

# CDE

## EXECUTIVE SUMMARY

November 2013



## RISING MIDDLE CLASSES IN INDIA, BRAZIL AND SOUTH AFRICA

What is happening and what are the implications?



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The rise of the middle class in emerging democracies is an important global issue. An expanding and large middle class is vital for inclusion and stability, especially in developing countries with many poor and excluded people. However, comparative research on this phenomenon from within developing countries has been rare. To address this gap, think tanks from India, Brazil and South Africa held a workshop late in 2012, hosted by the Instituto Fernando Henrique Cardoso (iFHC) in São Paulo, in partnership with the Centre for Development and Enterprise (CDE), Johannesburg, and the New Delhi-based Centre for Policy Research (CPR).

### Middle Class Trends in Brazil

Studies of the Brazilian middle class largely employ a definition developed by the federal government's Secretariat for Strategic Affairs, which classifies people as middle class if they have the relatively low household income of between US\$161 and US\$564 per month. The growth of this 'new middle class' is one of Brazil's most impressive achievements. Between 2001 and 2011 the proportion of people that could be classified as middle class grew from 35 per cent to nearly 50 per cent. In 2011 Brazil's population was almost 197 million, so the middle class now consists of nearly 98 million people.

Other important trends identified at the workshop were:

- The middle class will make up 57 per cent of the population by 2022. However, growth of the class will slow as middle class people advance to the upper class.
- Black Brazilians account for 80 per cent of new entrants into the class. People from rural areas, from the relatively impoverished north-east, workers in the informal sector and domestic servants are a growing proportion of the middle class.
- Between 2001 and 2011 the household income of people classified as extremely poor grew by an average of 14 per cent per annum. Incomes for people living in households classified as upper class grew by only 2 per cent over the period.
- Brazil's falling fertility rate is now 1,9 - lower than that of France. Smaller families with multiple incomes make households better off, which allows them to rise into the middle class.

### Key Insights about Brazilian Middle Classes

In contrast to commentators who claim that Brazil's successes in reducing poverty and inequality are the result of government income-transfer programmes, Brazilian economists have shown that this is far from the case. While the modest transfers have played some role in lifting people into higher income categories at the lower end of the spectrum, the impact of economic growth and access to employment has been far more important.

Inequality has fallen and the middle class has grown primarily because a period of solid – although not spectacular – economic growth generated income-earning opportunities that poor people with rising education levels could access. In the first decade of this century Brazil's economy grew, on average, at 3,6 per cent annually. As a result the number of unemployed fell and the productivity of many workers rose. Both processes allowed real incomes to rise and lifted almost 40 million people out of poverty.

Brazilian experts, including ex-president Cardoso, admit however that they have not been able to identify all the factors that contributed to Brazil's impressive successes in the 2000s. An important factor, clearly, was the ability to take advantage of the commodity boom, especially rising demand for commodity exports from China. Possible additional factors include accountable, relatively effective local government, high urbanisation (over 85 per cent) and employers' ability to work around complex labour market regulations.

An additional note of caution raised by Brazilian experts was the need to be careful when generalising about this 'middle class', especially in terms of its impact on politics. Diverse ranges and sources of income and a variety of identities stand in the way of this group constituting a coherent class in the strict sense. In addition, sociologist Bernardo Sorj pointed out that 'a person who receives a salary from the state will have different demands and expectations than somebody who receives a salary from a private entity'.



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Despite these complexities, there was broad agreement that the rise of this 'new middle class' is an important change. Such a large proportion of people consuming more and developing aspirations will have profound consequences. It was noted, with some irony, that the ruling Workers Party has presided over a situation where almost all workers are now classified as middle class. As a result, there is no longer an official working class in Brazil.

### **Middle Class Trends in India**

The subcontinent is characterised by considerable regional variation. India has achieved significantly higher growth rates than Brazil and South Africa recently, but with a population of 1,2 billion it is much poorer than the other two. Per capita income is US\$3 627, compared to South Africa's US\$10 960 and Brazil's US\$11 640.

An innovative way of analysing the middle class has identified two categories, local and global, allowing analysts to assess the rate at which people are moving out of lower income quintiles, while also permitting an evaluation of the much smaller income group near the upper end who have standards of living and aspirations comparable with middle classes in richer countries.

The 'local middle class' consists of urban Indians earning between 75 and 150 per cent of the median income. In 2005 median annual household income was US\$652 and median per capita income US\$125. The local middle class makes up 40 per cent of the urban population and consists of about 150 million people. The 'global middle class' is defined as people in households that consume between US\$10 and US\$100 per person per day. About 12,5 per cent of the urban population fits into this category, or about 50 million people. Together the two classes comprise some 200 million people, just under a fifth of the population.

Additional points raised about these two middle classes were:

- Access to higher education is the key to becoming a member of the global middle class. People in this class are largely English-speaking and mainly upper caste. They are heavily concentrated in two states, Delhi and Maharashtra.
- The local middle class is more diverse and widely spread. It is split along language, ethnic and caste lines.
- Average household size for local middle class Indians is 4,3 compared to 3,6 for global middle class Indians.
- Members of the global middle class spend five times more than local middle class Indians on education and shelter.
- The proportion of the local middle class working in the informal sector is 70 per cent. For the global middle class the proportion is still very high, at 40 per cent.

### **Key Insights about Indian Middle Classes**

Both middle classes have played a muted political role in recent times. The local middle class focuses on making a living and feels relatively disconnected from the political process. They are self-reliant but would greatly benefit from better government services. The global middle class, many of whom work in government, have opted for private services and therefore do not devote much energy into pressuring government for better service delivery.

In India, as elsewhere, the idea of the middle class is tied up with a universalising, inclusive vision that anyone who achieves a certain education and income can become part of this class. Seeing themselves in meritocratic terms helps middle class Indians justify their higher incomes. At the same time, issues of ethnicity and caste continue to divide Indians, even within the middle classes. These divisions can be exacerbated by affirmative action policies.

A positive element of the inclusiveness of society can be found in the ability of the poor to settle and ply their trades across Indian cities without too many restrictions. This avoids a contest between urban insiders and outsiders, which could explain why urban violence is much more muted than in countries like Brazil.



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### Middle Class Trends in South Africa

There are several definitions of 'middle class' in South Africa. For instance, economist Justin Visagie defines the 'literal middle' as households with monthly incomes between US\$190 and US\$570, which adds up to 4,2 million households and constitutes 30,9 per cent of the total population. 'Global middle class' households are defined as those with after-tax monthly incomes of between US\$700 and US\$5 000. There were 4,1 million such households in 2008, making up 29,9 per cent of the total.

Other approaches include:

- The South African Advertising Research Foundation, using Living Standards Measures (LSMs), finds that 23,5 per cent (about 12,2 million people) of South Africans were middle class in 2010.
- In 2006 some 42 per cent (19,9 million) of South Africans self-identified as middle class, according to the global World Values Survey.
- About 14 per cent, or 7,2 million, South Africans were middle class in 2012, according to the UCT Unilever Institute of Strategic Marketing.

Other points relating in particular to the black middle class from the Unilever study are:

- The black middle class more than doubled between 2004 and 2012, from 1,7 million to 4,2 million individuals.
- The average monthly income for a black middle class household in 2012 was R21 000, compared to R25 000 for a white middle class household.
- The annual spending power of the black middle class is R420 billion, compared to R320 billion for the white middle class.

### Key Insights about South African Middle Classes

Important changes have taken place in the size and character of South Africa's middle class. However, by contrast with Brazil, the unemployed and the poor are not able to move up the income ladder into the middle class in large numbers. While benefiting from some transfers and public services, they lack access to good infrastructure, job opportunities, decent health care and especially good quality schooling. The dire state of the education system prevents capable children from poor households moving into middle class trades and professions.

Under apartheid in the 1980s, despite heavy constraints on upward mobility, employment growth promoted the black middle class. By contrast, the extremely high unemployment of the democratic era has been a major constraint. As a result, the principal vehicle for advancement has been access to good schools and universities and economic opportunities as well as affirmative action and black economic empowerment policies. As in India and in other countries with similar situations, such as Malaysia, affirmative action policies may have had the unintended consequence of fuelling racial or ethnic tensions. On the other hand, despite often complaining about affirmative action, the white middle class has been able to maintain and even advance its position due to a period of solid growth at a time when South Africa has faced a serious skills shortage.

Whites, coloureds, and Indians (the 'minority groups') have increasingly abandoned the ANC at the polls. Interestingly, the black (African) middle class is beginning slowly to do the same. In the words of a university-based pollster, Dave Everatt, "Post-apartheid voting certainties are fading rapidly. . . it is apparent that there is a complex and fraught relationship between the ruling party and the black middle class". In many respects the ANC has been a party of and for the middle class, without admitting it and without the middle class entirely appreciating the fact. Thus, despite the ongoing importance of racial identities, a potential middle class alliance appears to be slowly emerging, largely driven by a set of shared grievances, at the heart of which is a growing perception of the ANC as increasingly inept, corrupt and nepotistic.



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### Comparative insights and concluding remarks

Global experts, especially those associated with the World Bank, the Washington-based Centre for Global Development and the Brookings Institution, are doing important work in defining and plotting the rise of a middle class in developing regions. They have focused largely on developing accurate, consistent measurements of middle class income trends across a range of countries, and they then tend to read off mainly economic and possible political consequences from these measurements.

What is striking about the conversation concerning 'the middle class' among experts and analysts who live in India, Brazil and South Africa is the concern to unpack and understand what is actually happening within their own countries. There is understandably far less interest in global comparability and incomes alone and much more in plotting the diversity within the broad 'middle class' category and analysing the varying implications of their rise.

Across the three countries, three major development challenges were identified in which middle classes were seen to play a pivotal role:

- Growing a large and dynamic internal consumer market;
- Reducing inequality and building a more stable social order; and
- Strengthening the state's accountability and capacity to deliver.

#### *Middle Classes as Consumers*

A major reason to promote middle class growth is its impact on local consumption. With higher incomes and a sense of being upwardly mobile, new middle classes develop wider aspirations, can more readily access credit, and become consumers of durables and services that they could not previously afford. These developments have important implications for economic growth.

In Brazil, the phenomenal growth of the new middle class appears to be associated with a greater propensity to buy durable goods. Brazil's economists are hopeful that this large group of new consumers holds a key to future economic growth. The shift to internal consumption is particularly important at a time when the commodity boom which underpinned so much of Brazil's recent growth has dissipated. Brazil cannot count on China to the same extent, so needs to re-orient production towards a large and growing internal market.

The challenge is the extent to which this group has financed consumption via loans. There have been dramatic improvements in the accessibility and affordability of loans for the poor but, as economic conditions tighten, many at the bottom of the middle class income group are finding it harder to meet their debt obligations. Household debt, 20,2 per cent of disposable income in 2005, rose to 41,3 per cent in 2011. This is feeding a growing sense of discontent.

In India, despite relative poverty and the small proportion of the population who form part of the 'global middle class', scale and economic potential create massive opportunities for market expansion. If a recent McKinsey study is to be believed, and assuming that India can overcome current growth challenges, income levels will almost triple over the next two decades, and India will climb from the 12th-largest consumer market to the 5th-largest by 2025. The study claims that by 2025 over 23 million Indians — more than the current population of Australia — will number among its wealthiest citizens. Consequently, demand for luxury goods could reach US\$14,73 billion by 2015, from an estimated US\$8,21 billion in 2013.

By contrast, a mere 7,2 million South Africans earn between US\$1 493 and US\$5 333 a month. South Africa has a relatively small population (52 million), with a large proportion living in poverty. While the rising consumption habits of this burgeoning group have a noticeable and important impact on the economy, the internal market remains restricted and tiny by comparison with India and Brazil. This makes it imperative for South African companies to seek markets outside the country (especially in the rest of Africa), which will not only expand the size of operations, but lead to economies of scale. This, in turn, will serve to lower companies' cost structures and make them more competitive internationally.



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#### *Middle Classes and Social Stability*

Expanding the number of middle income earners in developing countries should be regarded as an integral part of promoting inclusive growth and strengthening social stability. A society without a middle class is likely to create stark and glaring differences between rich and poor. A significant and growing middle income group can serve as a buffer between rich and poor, as well as providing evidence to poorer citizens that social mobility is possible.

Brazil's middle class growth is part of a broader process that has brought down inequality and reduced poverty. In 2001 more than half the Brazilian population (53,7 per cent) was poor; by 2011 only 35,6 per cent remained below the poverty line. During the same time, inequality (as measured by the Gini coefficient) fell from 0.572 to 0.511, a significant change. Boosting the proportion of Brazilians in middle income categories, lifting large numbers of people out of poverty, and making the distribution of income more equal has demonstrated that all Brazilians can benefit from growth and modernisation. This has the potential to reduce feelings of exclusion, to eradicate clear distinctions between a group of economic winners and a group of losers, and to make Brazil a more stable country.

In South Africa the middle class is growing (between 2005 and 2010 by just under 4 per cent per annum) and becoming more racially balanced. More than 50 per cent of the middle class is black. This is a considerable achievement but it is not enough.

The major challenge is that poverty remains too high. Poverty has been reduced, but in 2011 nearly 38 per cent of the population lived below a poverty line of US\$172 per person, per month. People in middle class professions tend to be among the top income earners. Those who earn incomes in the middle of the income distribution are actually quite poor (earning at best US\$120 per person per month). The global middle class constitutes a small elite, and there is an insufficient buffer between them and the poor. This presents a challenge for social stability.

#### *Middle Classes and Democracy*

Middle classes are frequently associated with demands for more representative governments, greater rule of law and expanding freedoms. As a recent optimistic observer said of African middle classes:

'They are your enlightened voters, they will support policies, and not just vote in terms of an emotional affiliation. They are the drivers of democracy.'

Rising incomes are associated with growing support for democracy. Higher incomes enable people to move beyond survival and have the time to get involved in protests or movements for better services. A rising middle class will therefore get more involved in political and social life. How governments manage this in democracies will be an important aspect of consolidation and stability.

However, we must be careful about assuming that all middle classes will automatically demand democratic reforms in the same way. To make sense of the ways in which middle classes are impacting on democracy in India, Brazil, and South Africa, it is important to understand how middle class people relate to the state. Do they rely on it for employment, economic support or services, and the enforcement of laws? Or have they become more self-reliant, relying predominantly on private provision of security, health, and education? The middle classes most likely to impact positively on the state are those based in the private sector with the independence and motivation to demand better public services and less corruption. Middle classes that are wholly dependent on the redistribution of state resources are unlikely to wage effective battles for greater democracy and accountability, higher economic growth, and value for money in state expenditure.

Nevertheless, in all three countries there are signs that middle classes are exerting political pressure to make the state more accountable and efficient. In Brazil, protests that broke out in June 2013 were, at least initially, dominated by middle class Brazilians demanding better public services, and less corruption. In India, middle classes have become increasingly mobilised in relation especially to corruption and sexual violence. In South Africa, while middle class politics is still somewhat muted, there are signs that



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'greater voice' is being exercised. This can be seen in the opposition to the bungling of e-tolling, the growth of non-governmental anti-corruption organisations and the growing number of independent voices outside the ANC fold. The 2014 elections could deliver some interesting new trends as increasing numbers of black middle class voters seek alternatives to the ruling ANC.

### Final thoughts

Middle classes in developing countries are difficult to pin down. The category has numerous dimensions and care must be taken before we assume economic and political outcomes merely from income levels. However, promoting middle class growth should be an important goal for emerging democracies. The experiences of both India and Brazil, while complex and not yet fully understood, point to the importance of economic growth and the creation of new economic opportunities as the best way to achieve this.

Middle class growth is therefore an important policy objective with potentially a series of interlinked benefits: the reduction of poverty, a more inclusive and stable society, and growing pressure on the state to be more efficient and accountable. For this middle class growth to produce maximum benefits, however, it needs to emerge out of a dynamic development process in which opportunities are expanding and accessible to those who find themselves outside the middle class.

Generating such opportunities depends on a number of critical elements.

Firstly, economic growth must be a priority for governments. High growth is the only effective way to meet the challenges that developing countries confront. By substantially and consistently increasing the size of their economies, developing countries build up resources that they can invest in services, infrastructure, and education, while also expanding the range and quality of economic opportunities. Redistribution of income tends not to form the basis of middle class growth as it is not sustainable; has only limited benefits unless accompanied by the expansion of economic opportunities; and makes beneficiaries reliant on the state.

Secondly, it is vital to remove barriers to the expansion of opportunities for people stuck in poverty. For example, laws preventing the expansion of relatively low wage, unskilled jobs are inappropriate for countries with many unskilled people unemployed or outside the job market. The nature of economic growth (i.e. whether it is labour absorbing and driven by the private or the public sector) is therefore important. In these three developing countries, and many others, absorbing more and more people into the formal economy is vital. In addition, it is important to encourage people to move out of rural areas into effectively managed cities.

Thirdly, the state must ensure the supply of essential services, healthcare, and quality education to the poor. Good quality services strengthen the capabilities of poor people and their ability to pull themselves up into the middle class.

In laying the groundwork for effective, ongoing middle class growth, all three countries need to find ways of re-stimulating the growth of their economies in the current difficult global environment. To do this, governments need to implement reforms that will open up their economies to new sources of entrepreneurship and innovation.

The fight against poverty, achieving inclusive growth, the reduction of inequality, and building a stable society will all emerge from pursuing one goal: growing the middle class.

Prioritising this goal brings about a shift in how countries think about development challenges. Rather than just measuring poverty and then finding ways to increase incomes above a poverty line, a more dynamic focus on assessing progress towards middle class status needs a detailed understanding of what holds people back. Once these barriers are identified, remedies are needed to create an environment which generates accessible opportunities that poorer people are able and willing to pursue. Additional interventions should ensure that all have access to the quality education and health services they need to make them, and their children, more productive and entrepreneurial, allowing them to progress up the income ladder into the middle class.

This is the executive summary of a CDE Round Table, *Rising middle classes in India, Brazil and South Africa: What is happening and what are the implications?* The full-length publication is available from CDE.  
It can also be downloaded from [www.cde.org.za](http://www.cde.org.za).



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