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A special report on Latin America Societies on the move

Expanding the middle class requires better schools and reforms in public spending

Sep 9th 2010



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HOME to over 1.5m people, Nezahualc6yotl sprawls over a flat, dried-up lake bed on the eastern outskirts of Mexico City. Back in the 1980s it was an impoverished settlement of dirt streets and one-storey shacks built of grey concrete blocks. Today the shacks have become comfortable homes of two or three storeys, the streets are asphalted and the traffic-clogged thoroughfares are lined with businesses of every type, lots of restaurants and several imposing gyms to work off all those meals. Since last year they have been facing competition from a big new shopping mall that would not look out of place in a suburb in the United States, anchored by Sears and C&A, with scores of boutiques and a multiplex cinema. Next door stands a large Wal-Mart and a private hospital that offers low-cost treatment. Behind, on a former rubbish dump, a new outdoor sports centre with 19 football pitches opened in July, operated by the charitable arm of Telmex, a telecoms firm.

Few people in Neza, as it is known, are still poor. "Before, people wanted a bicycle to get to the market. Now the least they want is a secondhand Volkswagen. They can afford to go out to eat at the weekend and take a holiday once a year, going to Acapulco," says Luis Ayala, a journalist who was born in Neza and now works for its mayor. His story typifies gradual upward mobility: his father was a factory worker; his elder son is studying at a university in Neza and wants to become an engineer, and his younger son is studying to be a dance teacher. This progress nearly always requires the extended family to pull together. Mr Ayala and his wife augment their income with two market shops. They live on a separate floor in his father's house and have two cars.

Neza exemplifies the rise in living standards many Mexicans have enjoyed since the recession of 1995. Over that period economic growth has been steady rather than spectacular. To a greater or lesser extent, this picture is repeated across Latin America. It has led some commentators to claim that the region is well on the way to building middle-class societies. That would have profound implications, for everything from politics to business.

But how middle-class?

"Middle class" is a slippery concept. What is clear is that Latin American societies are changing rapidly in response to urbanisation, democracy, economic reform and globalisation. Poverty has declined almost everywhere. Just as important, income

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distribution has been getting less unequal in many countries. In Brazil and Mexico the Gini coefficient, a measure of inequality, has been falling since the mid-1990s. According to a new study by Luis López-Calva and Nora Lustig, between 2000 and 2006 the Gini coefficient came down in 12 of 17 countries for which there are comparable data, including all the larger ones. Even so, income distribution in Latin America remains the most unequal in any continent (see charts 3 and 4). Such extreme inequality causes many problems. It is almost certainly a factor in Latin America's alarming crime rates, for example (see [article](#)).

The decline in poverty is a result of faster economic growth and the conquest of inflation (which eroded the incomes of the poor), but also of better social policies. In particular, conditional cash-transfer (CCT) programmes—an invention of Latin America's democracies—have proved effective in helping the poor. Under these schemes mothers receive a small monthly stipend (ranging from about \$5 to \$33 per child) as long as they keep their children at school and take them for health checks. Some 110m people in the region now benefit from such transfer schemes, according to the World Bank. Most of the schemes are well-targeted and relatively cheap, costing around 0.5% of GDP. Mexico's Oportunidades programme is estimated to have reduced poverty by eight percentage points. Brazil's Bolsa Família has made millions of extremely poor people less destitute. There is evidence, too, that such programmes have raised school enrolment and attendance and reduced drop-out rates, as well as increasing take-up of pre- and post-natal care and vaccinations.

The CCTs and longer attendance at school have helped to reduce income inequality. A better-educated workforce has been able to command higher pay. Income distribution has become more equal in countries with governments of both left and right, though Mr López-Calva and Ms Lustig found that social democratic governments (such as Lula's in Brazil and the Concertación coalition that governed Chile between 1990 and March 2010) are more redistributive than those of the centre-right or populists such as Mr Chávez.

CCTs on their own cannot improve the standard of education and health, which especially in the countryside often remains poor. But the spread of modern communications and electrification programmes are starting to transform rural areas. Mr Webb, the former central-bank governor in Peru, finds that in some of the remotest and poorest provinces of the Peruvian Andes better roads and mobile telephones have allowed former subsistence farmers to produce more lucrative items, such as cheese or vegetables and also take jobs in local towns.

All this has meant that across the region the lower middle class—what marketing people call social class C—has expanded. In Brazil Marcelo Neri of the Fundação Getulio Vargas, a research institute, defines this group as having a monthly household income of between 1,064 reais (\$608) and 4,561 reais (\$2,606). By 2008 it accounted for 53% of the population, up from 43% in 2002. The OECD, in its forthcoming *Latin American Economic Outlook*, defines the middle class as those with incomes ranging from 50% to 150% of the median. By this yardstick 275m people in Latin America and the Caribbean, or just under half the total, were middle-class in 2006. The proportion ranged from 56% in Uruguay to 37% in Bolivia, compared with 68% in Italy. It is worth noting that many of these people would be considered poor in better-off countries: the median annual income ranged from \$2,820 in Bolivia to \$6,036 in Mexico, whereas in Italy it was \$18,816.

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But income alone captures only part of the improvement in living standards. The money also goes further, as Luis de la Calle and Luis Rubio point out in a study on Mexico. First, nuclear families have got smaller. Today the average Mexican woman has two children, compared with seven in the 1960s. Second, opening the economy to trade has sharply reduced the price of many goods. Economic stability, too, has brought many benefits. Home loans almost tripled between 1998 and 2006, with over 7m new homes built in Mexico over the past decade. In 1960 four-fifths of Mexican homes had at most two rooms and no toilet; now 60% have three rooms or more and have a flushing lavatory.

Traditionally the middle class in Latin America was employed in the public sector. The new lower middle class is more entrepreneurial, though many of its members work at least partly in the informal economy. They aspire to the six Cs: *casa propia* (a home of one's own), a car, a cellphone, a computer, cable (or satellite) television and trips to the cinema.

All this progress is still fragile, and not everyone finds a way out of poverty. The children of poor households, and especially those in rural areas and of black or indigenous descent, are much less likely than the average Latin American to complete their schooling or have somewhere decent to live. A study for the World Bank found that between a quarter and a half of differences in consumption were due to such inequalities of opportunity. And there is a long way to go. If Brazil wants to achieve average social conditions for a country of its income level, it must keep up its "fantastic" progress in tackling deprivation over the past 15 years for another two decades, says Ricardo Paes de Barros of the Institute for Applied Economic Research, a government-linked think-tank.

Back to school

If it is to become a middle-class society, Latin America's first priority must be to improve the quality of schooling. Over the past 20 years the region's democracies have made a big effort to get children into the classroom. Primary schooling is almost universal, except in some of the poorer Central American countries; 70% of the children in the region now start secondary school, up from 60% in 1999 (but 90% do in rich countries). The number in some form of tertiary education has risen from a fifth to a third over the same period. But many drop out, and many who stay do not learn much. The six Latin American countries that took part in the OECD's PISA study on educational achievement in 2006 all ranked in the bottom third of the 57 countries covered.

At least people are becoming more aware of the need to improve the quality of public education. That is particularly clear in Brazil, where the progressive education policies of the governments of Fernando Henrique Cardoso (1995-2003) have been broadly continued under Lula. Both the government and educational pressure groups are backing a campaign that aims to raise school performance to developed-country levels by 2021, the eve of the bicentennial of Brazil's independence. The government has introduced a national exam to monitor standards, and some states have followed suit. In São Paulo the state education secretary, Paulo Renato Souza (who was education minister for eight years under Mr Cardoso), has also introduced a standard curriculum, required teachers to submit to a proficiency test and linked big salary increases for them to better school results in the standard tests.

The proof of these policies will be whether they work in places like the *Colegio Recanto Verde Sol*, a school in Jardim Iguatemi, a jumble of *favelas* climbing over steep hills next to a patch of virgin rainforest on São Paulo's eastern fringe. The school, built in 2005, is clean and reasonably well-equipped, with a small library, video room and cafeteria for school meals. But its results are poor. That is partly because its 1,800 pupils study in three shifts: 11- to 15-year-olds in the morning, six- to ten-year-olds in the afternoon, and over-15s in the evening, sometimes not finishing until 11pm. Not surprisingly, many older pupils drop out: "In secondary, we begin the year with seven classes and end with three or four," says Angela Regina Rodrigues, the head teacher.

Ms Rodrigues is charismatic and committed but somewhat defensive. Her main problem is getting teachers to turn up. Classes are too big, with 40 or more pupils. Ms Rodrigues herself has a second job at night, teaching history at another school. But she is trying to raise the quality of teaching and to get parents more involved.

The problems at *Recanto Verde Sol* are mirrored (and often magnified) across Latin America. Spending on education has increased almost everywhere, but average spending per pupil is only a fifth that in developed countries, according to the OECD. One reason for that is a demographic bulge that will soon subside. The main task is to train better teachers and to link extra spending to teacher performance. Attempts to do this in Mexico have largely foundered on opposition from the powerful teachers' union. Teachers there have jobs for life, which can be bequeathed, bought or sold. Mexico's president, Felipe Calderón, got the union to agree that posts would be filled by public competition, but enforcing this has proved hard.

Many countries are now trying to do some of the right things. Colombia, where Mr Uribe kept the same, competent, education minister for eight years, and Chile have both made big efforts to expand pre-school education, for example. In Peru the government of President Alan García introduced compulsory evaluation of teachers; when many of them failed the first exam, the teachers' union was thrown on the defensive. But many parents are complacent about their children's schooling, content that they are staying at school longer than they did themselves.

Others are voting against state education with their feet. The rich in Latin America have long sent their children to private schools, whence they often move on to free public universities. The lower middle class is following suit. In the decade to 2009 the number of private schools in Mexico rose by more than a third, to 45,000. In Peru Mr Rodríguez Pastor, the banker, has started a business aiming to provide good-quality schools in poorer areas. So far he has got three. He wants to turn teaching into a desirable career by offering good training, pay and conditions.

A welfare state of sorts

The second thing Latin America must do to turn itself into a more equal society is to reform public spending, which remains inequitable and shot through with perverse incentives. After the second world war many countries in the region set up European-style contributory health-care and pensions schemes, and in some cases unemployment insurance too. But these systems cover only a minority of workers (mostly the better-off), mainly because of the prevalence of the informal economy. Add in tax systems that rely heavily on consumption taxes, which hit the poor disproportionately hard, and taxes and government transfers reduce the Gini coefficient of income inequality by under two percentage points in Latin America, compared with 19 percentage points in Europe, according to the OECD.

The spread of democracy has prompted efforts to make society fairer by putting in place a modest welfare state. The cash-transfer programmes are the most prominent element, but many countries have also introduced non-contributory minimum pensions, and some have provided cheap health insurance to cover drugs and treatments at public hospitals. These innovations reinforce the idea that in a democracy all citizens have certain basic rights. But they have had the unintended effect of creating a two-tier system, full of duplication and contradictions.

Watch those income disparities

The first task for Latin American governments is to strengthen the emerging social safety-net. Bolsa Família and Oportunidades have been extended to urban areas, where many poor people now live. But greater income disparities in cities make targeting harder, and urban poverty often has complex causes. That is recognised in Chile, where the proportion of poor people in the population fell from 45% in the mid-1980s to under 14% in 2006. It rose a little in 2009, to 15%, partly because of the recession, but the increase also prompted officials in the new conservative government of Sebastian Piñera to question the effectiveness of social spending. Yet Andrés Velasco, the finance minister in the previous government, points out that the rise in world food prices pushed up the cost of the basket of staple goods typically bought by the poor by 36% between 2006 and 2009, whereas overall inflation was only 14%. Without social policies to cushion this shock, the proportion of people in poverty would have risen to 19%, he says.

That looks like a vindication of Chile Solidario, a programme aimed at eradicating extreme poverty. It puts the destitute in touch with social workers to make sure they benefit from programmes including job training, education and housing as well as income support. Colombia has set up a similar scheme. In Peru a programme in the poorest parts of the southern Andes has reduced child malnutrition.

These programmes are more complicated and costly than CCTs but they can be more effective, especially in cities. Ricardo Paes de Barros, who advises Marina da Silva, the Green Party candidate in October's presidential election, wants to see such a scheme in Brazil. He says it could deploy an existing network of community health agents. With Bolsa Família "for the first time we managed to identify a group of the poor who weren't visible before. Now we can make sure the poor receive social assistance in a joined-up way," he says.

The second big task for the region's governments is to ensure that social policies take account of the dual labour market. The CCT payments in themselves are not big enough to discourage people from working. But there is some evidence that additional non-contributory benefits, combined with high payroll taxes, are deterring people from taking formal jobs.

To make benefits universal, Mr Levy of the IDB calls for a radical reform, scrapping contributory health-care and pension systems and replacing them with a unitary scheme

financed by a consumption tax. This would go hand in hand with a reform of the labour market that would attempt to bridge the gap between the formal and informal sectors. His idea is backed by Enrique Peña Nieto, the likely candidate of the Institutional Revolutionary Party, or PRI (which governed Mexico for many years), in the presidential election of 2012. Economists at the World Bank think the answer is to eliminate hidden subsidies by switching pensions to defined contributions rather than defined benefits and basing health-insurance benefits on premiums rather than earnings.

Latin America has already gone a long way towards creating a universal safety-net in the past two decades, but coverage remains patchy. To improve it, taxes will have to rise in some countries, though in Brazil and Argentina they are arguably already too high as well as too complex. Elsewhere in the region the government's tax take has risen in recent years. But in some of the poorer countries, especially in Central America, it remains too low to finance a modern state that is capable of providing citizens with their most basic needs.

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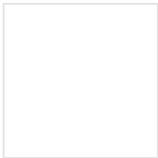
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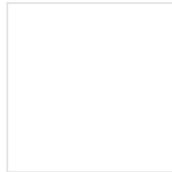
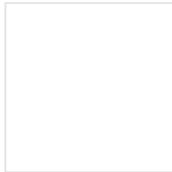
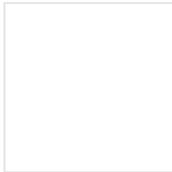
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