and South Africa, however defined, are crucial for ongoing development, but how these classes impact on democracy and development is not as straightforward as many policy makers and experts might think. CDE's Nairobi workshop pointed to these complexities and provided many reasons why defining and understanding the middle classes of developing countries deserves more attention:

- 'Middle classes' is a slippery term in the developing world. The people this term encompasses can range from individuals and households recently emerged from poverty with many of them in danger of slipping back into it, to well-established affluent households with developed-country standards of living. The conversation is often too general and more work is required on different components of the middle classes and how this affects their attitudes, political engagement and how they engage with other members of society. As a rule, anyone talking about middle classes in a developing country should be asked to define what they mean.
- Faster economic growth, expanding educational and economic opportunities and upward mobility will see more independent middle classes emerge, that are publicly active, vocal in their demands and less easy to control. In their own and in their countries' interests, governments should resist the temptation to see this as a threat and rather work to adapt as the demands of their constituency change with social mobility.
- State-dependent middle classes are likely to hold back changes required to make states more accountable and economies more competitive and dynamic. They can also sometimes be a factor pushing for higher wages in the public sector irrespective of improvement in service delivery or what impact this has on other aspects of the budget affecting poorer people.
- The expansion of middle class consumption can boost economic growth, but can at the same time threaten long-term growth prospects if it leads to rising indebtedness. Careful macro and micro-economic management in respect to interest rates and financial stability is required to manage this process in an optimal way.
- Those who have just made it out of poverty, the so called floating classes, are frequently focussed on not slipping back and may lack the security and confidence to pursue long-term middle class interests like demanding an accountable state and pushing for more access to employment and entrepreneurial opportunities. The emergence of such classes, especially when led by young urbanites, can shake up existing political alliances and may be a force for change. But of course they hold real dangers as well - middle class voters, especially when economically vulnerable, will sometimes contribute to the strengthening of ethnic or nationalist movements, or populism in the form of support for policies of extreme redistribution and opposition to market reforms promoting productivity and competitiveness.
- Governments seeking a more tax-compliant middle class must find ways to strengthen tax enforcement and the efficiency of tax agencies. This requires state capacity as well as gaining and maintaining taxpayers' trust that their taxes will be used for legitimate ends. To do the latter, states must focus on reducing corruption and finding cost-effective ways to deliver services.

In all three countries the middle classes are contributing positively to democracy and development. However, there is room for



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improvement. India, Kenya and South Africa would all benefit from more secure middle classes, less dependent on the state. This can be achieved by focusing resolutely on the kinds of market reforms that are necessary in all three countries for stronger more entrepreneurial and labour intensive economic performance. Higher growth, an expansion of economic opportunities and more effective governments will all lead to larger, more independent middle classes. In addition, education reform is essential. In all three societies poorer households find it difficult to access quality education that their children need to compete for better paying jobs. Expanding access to quality education will therefore enable more people to move out of poverty and create dynamic societies with growing middle classes.

The growing focus on middle classes, defined variably and very widely, tends to ignore questions about the working class. If the middle class has grown spectacularly in Brazil for example, where does this leave our understanding of the working class? Where does it fit exactly within the very broad definition of middle class in that society? And in South Africa if anyone with a formal full time job is in the literal middle, or even higher in our society, this has profound implications for the 'organised working class' who are not the poorest in the society by a long way.

Changing patterns of growth, employment and the organization of work, especially under conditions of globalisation have rendered obsolete many of the traditional assumptions about working and middle classes. This means that the 'working class' is as slippery a term as middle class. The idea that the unemployed, the informal sector and semi-skilled, skilled and even lower professional workers in the formal sector can be covered by the uniform category 'working class' simply does not fit reality. At the same time, people who are middle class in terms of their place in the income distribution and perhaps even by virtue of possessing tertiary qualifications may be militant trade unionists.

In sum then, while there are no simple or easy definitions or assumptions about class, we should think hard about middle classes and what their growth means for policy, politics and society. In our view, the middle class should be an important focus in how countries think about promoting development. Raising people above the poverty line is a vital starting point. However this needs to be coupled with far more attention on the dynamics of how to encourage social mobility and the expansion and consolidation of middle classes.

A more dynamic focus on growing a stable middle class requires a detailed understanding of what holds people back, either through a lack of economic opportunities or an inability to take advantage of what opportunities there are. Focussing on liberating such potentially productive and entrepreneurial individuals would mark an essential broadening and deepening of democracy in all three countries: from formal political rights to the empowerment of economic freedoms and educational opportunity.

This is the executive summary of a CDE Round Table, The middle classes of India, Kenya and South Africa.
The full-length publication is available from CDE. It can also be downloaded from www.cde.org.za.



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