

II ANNUAL CAF-OXFORD CONFERENCE

The Emerging Middle Class in Latin America: Causes, Challenges and Opportunities





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INTRODUCTION

On 31st October 2014, the Latin American Centre at the University of Oxford and CAF – Development Bank of Latin America had a conference on “The Emerging Middle Class in Latin America: Causes, Challenges and Opportunities”, held at the Nissan Theatre in St Antony’s College.

Attended by 150 students, the conference featured internationally renowned scholars and senior members of CAF analyzing the emergence of a “new middle class” in Latin America. Contributors to the conference highlighted the following three key themes:

- **The middle class remains a contested concept.** The concept, definition and proper measurement of the middle class are all contested in Latin America. While governments claim that a large part of the population has entered the middle class, definitions based on economic security show that they are still vulnerable.
- **There is a gap between aspirations and the delivery of public services.** The expectations and aspirations of the new middle class have yet to be met. Due to fiscal and institutional shortcomings, the states’ capacities may be insufficient to keep pace with the rising demand for better public services.
- **The effect of declining economic growth on the new middle class is unknown.** The new middle class emerged in a recent period of economic growth in Latin America, largely coinciding with the commodity boom. The extent to which this positive trend can be sustained in a time of economic volatility and lower expansion is uncertain.

The following sections of the document develop some of these themes by presenting the contributions of each panel to the discussion.



WELCOME PANEL

The Vice-Chancellor of the University of Oxford, Andrew Hamilton, opened the floor and gave a warm welcome to the audience of the conference. He pointed that the establishment of the partnership between CAF and the Latin American Centre of the University of Oxford in 2012 has meant a new stage in the universities' study on Latin America. As a result, the subject of this conference "The emerging middle class in Latin America" represents one of those changes in response to the growing economic power of the region.

Following Professor Hamilton, the President and CEO of CAF – Development Bank of

Latin America, Enrique García underscored the Bank's role in promoting intellectual thinking inside and outside Latin America. In his address, Mr. García denoted that the strong relationship between CAF and the Centre, which includes a scholarship and fellowship scheme as well as the organization of academic events, is a significant contribution to future development thinking. Margaret MacMillan, Warden of St Antony's College, in concluding the panel, pointed to the way that the intellectual and academic agenda for Latin America has changed as Latin America itself has transformed, and emphasized the enormous importance of the topic of this conference.



OPENING PLENARY

In the opening plenary, Guillermo Perry, Professor of the University of the Andes and former Minister of Finance of Colombia, discussed the size and growth of the middle class. He pointed to several implications of this trend, with a focus on economic growth, public goods, social and political stability, and democracy and human rights.

The composition of the middle class is not the only way to consider issues regarding inequality. Other dimensions of the distribution of income relevant for development include the poverty rate, the concentration of income at the top, inequality across the whole distribution, inequality of opportunities, and social mobility.

Perry pointed to the competing definitions and measurements of the middle class. Economists, for example, draw on definitions based on income, income and occupation, and economic security. However, we should probably consider other characteristics such as human capital and urban or rural location as well as attitudes and values that may distinguish the middle class from the poor and the vulnerable on the one hand, and the rich on the other.

Perry concluded with a proposed future research agenda centred on three areas:

- The selection of more objective criteria to set the cut-off points between the middle class and the rich in order to define clear measures.
- The use of (panel) household surveys to deepen our knowledge about class values and attitudes.
- The need for empirical studies to test hypotheses on the comparative impacts of the share of the middle class, the share of the poor and the share of the super-rich on development outcomes.



PANEL 1

THE EMERGING MIDDLE CLASS: HOW MANY? WHY?



The first panel was chaired by Guillermo Fernández de Soto, Director of CAF's Office for Europe, and brought together three experts: Michael Penfold (CAF), Luis Felipe López-Calva (World Bank), and Maria Herminia Tavares de Almeida (University of São Paulo). The panellists discussed the main characteristics of the middle class in Latin America, mostly regarding measurement and vulnerability issues. The Brazilian case was presented as an example of these features.

A study from CAF measured the size of the middle class considering two main dimensions:

- Income (objective measure), divided into low, vulnerable, mid-low, mid-high and high class; and
- Attitudes/preferences (perception measure), based on the sense of belonging to each class: low, middle or high class.

According to the income measure that divides the Latin American society into low, vulnerable, mid-low, mid-high and high classes, from 1981 to 2010 there was a growth of the mid-low class (from 13% of the total in 1981 to 22.2% in 2010). In the same period, the vulnerable segment has become the largest one (from 30% to 36%). In Latin America, there is also a significant difference

between feeling and being de facto middle class. Individuals consider themselves as part of the middle class even though they do not have the income to be objectively considered as such.

Regarding values and ideology, the Latin American middle class is slightly more inclined to the right than in other regions, has higher trust in institutions and in market rules and it has a preference towards individual responsibility with regard to social protection. Despite these small differences, the study's findings suggest that there is no 'Latin American style' of the middle class because most preferences and values are similar in other regions across the globe.

The contribution of the growing Latin American middle class to regional development through entrepreneurship and demand for better quality services is considerable. This emerging middle class poses new challenges, including public policy failures and social mobilisation over unsatisfied demands.

Another definition of "middle class" was developed in the panel according to which an individual becomes part of this group when it is no longer vulnerable to poverty (see López-



Calva and Ortiz-Juárez, 2012). This concept of the middle class is a non-arbitrary principle because it is based on welfare. Economic security is thus what distinguishes the middle class from more vulnerable situations.

Based on this definition, the Latin American middle class is certainly on the rise, even if countries in the region are not yet middle class societies. There is an intermediate category between the poor and the middle class - the vulnerable -, which has grown considerably from 34.4% of the population in 2000 to 37.8% in 2011. If the Latin American middle class is to continue growing, it is critical to protect this segment of the population in transit from falling back into poverty.

Following this perspective, the Latin American middle class has three main characteristics:

- No homogenous values for all the middle class group members;
- Pragmatism with regard to the quest for economic security, and
- Moderate views regarding politics and societal change.

While these characteristics could contribute to increased social cohesion, the middle class could also opt out from the social con-

tract if it does not perceive benefits. This danger is clear when considering the challenges around the quality of public services. The middle class increasing reliance on private services (e.g. transportation, schools and hospitals) reduces their willingness to finance the public sector through taxes.

An example of the middle class general characteristics was portrayed through the Brazilian case. The middle-income group has reached approximately one hundred million people in the country. Nonetheless, in Brazil and other developing countries, there is still a "poor middle class." There are two types of explanation for the growth of these groups:

- Market: employment growth and mean salary growth; and
- Public policies: conditional cash transfer programmes (CCT), an increase of the minimum wage, subsidised credits, the expansion of access to higher education via loans and the opening of public universities.

Additionally, external factors have also contributed to the growth of the middle class, such as the favourable scenario of the international market at the beginning of the 2000s.

The Brazilian case introduces another feature of the middle class: belonging to the middle class is not only related to income levels and consumption power, but also to prestige and attitudes. This includes for instance access to leisure activities, shopping malls and travelling by airplane.

Taking all these facts into account, the demographic characteristics of the new Brazilian middle class are: 49% are white and 51% are black/mulatto; 89% are urban residents; 36% live in the Southeast and 34% live in the Northeast; 57% work in the formal labour market; and in 64% of the families the head of the family has very low levels of education (4 years or less of schooling).

In Brazil, this rise of people entering the middle-income group has consequently increased the demand for better provision of public services. The protests that hit Brazil in June 2013 were mainly led by the middle class and advanced a positive policy agenda, particularly centred on the fight against corruption and demands for better public services.

PANEL 2

THE IMPACT OF THE MIDDLE CLASS



Horst Grebe from CAF chaired this panel that assessed the consequences of middle class growth on society's demands. Carol Graham, from Brookings Institution, shared the stage with Pablo Sanguinetti, from CAF, and Diego Sanchez Ancochea, from the University of Oxford. The scholars presented various perspectives regarding well being and insecurity. The Costa Rican case was described as an example of the role of the state in middle class growth and of effective responses to its demands.

The "progress paradox" theory focuses on the well-being measurement and the unhappy emerging new middle class in Latin America from a comparative perspective. For that purpose, well-being was measured in two main dimensions: hedonistic or daily experience; and evaluative or satisfaction with life as a whole. The "paradox of unhappy growth" suggests that the process of change can be filled with frustration. This is particularly worrying for the middle class, which tends to experience the biggest well-being drops, even more than the poor.

The frustration of the middle class results from the difficulties to acquire new goods

and the fear of losing acquired standards of living. The Latinobarómetro data shows that the Latin American middle class is significantly less satisfied with education and healthcare than their peers in other regions. For instance, 52% of the middle group in Latin America is satisfied with the education they receive, compared to 55% in other parts of the world. This is likely to be associated with the high expectations towards institutions and public services and the consequent frustration that comes with these unmet expectations.

Insecurity perceptions and their relation with the emerging middle class was another point discussed in this panel. Latin America has the highest homicide rates in the world, although intraregional cross-country variance is also high. In all Latin American countries people's perception of insecurity is very high, with significant social costs. The perception of insecurity does not seem to be related to the emergence of the new middle class. It is prevalent across income classes and actual victimisation rates are similar across classes as well.

For example, Latin Americans often change their habits to reduce fear from crime: ac-

According to a 2013 CAF survey, around 90% of Latin Americans take protective measures such as not carrying valuable objects, not talking to strangers and not arriving home late. People also take protective measures at home, which vary across classes.

The high perceptions of insecurity can be explained by high actual crime occurrence and the lack of reliable information and statistics on crime. The lack of trust in the police and the lack of effective police services could further contribute to perceptions of insecurity. Low-income families are least confident that police institutions can be trusted: according to the 2013 CAF survey, 50% of the low-income families disagree with the statement that one can count on the police. In the middle- and high-income families it is 47% and 48% respectively. The multiclass character of violence (and the perception of violence) makes the creation of supporting coalitions towards change more likely than in other areas.

The Costa Rican case offers an interesting example of the determinants for the emergence of a middle class society based on its historical experience. Expanding the middle class in a sustainable way requires both market and social incorporation, that is, good

jobs and access to social rights. Although securing this double incorporation has been difficult in the developing world, Costa Rica has been one of the few exceptions. Between 1940 and 1980 this country created more formal jobs than its neighbours and became the Latin American case most closely approximating a universalistic egalitarian social state.

Costa Rica's success relied heavily on the central role of the state, which promoted sectorial modernisation, gave incentives to small medium firms and cooperatives and expanded health care, education and other social services. An emerging middle class elite made of professionals and small entrepreneurs drove Costa Rica's process of state building during this period. This new elite implemented a set of policies for their own benefit, which in turn contributed to the expansion of the middle class.

This case's analysis leads to several significant conclusions on how to build a middle class society: (a) the importance of simultaneously securing market and social incorporation; (b) the need to consider the role of the state over the long run; and (c) the importance of enhancing the policy influence of at least some segments of the middle class.



PANEL 3

HOW SUSTAINABLE IS THE GROWTH OF THE MIDDLE CLASS?

In the following panel moderated by Leigh Payne from the University of Oxford, Ludolfo Paramio (CESIC), Christian Daude (OECD), and Leonardo Garnier (University of Costa Rica), discussed the sustainability of the emerging middle class.

To analyse the political consequences of the new middle class it is necessary to distinguish between the traditional middle class and the new middle class. The achievements of the new middle class constitute a generational rupture. At the same time, this new middle class is shaped by the frustration of expectations, leading to mistrust in politics as exemplified by the strong mobilisation of discontent against governments. Discontent and social polarisation cannot be explained with economic variables alone. The national context has to be taken into account, including weak governments and party systems.

In this scenario, the new middle class competes with the traditional one for resources, including public transport and other public services as well as infrastructure. Latin America's public policies are still based on the pro-poor model of the 1990s and lack sufficient focus on the improvement of the situation of

the traditional middle class. New policies in areas like infrastructure or education must be designed, along with incentives for the middle class to pay taxes.

Education is also a crucial factor regarding upward social mobility in Latin America. Formal education is a key determinant for acquiring better job opportunities and thus higher earnings. Social mobility must be assessed as a multidimensional concept that incorporates the educational level, occupation and social status.

By presenting some measures of mobility such as educational attainment and intergenerational mobility (correlation between a person's own educational attainment and parental educational attainment), an OECD study suggests that there is significant upward mobility in Latin America. However, overall social mobility is still low in comparative perspective.

The OECD study also assessed how much variation in PISA test scores is explained by family background. The influence of background is still very high in Latin America, consequently suggesting a low social fluidity in





the region. This leads to at least three main policy recommendations to increase mobility and reduce vulnerability in Latin America:

- Increase the number of secondary schools and improve their quality by securing a more equitable distribution of resources, expanding the number of years of compulsory education, and focusing on quality, results and skills;
- Expand the social mix within schools; and
- Create better funding mechanisms for tertiary education (grants, scholarships, among others).

There is no doubt that education has been one of the most important elements to support the formation of the new middle class in Latin America. However, there are still many differences between middle class and the poor. While the middle class has been growing in Latin America, two thirds of the population are still considered poor or vulnerable. On average the poor have not completed their basic education, while adults in the middle class have at least attended high school and adults in the upper class have gone to, and probably graduated from, university.

It was stressed that the case of Costa Rica was successful from the fifties to the seventies in terms of social and institutional development, but lost momentum later. The government adopted in recent years some policies to reverse the negative trend. Improving rates of enrolment in education is not sufficient to secure the growth of the middle class. Instead, the quality of education needs to be improved.

In today's world, creative reasoning is one of the most important skills people should have. Therefore, high quality education should teach logic and maths through discovery and collective problem solving. Another element of high quality education should be learning to become a citizen, i.e., to live with others in a respectful manner. Some of these reforms will require higher investment in education, while others will demand better policymaking.

CLOSING PLENARY



In the closing plenary, Miguel Castilla, Former Minister of Finance of Peru, used the example of his country to illustrate the decline of poverty and the growth of the middle class, which in turn has contributed to a consumption boom. He then focused on how to tackle the need for higher fiscal and institutional capacity to meet the growing demands from the emerging middle class. He underscored that good quality education is a key point to sustain social mobility and enhance productivity.

Castilla stressed the challenge of responding to the demands for more and better services in countries where there is precarious fiscal and institutional capacity. This is the case in Peru, where informality accounts for approximately 60% of the urban labour force, affecting the country's tax revenues collection.

A way of solving the growing demand for public goods would be through public private partnerships (PPPs). PPPs could potentially be a way of accelerating the provision of public goods and sharing risks. These initiatives, however, face two main constraints:

- Focus of politicians on projects with short-term outcomes; and
- Raising taxes to increase public investment.

Castilla concluded his presentation highlighting that the rise of the middle class should be taken as the basis for the future prosperity of Latin America. In order to sustain its growth, the region needs to further economic and institutional reform.

AGENDA

- 9:00 – 9:30 Welcome panel**
Andrew Hamilton (Vice Chancellor, University of Oxford)
Enrique García (President, CAF-Development Bank of Latin America)
Margaret MacMillan (Warden of St Antony's College)
- 9:30 – 10:45 Opening plenary. The Emerging Middle Class in Latin America**
Chair: Timothy Power (University of Oxford)
Guillermo Perry (University of the Andes)
- 10:45 – 12:30 PANEL 1 The emerging middle class: How many? Why?**
Chair: Guillermo Fernández de Soto (CAF-Development Bank of Latin America)
Michael Penfold (CAF-Development Bank of Latin America) – The growing (but vulnerable) middle class in Latin America
Luis Felipe López-Calva (World Bank) – Mobility, vulnerability, and middle classes in Latin America
Maria Hermínia Tavares de Almeida (CEBRAP) – The experience of Brazil in comparative perspective
- 12:30 – 13:30 Lunch**
- 13:30 – 15:15 PANEL 2 The impact of the middle class**
Chair: Horst Grebe (CAF-Development Bank of Latin America)
Carol Graham (Brookings Institution) – Happiness, protests and the emerging middle class from a comparative perspective
Pablo Sanguinetti (CAF-Development Bank of Latin America) – The middle class and insecurity in Latin America
Diego Sánchez-Ancochea (University of Oxford) – Middle class-based elite: the Costa Rican experience
- 15:15 – 15:45 Coffee break**
- 15:45 – 17:30 PANEL 3 How sustainable is the growth of the new middle class?**
Chair: Leigh Payne (University of Oxford)
Ludolfo Paramio (CESIC) – Political consequences of the new middle class
Christian Daude (OECD) – Education and the future of social mobility
Leonardo Garnier (University of Costa Rica) – Education reforms for the consolidation of the middle class
- 17:30 – 18:00 Closing Plenary**
Chair: Enrique García (CAF-Development Bank of Latin America)
Miguel Castilla (Former Minister of Finance, Peru)
- 18:00 – 18:15 Closing remarks**
Leigh Payne (University of Oxford)
Enrique García (CAF-Development Bank of Latin America)



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