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Dollar & Sense podcast
How will the rise of the global middle class affect trade and consumption?
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DAVID DOLLAR: Hi, I'm David Dollar, host of the Brookings trade podcast, [Dollars and Sense](#). Today, my guest is Homi Kharas, a senior fellow in the Center for Sustainable Development at Brookings. Homi's recent research focuses on the rise of a global middle class. Our topic is how this global middle class affects consumption, production, and trade. So welcome to the show, Homi.

HOMI KHARAS: Thanks so much, David.

DOLLAR: So let's start with how you define the middle class. What does it mean not just in terms of income, but in terms of lifestyle and consumption?

KHARAS: Let me start by saying that how I define the middle class and how I measure the middle class are two quite distinct concepts. So I'd like to talk about defining the middle class in terms of a group of people who basically make choices about their lives and about the economics of their lives.

If you think about people, if you are poor, you don't really have the ability to make choices. You just don't have the discretionary income to go around. You are really struggling just to make ends meet. If you are rich, you don't have to make choices because you can afford pretty much anything that you want. And if you are in between, then you are making choices. That's how I think about the middle class, and it's consistent with this idea that the middle class feels a responsibility for themselves. It's a very individualistic kind of concept. They take responsibility for their own well-being and for their families. They invest in themselves. So it's really a group of people that are making those choices.

So how do we measure it, which is a slightly different thing? I try to choose people who are living in households that are spending between \$11 and \$110 per day per capita in 2011 purchasing power parity terms. That's a huge mouthful; let me just give a very quick explanation. Purchasing power parity allows us to compare the middle class size across different countries both spatially and over time, so it essentially adjusts for price differences. The levels of the thresholds are levels at which we start to see, at the bottom level, for example, people not worrying about falling into poverty. The probability of falling into poverty if you are in a household spending more than \$11 a day is less than five percent over three years. So you are actually actively thinking about how do I choose to spend my money. At the top end, it's a fairly rough estimate about when is it that people literally don't have to worry too much about a budget constraint; they can basically choose whatever they want. Then last, I would just say the reason why I talk about these things in terms of per person per day is because of the very long literature on defining poverty in terms of an amount that you spend per day.

Finally, let me say I think about the middle class in terms of expenditures rather than incomes because all of us know that you might be a student with a very low level of income today, but if you are in college you have a high future expected income. So your spending might be much higher because you can afford to take out student loans, maybe your family is helping you, all kinds of other things. You are living a lifestyle which is significantly different from the lifestyle of somebody who is really poor.

DOLLAR: Homi, in your research you argue that there are going to be big shifts in the global middle class over the next 10 years. Traditionally it's been a mostly rich country phenomenon, but now we are going to see big shifts. So, can you characterize those shifts?

KHARAS: It's really interesting to me that there are two very distinct narratives about what's happening to the middle class right now. In advanced economies, which is where the bulk of the middle class used to be constituted—and certainly the first billion people in the middle class were almost entirely in Europe, North America, and Japan—the narrative is about how the middle class is getting hollowed out. What people are not really focusing on is that there is an emerging middle class, largely in Asia, which is expanding at a rate that we have never seen before in history.

Just to give you an example, we are adding probably something like a billion people to the middle class every seven or eight years, largely because of what's happened thanks to rapid growth in China and India and all these other East Asian countries, each of which have hundreds of millions of people. I mean, we have Indonesia with a couple of hundred million people, and we have Bangladesh with a couple of hundred million people and the Philippines with 100 million-plus people. Add them all up and you start to get some very big numbers. Now COVID-19 has kind of set that back, probably by at least a couple of years, but it probably hasn't done that much to alter the trend. It's more of a level shift assuming we don't get some additional really bad variants and bad news. But when you look at how the IMF projects the global economy to move now, over the next few years we will see the middle class returning to its old trend growth.

DOLLAR: So Homi, you have emphasized a number of large Asian countries. Outside of Asia, are there some key countries that you would mention where this growing middle class is also an important phenomenon or is it primarily Asian?

KHARAS: Asia is the most rapidly growing region in the world. There was a period of time, for example right after the Berlin Wall fell, you had very large numbers of people in the former Soviet Union countries that were not in the middle class from the sense I gave you before about having the choice and the freedom to choose. They might have had a reasonable standard of living in terms of not being in extreme poverty, but they didn't have that choice. All of those people have joined the global middle class—probably something like 300 million of them.

Latin America has a segment of its population which is middle class, but Latin America is not growing very rapidly either in terms of income growth or in terms of population. Africa has a very high population growth rate but not a very significant per capita income growth rate, especially in the two most important economically countries in Africa, which are South Africa and Nigeria. Both of those seem to be pretty stuck in terms of economic development so their middle classes are not expanding that rapidly. So that means the real heart of middle class growth, as opposed to its level, is actually in Asia, and more specifically in South Asia and East Asia right now.

DOLLAR: So in terms of measuring the middle class, you emphasized what I would call real consumption. It seems to me as an economist, you are an economist, too, that naturally there have to be some shifts in production that go along with this rising middle class. If you have changes in consumption and production, then normally you have changes in international trade. I always like to bring our topic back at least a little bit to international trade which is the theme of our podcast. So how do you see this rise of the middle class—particularly this rapid increase now in Asia—how do you see this affecting production and trade?

KHARAS: The middle class tends to have its own very specific preferences. So I think that having domestic brands that will be able to respond quickly to changes and fashions will be very important. But those domestic brands can in turn be sourced globally. To give you one example from trade, maybe not your traditional trade, but take music. You have a very distinctive type of Asian music that is now becoming enormously popular, K-Pop, becoming hugely popular everywhere in Asia. That's an example of how an Asian production cycle will be tapping into Asian markets.

You are seeing this now in so many of the new digital start-ups that are happening in Asia. Every time you read about one of these unicorns that is a digital marketplace for delivery of groceries or delivery of something, it's all oriented toward the middle class, and each one is oriented toward its own segment of the middle class in that country. So whoever controls those platforms will really benefit from this expansion of trade. Right now, those platforms are being developed in Asia by large Asian countries. And the explosion of online consumption by Asian middle class families is actually huge, so I see that as being central. It means essentially the development of what we have sometimes called regional value chains. You have to be close enough to the consumer to detect the changes in fashion, but you have to be at sufficient scale to be able to deliver a real global digital platform.

DOLLAR: In reading your report, Homi, it struck me that some of the countries that you emphasize with the growing middle class, Vietnam and Bangladesh are great examples that you mention, these are the same countries that are increasing their participation in global value chains. So this growing middle class you are talking about, they are moving to cities, they are getting more education, and that creates the production foundation. You need the production if you are going to have the income in order to have this middle class lifestyle.

KHARAS: Absolutely. The foundation of the middle class in Asia was export-led growth. It was export-led growth early on in light manufacturing that generated the creation of very large numbers of jobs—and let me say specifically jobs for women. So whenever you think about garments or electronics as export items, what you ought to be thinking of is these are actually creating jobs for young women. That led to a very new phenomenon in Asia, which was the two-income household, and it was that two income households that was able to bring households into the Asian middle class. Now you are seeing the same thing happening again in the services sector in some of these Asian countries. So as they enter into participating in these global platforms, they are getting the kind of income that's required to support them. The most clear example of that today is India.

DOLLAR: Let's talk a little bit about China, which plays a big role just numerically in terms of the expanding middle class. Obviously, relations between the U.S. and China on the economic front have become very tense—other aspects of relations as well. You mentioned a lot of the countries we have talked about are Asian countries, particularly Southeast Asian countries like Vietnam, Bangladesh, Indonesia, Pakistan. How do these countries respond to this U.S.-China trade tension? Do you see this as a problem in their growth and emergence?

KHARAS: You know, I think for the middle class, some of the real problems at the heart of the U.S.-China tension which are strategic and what I would call national defense issues are not that important. Most of these people, they want to have a smartphone. They want to be able to access the Internet. And if Huawei is producing the cheapest 5G compatible phone around, they are going to be buying a Huawei phone. If somebody else produces something better, they will buy that. So I

don't think that these kind of big picture national security issues really will influence the middle class in some of these places that intensively.

What is happening is that in a lot of these countries mid-sized businesses are starting to use these platforms, and that has actually not been a real focus of the mega platforms of the U.S. I mean, we are used to thinking about things like Facebook and to a lesser extent Amazon certainly does this, but the presence in Asia of the big platforms that cater to small and medium enterprises are largely Chinese. That's why I think many of the mid-sized companies in Indonesia, Vietnam, Pakistan and even in India are actually starting to migrate onto some of these Chinese platforms.

You know very well, David, Vietnam and China don't exactly enjoy the warmest of international relations. China and Korea don't enjoy the warmest of international relations. But China and Korea are very, very large integrated economies. So there is an ability in Asia to set aside the geopolitical national interest sets of arguments and focus on the economics where that's of mutual benefit to both countries.

DOLLAR: This middle class lifestyle we are talking about is much more resource intensive than the pre-industrial lifestyle, particularly energy intensive. So I think a question that naturally arises is does the world have enough resources to sustain such a large population living this middle class lifestyle?

KHARAS: It's interesting because I think the answer to that very simply is a resounding yes. I would go even further, because some people have tried to say, "we need to reduce growth in order to reduce carbon emissions and save the planet." Terrible mistake. When we had much lower levels of global GDP, we were still polluting the planet. What the middle class is actually doing is in every important country they are putting political pressure on their leadership to deal with the issues of climate change. China is not joining the Paris agreement and making commitments to net zero because they want to save the planet. They are doing it because the Chinese middle class doesn't want to live in cities where particulate matter is so high. They are doing it because they think that they can leapfrog in the automobile industry into whole new areas of essentially electronic vehicles where it would take them years, if ever, to be able to dominate the traditional automobile sector.

I haven't actually been to Beijing in a long time now, but I think that a lot of Chinese citizens will have an app on their smartphone that will tell them exactly what is the particulate matter concentration today. They are tracking that in the same way that people in the United States might be tracking the movement of the Dow Jones or something like that. It's become part of the daily discourse of life.

So I actually think that the middle class is the heart of the environmental movement, both for climate change and for the preservation of nature. They are leading that charge. They are putting pressure on their political systems to deliver. And if their political systems don't deliver, they will be accountable to that middle class. The technology is there; we all know we can shift to renewables and other ways of reducing our carbon emissions. What's really lacking is the political determination to put in place programs to accelerate this transition. And it's the middle class in every country that's going to provide that political momentum.

DOLLAR: You are absolutely right, Homi, about middle class Chinese tracking air pollution and being a political force for improving it, which has happened. Last question for you, Homi. There's

obviously a set of international institutions that underpin a lot of these developments we are talking about: the WTO and free trade, Paris agreement and getting carbon emissions under control. Do you think the international institutions are strong enough to deal with these changes? And how is this emerging developing country middle class likely to change those institutions?

KHARAS: I think the international institutions are as strong as their shareholders would like them to be. They certainly have the internal organizational capacity to do much more and to be far more ambitious, but I think they are being held back, and they are being held back in part because, certainly in the financial institutions, the governance is still dominated by the countries that represent the traditional, the old middle class. As I said initially, that's the part of the middle class that's actually right now stagnant and hurting. The voice of the new emerging, rapidly growing middle class is much less visible in these international financial institutions. So we do have, I think, a governance problem in making them more responsive to the needs and preferences of this new middle class. And I hope that the reforms that are currently underway— we have new leadership in the WTO, for example—I hope that the reforms that are currently underway will pay attention to those voices so that we have international institutions that are more representative of the middle class across the world.

DOLLAR: I'm David Dollar and I've been talking to my colleague Hamid Kharas about the rise of a global middle class, his research on defining and measuring that middle class, and what are some of the important changes coming with the expansion, particularly in the developing world, particularly in developing Asia, of a global middle class. So thank you very much, Homi, for sharing your research with us.

KHARAS: Thank you for having me on this podcast, David.

DOLLAR: Thank you all for listening. We'll be releasing new episodes of Dollar & Sense every other week, so if you haven't already, follow us wherever you get your podcasts and stay tuned.

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