



A Global Forum



Nancy Birdsall

in conversation with
Ann Bernstein

CDE@25 | Democracy | Markets | Development

A South African resource influencing policy for 25 years

In November 2020, CDE initiated a series of events to celebrate 25 years since its launch in August 1995. The series focuses on global conversations on democracy, business, markets, and development.

Cas Coovadia, Chief Executive Officer of Business Unity South Africa and founding CDE Board Member, opened the event: "CDE has done a lot to help consolidate our democracy during the past 25 years of its existence. The organisation has earned recognition as a national resource for business, government, and civil society. CDE has become the go-to place for critical thinking on economic growth, social development, and the role of business in development. It was recently challenged by Reverend Frank Chikane, a veteran of the anti-apartheid struggle, to help "shift the country off the bad trajectory we are on, onto a more constructive and productive path." I am proud to have been a member of CDE's board since its inception. I think that the organisation has positioned itself well to promote a growth path that is sustainable and inclusive. I am sure that CDE will continue to play a critical role in our society for the foreseeable future.

Through this innovative platform, CDE brings together leading experts and critical thinkers from South Africa and across the globe to discuss vital issues that relate to the future of our society and our democracy. In this session, we look at the role of the middle class in developing countries, and ask whether such countries can succeed without one."

This is the eleventh conversation in the CDE@25 series.

Ann Bernstein: It is my privilege and pleasure to welcome our guest tonight. Nancy Birdsall is a legend in the development world and a key player in Washington, D.C. She is President Emeritus and Senior Fellow at the Center for Global Development, one of the world's leading and most effective development think tanks, which she founded in 2001. Prior to that, she spent time at the World Bank, at the Carnegie Endowment, and she was an executive Vice President at the Inter-American Development Bank for some five years. She is a member of the boards of numerous organisations, including the International Food Policy Council, the African Population and Health Research Organization, and she chaired the board of the International Council for Research on Women. Two years ago, I was in Washington attending an event at the prestigious Peterson Institute, where the Governor of South Africa's Reserve Bank – the next guest in this CDE@25 series – was delivering an important speech. I walked into the large auditorium and then stopped, because the hall was almost completely dominated by men. I am used to this in South Africa, although it is not as bad now as it used to be, but I did not expect it in Washington DC, in 2019. It is in this context that Nancy has been a pioneer of excellence and effectiveness.

Nancy, welcome both to CDE and to South Africa. We are delighted to have you, even if only on Zoom.

Nancy Birdsall: Thank you very much and congratulations to you on your 25th anniversary.

Ann Bernstein: I have a lot of issues to explore with one of the world's leading development researchers. About seven years ago, partly inspired by your work, CDE, together with think tank partners in India and Brazil, undertook a large study on the middle classes of the three countries. Some major 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; strengthening the state's accountability and capacity to deliver. Many people on the left would say that this is the wrong lens through which to think about development. They would say we should much rather focus on helping the poorest of the poor, or the working class. Can you tell us why middle classes are so important for development?

Nancy Birdsall: I think it is great that you chose to examine the middle class and why it matters. The simple answer is that, in order to address the needs of the poor and see poverty reduced, including through a healthy expansion of the economy, it helps to have a large group of people who have the capacity to do two things. Firstly, middle class people can pay taxes that create the financial capacity for a government to provide healthcare, education and other public goods to a broad swathe of people, including the poor, on whose human capital and productivity growth, poverty reduction depends in the long run. Secondly, middle class people are more likely

than those living in poverty to have the time and the ability to make government accountable – for honoring contracts, providing public goods, addressing other market failures. I think it is too extreme to say that you need the middle class to make any progress on poverty, but it is entirely reasonable to say that it helps to have a middle class in order for a government to make progress on poverty and reducing inequality.

Ann Bernstein: How do middle classes hold governments accountable? Why are they more likely to promote the rule of law in a developing country?

Nancy Birdsall: The middle class thrives on a level playing field where there are no insider privileges, and where corruption is minimised, so the middle class demands fair and equitable treatment from government. Further, middle-class people in developing countries are more likely to have at least secondary education, which along with their relatively secure income, allows them more time and ensures them more leverage with government. And a large enough middle class means its members are likely to recognise their common interests, and to organise via activism and the vote in democratic systems – not always and not ideally without selfish interests, of course. Those who are in the middle class tend to benefit from having an even playing field, a good investment climate and steady growth.

Ann Bernstein: In 2014, CDE organised a roundtable on the middle class in São Paulo, Brazil. At the time, there was a lot of optimism about the rising middle class in Brazil, with politicians and others claiming 40 million new people in the middle class, resulting in a population overall that was nearly 50 percent middle class – nearly 98 million out of 200 million Brazilians. Quite a few Brazilian economists were sceptical about these numbers and their sustainability. In hindsight, it looks like the economists? or the politicians? may have been right. How do you see the situation in Brazil now? Did this middle class materialise, and has it been sustained?

Nancy Birdsall: It's very important to recognize that the growth of the middle class during that period in Brazil, culminating around 2015, had been a product of very strong growth over a period of 10 to 15 years. With the slowdown in growth, the new and still fragile middle class was threatened. A middle class that is dependent on a pay-check and a steady, secure income is always going to be fragile in the face of an economy-wide recession, evidenced by what happened to the middle class in the US in the 1930s, or the loss of savings and massive inflation that impacted Germany's middle class in the post-WWI period, culminating in the rise of Hitler and the Nazi regime. The lower-middle class, which made up a large proportion of the new middle classes in Brazil before 2014, is particularly vulnerable to economy-wide recessions, and in the case of Brazil, dependent on commodity exports, to a worldwide decline in commodity prices – and now to the global slowdown associated with the pandemic. So the middle class can be good for growth and the reduction of poverty and inequality, but it is neither necessary nor sufficient to bring those about.

Ann Bernstein: In one of your articles, you pointed out that between 1990 and 2015, around 1 billion people escaped poverty around the world, including about 650 million people in China and India. During the same period, some 900 million people entered the \$10-a-day middle class. What are the implications of this, in your view? What does it mean for a society to move so many people out of poverty, and with such speed? How does the society change?

Nancy Birdsall: Your question goes to the heart of what a middle-class society is – big enough and secure enough to make some difference in the politics of a country. I would say it is a society in which at least 50 to 60 percent of households have an income per person of at least \$10 a day, with the overall country median income close to or above \$10 a day; these households are reasonably secure against temporary household shocks such as short-term unemployment of a working adult. By that measure, only Russia and Brazil are middle-class societies. China is close to becoming a middle-class society, in marked distinction from India (and from South Africa). China now has 30 to 40 percent of its people in the minimum \$10 a day middle class; those middle-class households are highly concentrated in urban areas, and their numbers have grown remarkably in the last 30 years. \$10 a day per person is well above what most people in Africa, including South Africa, and in India enjoy today – where median incomes are more like just over \$3 day. India is much poorer than China - closer to most African countries in per capita income terms - and India's middle class is still very small, at not much more than 10 per cent of the population. About a decade ago there was a lot of excitement – even hype among international producers of consumer goods - about India's growing middle class. After all, 10 percent of the Indian population is a lot of people and constitutes a very large market for global producers. In that sense, some of the hype is justified. Nevertheless, India, like South Africa, cannot be called a middle-class society.

I think what happened in China is extraordinary. It is the greatest example of how rapid and sustained economic growth can lead to a large, solid middle class. This holds true even in cases where the distribution of income starts out very unequal, as has been the case in Brazil. In Brazil, economic growth (until the last five years or so) is what led to an expansion of the \$10 a day or more middle class. There, growth also lifted large numbers of people moving out of poverty into an intermediate group that I call 'the strugglers' – between the truly poor and the materially secure middle class and at high risk of falling back into poverty.

The aforementioned 'strugglers' (a large group in South Africa) are a group that development orthodoxy has failed to pay enough attention to, in contrast to the attention focussed on the poor. In my view, development only becomes assured once there is a large group of people who are investors and consumers, and who make their government responsive to their needs and demands. Until you get the middle class to at least 50 or 60 percent of the population, development remains fragile in the face of economy-wide or world-wide recessions, as we have just experienced due to the Covid-19 pandemic.

Ann Bernstein: Let's talk a bit more about the strugglers, as you have called them. In your view some very prominent economists in the Asian Development Bank and the African Development Bank talk too glibly about the middle class, and that it really matters whether you are living on \$2 a day or \$10 a day. Can you tell us a bit more about how you see this, and why it is so important to make this distinction? What would this mean for policy?

Nancy Birdsall: Most people in the developing world – probably 70 or 80 percent of people – are in households where income per capita is between \$2 and \$10 a day per capita. Research undertaken in Latin America has indicated that a household made up of individuals who earn on average \$5 a day has a 50 percent chance of falling back down to lower incomes, including all the way down to \$2 a day or less, over three or four years. At 3 dollars a day, the chances of slipping back down are even higher. What is important about 10 dollars a day, at least in Latin America, is that when a household reaches \$10 a day per capita, it becomes much more secure. In addition, \$10 a day per capita is associated with at least one adult in the household having secondary education, and at least one adult per household having a relatively secure income.

The other thing I would say about the strugglers is that, again in Latin America, almost all work in the informal sector, where their incomes are insecure against household as well as economy-wide shocks. It is unusual for those households to include anyone with schooling beyond primary school. Many survive from day to day. This group of people have been badly hit by Covid-19 because they have suffered huge losses of employment and income, including for the self-employed running small informal businesses. Many of them are street traders and involved in informal production, which is highly dependent on other people's consumption.

Ann Bernstein: In that context, you have commented that for most people, losing ground is more troubling than never gaining it, that the phenomenon of 'dashed expectations' is something that you are really concerned about. Talk to us a little bit about this.

Nancy Birdsall: I think this is a huge problem and has been evident with the slowdowns resulting from Covid-19 and the massive loss of employment in informal sectors in particular. Overall, a lot of people in developing countries who are in this struggler group (and in the new middle classes) got accustomed for much of the early 21st century to the expectation that things would get better. Now that this no longer appears to be the case there are likely to be political consequences.

We have seen this reality in the US for a while, where we have a struggling middle class. Anne Case and Angus Deaton addressed this in their book, *Deaths of Despair and the Future of Capitalism*, describing a group of mostly white men, who have lost all hope that things will get better. Consequently, as had happened in the Soviet Union in the early 90s, we have rising levels of alcohol abuse, suicide, drug usage, and so on. These are people who have suffered a complete loss of hope. A colleague of mine at the Brookings Institution, Carol Graham, has done great work recently indicating that lower-income working-class blacks in US cities are much less likely to suffer despair than whites in the same income category, because African Americans still tend to expect that things will improve for them.

Ann Bernstein: I'd like to bring the discussion back to the topic of jobs and the developing world. On the question of the impact of automation and digitisation on low-skilled jobs, you have expressed the opinion that, in the context of poverty and the desperate hunt for jobs, this is not as big a priority in the developing world as people are making it out to be.

There is a lot of hype around all of this at the moment, so I would like to know what your view is on how we should think about this from the perspective of a developing country.

Nancy Birdsall: As a typical economist, my views are generally optimistic. I believe that automation and digitisation will make us all better off and more productive. It could, in fact, be a great blessing if everybody around the world only has to work for 30 hours a week as a direct result of becoming more productive. This is something that Keynes predicted almost 100 years ago.

So far the feared job losses have yet to materialise at the aggregate level. The concerns about automation and its impact remind me of earlier concerns about globalisation and its likely impact on developing countries. It turns out that globalisation has been good for the developing world, which is why it is the developing countries that push back on rich-country trade restrictions, and are changing back rules of the global game on trade and investment. On the whole, middle-income countries are much keener on continuing with and managing globalisation better than nations like the US, France, and Britain.

Ann Bernstein: I think trade has been great for most developing countries, and the more, the better. This is a complicated issue in South Africa at the moment, where we have a big push for localisation taking place, which I think will take us in a different direction. This leads to a question I want to pose on the topic of economic policy. You have argued that to avoid the worst outcomes, countries with emerging middle classes cannot take shortcuts. What did you mean by that?

Nancy Birdsall: Well, an example might be countries deciding to restrict imports. In Latin America, for example, the tradition has been to industrialise at home and minimise competition from outside. That kind of thing can work for a short period, as it did in Brazil, but it then reaches its limits and starts imposing big costs. That was certainly the case in Brazil during the macro shocks resulting from the oil crises of the 1970s. Economists have been arguing about this for decades, but the consensus is pretty strong now that the general lessons of liberal economics are good, and that you should not resort to shortcuts.

Ann Bernstein: I want to delve deeper on the subject of globalisation. There has been a significant push back in the developed world in response to globalisation and growing inequality. On the other hand, you and I probably would agree that globalisation has led to enormous opportunities for millions of people in poorer countries. Could you expand on why globalisation is a good thing for developing countries?

Nancy Birdsall: Developing countries should continue to be advocates for globalisation and embrace open markets and developed countries should not impose restrictions on developing country exports. But I would go further to say that we should be redefining globalisation to take into account the need for more effective management of the problems of the global commons, such as the Covid-19 pandemic and climate change. This may be a setting in which more people across the developed and developing worlds can understand the importance of having global cooperation and multilateral action. There is more to globalisation than trade, workers, and tariffs. I think that the next stage of globalisation will have to focus on a shared approach to certain regulatory standards and a shared approach to addressing the commons problem at the global level.

Ann Bernstein: That is a tough challenge as global standards can lead to protectionism on the part of rich countries. However, let's turn to education reform. You have said that if one is serious about education reform it is vital, as a first step, that political leaders and education officials recognise the depth of the problem. How do we persuade both the general population and leaders about this in countries, like South Africa, where there has been an absence of outrage about our poorly functioning education system and a tendency to divert attention away from the real issues?

Nancy Birdsall: There is an increased recognition in many developing countries of the growing financing challenges in education. There is not much money available that can be spent on education in many countries. It is a vicious cycle; there are not enough middle-class taxpayers to allow governments to finance education reform, which would be an important way to boost the size of the middle class. At the same time, every effort must be made to persuade leaders that the challenge is not about getting children to spend more time in school. The challenge is primarily about raising the quality of schooling and making sure that children are actually learning something. The numbers we have for the learning that takes place in schools across Africa are really shocking. South Africa is not exempt from this.

In the context of the aid system, in poorer countries, one way to bring about change could be through 'cash-on-delivery' aid, which entails donors making a contract with recipient countries stipulating that aid granted to national, provincial or city governments is contingent on their achieving higher numbers of school graduates who pass tests of basic competency. The benefit of this hands-off approach by donors is that it clarifies who bears the risks and the responsibility for the change. It would inspire innovations in recipient countries. There is an extensive literature on useful low-cost interventions. For example, women in possession of a secondary education who are not working could be enlisted to assist in promoting literacy amongst children who cannot read. Randomised control trials conducted in India by Nobel Prize winners Abhijit Banerjee and Esther Duflo show that this kind of intervention can make a huge difference.

Ann Bernstein: I have to ask you about your work on the development and empowerment of women. I sometimes think that this is the biggest revolution the world is going through – opening up opportunities for women to become equal citizens. Unfortunately, it is not being achieved in a lot of countries. You have said that contraception is the single most important technology for development in that it liberates women to think ahead as men have always been able to do.

Nancy Birdsall: A lot of what we have talked about on expectations, strugglers, and the middle class has been about people's ability and willingness to plan for the future. If you're a 10-year-old girl and you live in a context in which your future seems predefined – you will simply end up married to somebody, and you may not even have a choice of whom – then you cannot be part of those processes. It is in this context that the concepts of family planning and having access to contraception gain importance. Providing women with that choice can change the way young women think about their prospects. Their futures open up. We then see girls who are pushing back and saying, "I don't want to marry this old man that my parents chose for me, because this closes off options for me." If we think about contraception as the key that allows planning for a future to become the same for girls as it is for boys, then it is not complicated to see its importance for development.

Ann Bernstein: I would also like to touch on an article that you wrote, provocatively titled *Globalism and Wife-Beating*. South Africa has to deal with an unbelievably high rate of violent attacks on women. Can you offer us any insights from your work that might be helpful to us in addressing violence against women?

Nancy Birdsall: This relates to my ideas around the importance of 'globalism'. This concept is not just about globalisation in the traditional sense, but also about the spread of ideas around the world. When more of us begin to think of ourselves as global citizens, we will direct more money and attention to issues like wife beating. What we then need is to arrive at a point where we have a global standard around the rights of women that everyone across the world recognises.

Ann Bernstein: That is a good and provocative place to end our discussion. Thank you for sharing your time with us, as well as your insights on the middle classes, globalisation, and many other important issues. I am sure everyone has found it as thought-provoking and interesting as I did.

Nancy Birdsall: Thank you, Ann.

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