

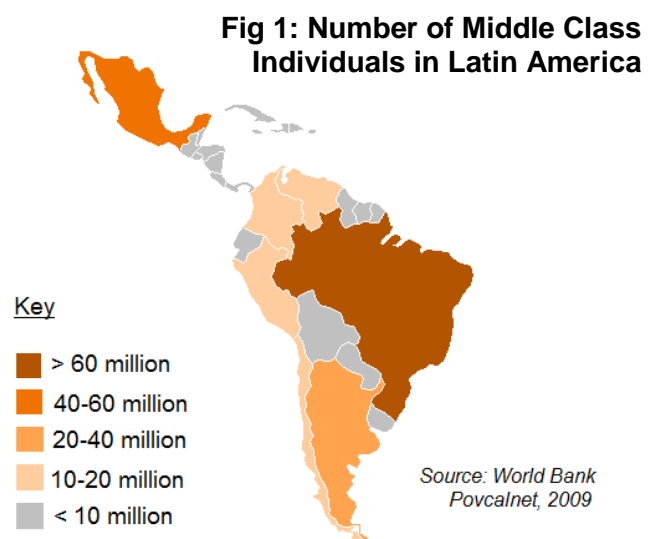


## The stable consumer? The expansion of the middle classes in Latin America

*This report takes a careful look at who the middle class are in Latin America to get a better sense of how they are reshaping the economics and politics of countries in the region. This is mostly a 'good news story' for the UK. There are clear commercial opportunities, particularly targeted at the 'established' middle classes who are likely to want the sorts of goods and services we export. The unexploited potential in education is especially striking. On politics, it is possible that as the middle classes grow, they will generate political parties more at ease with the globalised world, and keen to protect their stakes in it.*

### Summary

1. There are almost 300 million people in Latin America that can be considered 'middle class', more than in China and India combined, according to the most recent data. Although less prosperous than their Western counterparts, the middle class in Latin America is a key driver of economic growth and a key opportunity for UK businesses. UK exporters of advanced manufacturing goods, education products and financial and other professional services are most likely to benefit from the emergence of the middle classes. The middle classes are concentrated in the emerging powers in the region, mostly in Brazil and Mexico. Politically and economically they are typically a constituency for stability, although it is difficult to generalise across the whole region. The growing middle classes have implications for policy on education, infrastructure, energy and taxation in the region.
2. This report continues as follows: first it examines the characteristics of the middle classes in Latin America; in terms of their number, their distribution in the region, and their future growth and who they are. Secondly, it focuses on the implications for Latin America of this expansion, in terms of economic growth, political economy and policy. Finally it looks at implications for UK businesses of the expansion of the middle classes through increased commercial opportunities.

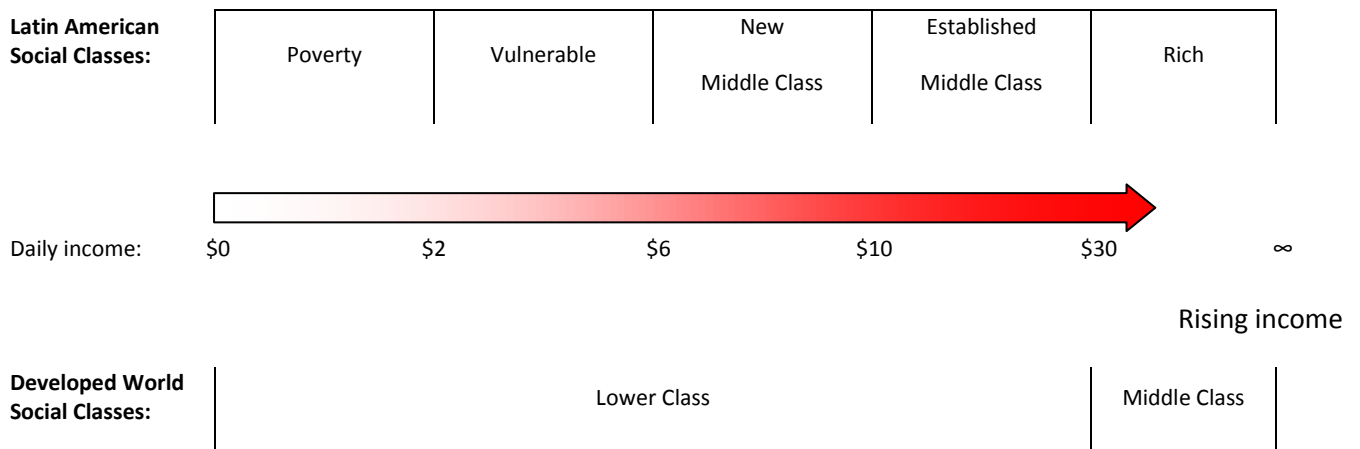


### The characteristics of middle classes in Latin America

3. The middle classes are typically those with disposable income to spend on non-essential items. Although there is no universally agreed middle class income threshold **this report defines the middle classes as those with an income per head of \$6-\$30/day (\$2,190-\$10,950 /year).**

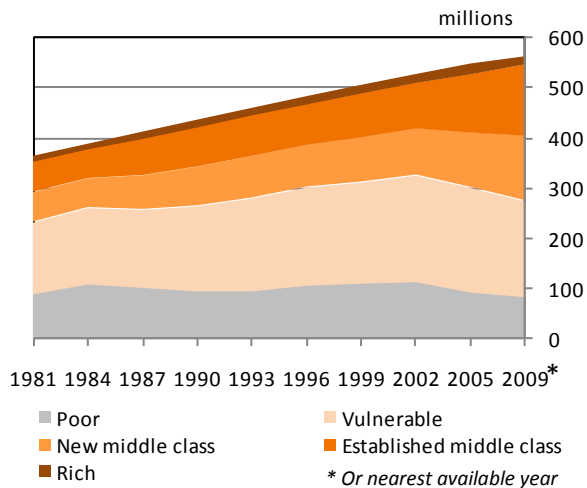
This may seem low by advanced economy standards, and partly reflects different costs of living. But it is important to view the middle class in the developing world as distinct from those in developed countries. They are not what we think of as middle class in the UK (see fig 2).

**Fig 2**

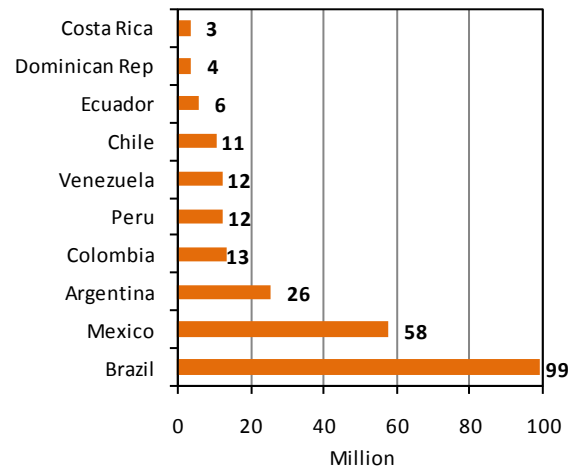


4. The middle class definition is further subdivided into the 'new' middle class (\$6-10/day) and the 'established' middle class (\$10-30/day). The new middle class are more likely to have recently left poverty, while the 'established middle class' are better off and more able to buy foreign goods.
5. **The middle class in Latin America has more than doubled over the last 30 years, from 120m to 274m** (see figure 3). Latin America had a larger middle class than China (183m) and India (18m) combined in 2005, the most recent year for which data is available. The middle class now account for 48% of the Latin American population, up from 32% in 1981. The expansion has gathered pace since 2002. Growth has been particularly marked in the 'established' middle classes, which have accounted for 50m of the 70m increase since 2002. The established middle class now account for 145m of the 274m in the middle class. The expansion of the middle classes has occurred concurrently with a reduction in poverty, which has decreased from 25% to 15% of the population - evidence that the lower middle classes have expanded due to the poor rising up the income ladder.

**Fig 3: Income distribution in Latin America 1981-2009**



**Fig 4: Top ten middle class countries in Latin America**



6. **Both economic growth and income distribution have been key to the growth of the middle classes.** There is positive correlation between the level of economic growth and the extent of the growth of the middle class. However, it is not always true that the countries that grow fastest show the largest growth in the middle classes. Income distribution is also important; countries where inequality has decreased have generally seen larger increases in their middle classes. Redistribution policies must be carefully balanced, however. Too much redistribution will hurt economic growth through reduced incentives, whereas too little may lead to social breakdown. When there is a slowdown in growth through external shocks, such as at present, middle classes may be more likely to be affected, as they are more likely to work in value added export industries such as manufacturing than the poor. However, they are more likely to be able to cope with such shocks; they are more likely to have savings, and more likely to enjoy employment protection.
7. **The middle classes are mostly situated in the emerging powers in Latin America, particularly Brazil and Mexico.** Brazil accounts for about 40% of the Latin American middle classes, and Mexico accounts for 25%. There are also significant middle class populations in Argentina, Colombia, Peru, Venezuela and Chile (see figure 4).
8. **Latin America's middle class is predicted to increase substantially. The majority of the middle class in Latin America are less than thirty years old.** The World Bank and the Brookings Institute estimate that the middle classes in Latin America will increase by 60-70% over the next 20 years. On our figures, this would mean a Latin American middle class of around 450m in 2030, which verges on the current EU population.
9. **The middle classes in Latin America have attained a degree of economic prosperity,** but do not have the job security of their Western counterparts and **many fear lapsing back into poverty.** Although the number of formal sector middle class jobs has increased, many are still employed in the informal sector. Due to fears of poverty relapse, Latin American middle classes are often fiercely protective of their economic interests, and will use family and informal networks to protect these interests. This can sometimes lead to the marginalisation or exploitation of the less-powerful, including indigenous people. Latin American middle classes often do not feel middle class, whether because of high inflation, high living costs or their

aspirations to US lifestyles. These aspirations to US lifestyles, and the cultural pervasiveness of the US in the region, could be behind the recent increase in positive public attitudes to the US in the region. However, this public softening of attitudes to the US has not led to changes in foreign policy; many states in the region do not have especially cordial relationships with the US.

10. **More widespread education is helping people graduate into the middle classes and gain middle skilled jobs.** Currently education levels are low by international standards, with generally only some secondary education among the middle classes. But this is gradually changing. Most Latin American students currently in school are likely to finish their secondary schooling. Better-educated individuals are increasingly likely to be employed in medium-skilled occupations and get paid accordingly. These jobs are in industries such as construction, transport, communications, wholesale and retail, and hospitality. OECD data show that employment in the public sector is not as high as in these other sectors, although some local government employees may not appear in official statistics.

### Implications for Latin America

#### *Economic growth*

11. **The middle classes have been described as ‘sustainers’ of economic growth, partly by boosting consumption.** Economist William Easterly has shown that a sizeable middle class is correlated with long term economic growth. Fuelled by greater disposable income, middle class consumption can stimulate demand for a wide range of goods and services. This is evident in Latin America, as domestic consumption is expanding faster than the economy overall.
12. **The middle classes also make the economy more resilient.** They are more able to save, and can draw down these savings in times of economic turmoil, so the economy is more resilient to shocks. This saving can also be used for investment, both physical (plant and machinery) and human (education), which is good for growth.
13. **Middle class individuals are typically more productive due to their better education and health. However, productivity in Latin America is perhaps lower than in other emerging powers due to lower entrepreneurship, which could be holding back growth.** One international entrepreneurship index<sup>1</sup> shows that Latin American countries generally score lower than Asian or Eastern European countries, but higher than Middle Eastern or African countries. In Latin America, between 10 and 25% of the middle classes own their own business or are self employed. This is higher than among the poor, but slightly lower than among the rich. This could be because of barriers to entrepreneurship among the middle classes (low availability of credit, no support for entrepreneurs etc).

#### *Policy*

14. **The expansion of the middle classes in Latin America could push governments in the region to address education and infrastructure issues.** Historically, in regions lacking a substantial middle class, elites have underinvested in education and infrastructure. This is true in Latin America, and is holding back economic growth. Although government spending on

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<sup>1</sup> The Global Entrepreneurship Index, <http://www2.druid.dk/conferences/viewpaper.php?id=502261&cf=43>

education has increased, it is still below the world average<sup>2</sup>. Furthermore, generally state educational quality is poor; Latin American schools perform poorly in international comparisons of education achievement. Projected infrastructure investment for Latin America in 2011-2015 is just 2% of GDP. Other developing economies are investing more - three times as large a share of GDP in India, and five times as large in China.

15. **In terms of economic policy, the middle classes are a constituency for economic stability**, as they are likely to demand a stable macroeconomic environment, in order to protect their own economic interests. Orthodox economic policies such as inflation targeting, fiscal discipline and floating exchange rates are seen in many countries with sizeable middle classes (except Argentina). Unorthodox policies are often unpopular. Some suggest middle classes are more likely to support private ownership of business and strong competition, which may lead to higher growth.
16. **The expansion of the middle classes will also lead to higher tax revenues**, through a broader tax base and higher taxable incomes. Tax revenue has increased over the last few years in several Latin American countries. This enhances government capacity to spend on areas such as education, infrastructure, R&D and social security. This will increase the ability of governments to address bottlenecks to economic growth and inequality. Improved public services may also reduce tax evasion, as people are more likely to pay tax when they see the benefits they receive from public services. The expansion of the tax base will be especially welcome in Mexico, where the non-oil tax base is particularly low.
17. **Energy policy will have to adapt to the expansion of the middle classes**. As incomes increase, greater consumption means per capita energy use is also likely to rise rapidly. As a relatively low carbon region, Latin America needs to beware of 'locking in' a higher carbon growth path. For example, in Chile, energy demand is expected to grow 60% between 2010 and 2018. Recent increases in energy production have come from dirty coal power stations, and efforts to build more hydroelectric plants are meeting opposition. More low carbon energy sources are needed to avoid high carbon 'lock in'.

#### *Political economy*

18. **The middle classes are widely recognised as being a political constituency for stability**, and democratic regimes are more likely in countries with larger middle classes. However, the demand for stability could manifest itself in several ways. It could lead to support for democracy and moderate, progressive political platforms, if the middle classes desire stability through predictable management of the economy and centrist political parties. There are examples of recent elections in which middle classes have arguably been decisive in the outcomes. However, if the middle class is 'squeezed', for example, by radical left-wing governments, it is possible middle classes might resort to supporting non-democratic means of ousting the politicians, in extreme situations.
19. **The expanding middle classes often have aspirations for better public services, and can act as a driver for positive reform**. Sometimes demand for these reforms can come through more fractious means. The rise of the middle classes could lead to more of these types of

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<sup>2</sup> 4.1% of GDP in Latin America, 4.6%.worldwide (2007)

protests in the future if the aspirations of the middle classes are not met. Furthermore, the explosive expansion of internet usage (which has doubled, if not tripled, in most Latin American countries over the last seven years), makes these sorts of protests easier to organise through social media.

## Implications for the UK

### *Prosperity*

20. **Expanding consumption opportunities for the middle classes in Latin America presents commercial opportunities for the UK.** The UK focus should be on the ‘established’ middle classes, which have seen the fastest expansion recently. These consumers have more disposable income, and are more likely to purchase the sophisticated and specialised goods and services the UK produces. In contrast, the new middle classes are more likely to disproportionately consume durable goods, which the UK has no particular comparative advantage. The established middle classes are also more likely to desire high quality goods and branded goods, which will benefit the UK. The commercial opportunities are concentrated in the markets with the largest middle classes: Brazil, Mexico, and to a lesser extent Argentina, Colombia, Chile and Peru.

21. **UK exporters of advanced manufacturing goods, education products and financial and other professional services are likely to benefit from the emergence of the middle classes.** This is both from direct demand from the middle classes for the goods and indirect demand from companies selling goods and services to the middle classes. Encouragingly for the UK, the Brookings Institute notes that imports are more likely to satisfy the middle class-led consumption boom of advanced manufactured goods in the region, rather than domestic production, as domestic comparative advantage is not in advanced manufactures. The UK has a comparative advantage in advanced manufacturing and services, and has already seen above average growth in exports to the region in these sectors (see figure 5). Luxury goods have seen high, but not above average, growth so far. UK financial services exports are also likely to accelerate further over the next few years as local financial markets develop further.

**Fig 5: Selected UK Exports to Latin America**

|                               | 2005<br>£m   | 2010*<br>£m  | Percentage<br>increase |
|-------------------------------|--------------|--------------|------------------------|
| <b>Advanced manufacturing</b> |              |              |                        |
| Pharmaceuticals               | 226          | 762          | <b>237</b>             |
| Vehicles                      | 191          | 455          | <b>138</b>             |
| Scientific/medical equip      | 94           | 227          | <b>141</b>             |
| <b>Luxury goods</b>           |              |              |                        |
| Clothes                       | 5            | 10           | <b>106</b>             |
| Whisky                        | 188          | 287          | <b>53</b>              |
| Books/newspapers              | 29           | 41           | <b>41</b>              |
| <b>Services**</b>             |              |              |                        |
| Financial services            | 95           | 206          | <b>117</b>             |
| Other business services       | 87           | 426          | <b>390</b>             |
| <b>Total goods exports</b>    |              |              |                        |
|                               | <b>2,287</b> | <b>4,729</b> | <b>107</b>             |
| <b>Total services exports</b> |              |              |                        |
|                               | <b>837</b>   | <b>1,253</b> | <b>50</b>              |

\* Services data from 2009

\*\* Services data only available for Brazil, Mexico, Argentina, Chile

Source: UN COMTRADE and ONS

22. **The emergence of the middle class also provides an opportunity for UK retailers to invest in Latin America, which has not, as yet, been capitalised upon.** Management consultancy AT Kearney cites Brazil, Chile and Uruguay as the three most attractive countries worldwide for retail expansion, due to strong growth, surging retail sales, low risk, good

investment climate and low market saturation. UK retailers that focus on luxury stock and convenience food are likely to gain from a middle class that is becoming more brand-focused and time-poor.

23. **Education is a growth area for UK, including in English language tuition and educational materials. However, in higher education, spending is coming from the Latin American rich, rather than middle classes.** Education spending has risen more than proportionally among the middle classes in Latin America. The education spending share of the middle classes in Brazil, for example, has increased by 150% over the last eight years. This presents opportunities for the UK, mainly in English language tuition and materials. **Latin American students are increasingly attending university in the UK (see figure 6), although absolute figures are relatively low, and significantly lower than student numbers from China or India.**

**Fig 6: No of Latin American students in UK**

|                               | 2005/6       | 2009/10      | Percentage change |
|-------------------------------|--------------|--------------|-------------------|
| <b>International Students</b> |              |              |                   |
| Brazil                        | 1,040        | 1,315        | 26                |
| Mexico                        | 1,370        | 1,360        | -1                |
| Colombia                      | 425          | 825          | 94                |
| Chile                         | 315          | 490          | 56                |
| Venezuela                     | 275          | 295          | 7                 |
| Argentina                     | 285          | 220          | -23               |
|                               |              |              |                   |
| China                         | 46,960       | 56,900       | 21                |
| India                         | 17,725       | 38,500       | 117               |
| <b>Lat Am Total</b>           | <b>3,710</b> | <b>4,505</b> | <b>21</b>         |

24. **International tourism is another growth area that is being driven by the rich, rather than the middle classes,** as intercontinental travel is unaffordable for almost all of the middle class. Tourism spending increases more than proportionally among middle classes, but little of this is likely to be spent in the UK. Figure 7 shows the UK is benefitting from more tourist visits from the region though, which have increased by 66% since 2005, with particularly large rises from Brazil and Argentina. In stark contrast to the higher education situation, the region also performs well against China and India in this measure; tourist arrivals from Brazil in 2010 were double those from China.

**Fig 7: No of Latin America tourists to UK**

|                            | 2005<br>(000s) | 2010<br>(000s) | Percentage change |
|----------------------------|----------------|----------------|-------------------|
| <b>UK Tourist Arrivals</b> |                |                |                   |
| Brazil                     | 51             | 124            | 145               |
| Mexico                     | 60             | 48             | -21               |
| Argentina                  | 16             | 44             | 182               |
| Chile                      | 10             | 9              | -10               |
| Colombia                   | 4              | 8              | 100               |
|                            |                |                |                   |
| China                      | 53             | 58             | 9                 |
| India                      | 138            | 208            | 51                |
| <b>Lat Am Total</b>        | <b>140</b>     | <b>232</b>     | <b>66</b>         |

Source: BIS

#### *Security and foreign policy*

25. **The implications of the expanding middle classes on security are complex, ambiguous and situation dependent.** The analysis in a previous section described how the middle classes could have different impacts on national political stability. Furthermore, security is of high concern for the new middle classes, who cannot afford the private security that the wealthy can. They are more reliant on the state, and if security issues worsen, could support radical or zero tolerance policies to tackle insecurity and crime, with potential human rights implications.

26. **Expanding middle class incomes are likely to lead to more domestic drug consumption,** at a time when drug supply is being diverted to Latin America as it becomes increasingly difficult to traffic drugs through the region to the US. Cocaine consumption in Mexico has doubled over the last six years and cocaine consumption per capita in Argentina now rivals the US. Drug consumption worldwide is usually highest among middle and upper classes.
27. **The expansion of the middle classes has so far had little effect on foreign policy.** The middle classes in Latin America are largely concerned with domestic, economic, affairs; unless international affairs directly affect them. The expanding middle classes have not pushed for liberal intervention abroad, for example. It is conceivable that the middle class may have a greater impact on foreign policy in the future, particularly in Brazil.