1. Introduction

There has been considerable interest in recent years in the impressive emergence and growth of the Asian middle class, particularly in the wake of the “Great Recession” of 2008–09 in the United States (US) and Europe. Policymakers are wondering how great a role the Asian middle class can play in the coming years and decades in the necessary rebalancing of the world economy. US and European households are engaged in a long and painful process of deleveraging—increasing savings to reduce high debt levels and rebuild lost wealth—which will limit the extent to which they can drive global consumption.

Consumer spending in developing Asia, meanwhile, has shown surprising resilience, even during the recession. It reached an estimated $4.3 trillion in annual expenditures in 2008—nearly a third of private consumption in the Organisation for Economic Co-operation and Development (OECD) countries. Assuming consumption expenditures continue to grow at roughly the same rate as in the past 20 years they are likely to reach $32 trillion and comprise about 43% of worldwide consumption by 2030, placing the region at the forefront of worldwide consumption (Chun 2010a). On this count, as developing Asia’s people secure their middle-class status, its emerging consumers are very much expected to become the next global consumers and assume the traditional role of the US and European middle classes. Moreover, given the call for "rebalancing" Asian economies from export-led to domestic-led consumption growth—to reduce exposure to negative shocks from regional economies outside of Asia (ADO 2009)—it is expected that this process will depend highly on the emergence and expansion of the Asian middle class. This can create more stable and efficient poverty reduction and economic development.

However, as the special chapter argues, this is not a given. While 56% of developing Asia’s population,1 or nearly 1.9 billion people, were already considered part of the middle class based on an absolute definition of per capita consumption of $2–$20 per day in 2008, nearly 1.5 billion Asians were still living on less than $2.0 per day. Moreover, the majority of the Asian middle class still falls in the $2–$4 range, leaving them highly vulnerable to slipping back into poverty due to economic shocks. Thus, for the middle class to become a prominent force it will likely depend on its size and spending levels and characteristics. It will require governments to introduce policies that bolster the incomes of those already in the middle class. It will also require social policies to expand the middle class—such as through greater spending in education and health. Through these, it is possible to build a strong and stable middle class that continues to grow.

The focus on the middle class and policies for promoting it is rooted in the belief that the middle class is an important prerequisite for stronger, more sustainable economic growth and development. Economic historians such as Adelman and Morris (1967) and Landes (1998), among others, have argued that the middle class was a driving force in the faster pace of economic development in the United Kingdom and continental Europe in the 19th century. According to the “political economy” argument, societies with a small middle class are generally extremely polarized, and find it difficult to reach consensus on economic issues; they are overly focused on the redistribution of resources between the elite and the impoverished masses, each of which alternates in controlling political power. Societies with a larger middle class are much less polarized and can more easily reach consensus on a broad range of issues and decisions relevant to economic development (Alesina 1994).

Easterly (2001) has developed the latter argument further. According to him, a “middle-class consensus”—defined as a situation of relative equality and ethnic homogeneity in a society—facilitates economic growth by allowing society to agree on the provision of public goods critical to economic development. These include goods such as public education, public health services, and physical infrastructure (e.g. roads and electricity). The elites in control of government in societies without a middle-class consensus tend to underinvest in such goods for fear they will empower opposing factions. In testing this hypothesis, Easterly estimated regressions of economic growth, per-capita income, human capital accumulation, and infrastructure on ethnic diversity (measured by a linguistic fractionalization index) and the size of the middle class (measured as the income share of the middle three income quintiles), using cross-country data on about 175 countries circa 1990.2

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1 Developing Asia in the special chapter generally refers to 22 countries; Armenia, Azerbaijan, Bangladesh, Cambodia, People’s Republic of China, Georgia, India, Indonesia, Kazakhstan, Kyrgyz Republic, Lao People’s Democratic Republic, Malaysia, Mongolia, Nepal, Pakistan, Philippines, Sri Lanka, Tajikistan, Thailand, Turkmenistan, Uzbekistan, and Viet Nam. These countries were selected on the basis of data availability, and comprise 96% of the population of the Asian Development Bank’s developing member countries. When the analysis does not refer to all countries in this list, that is indicated. For a complete list of the countries within this region and the other regions presented in the chapter, please see Appendix Table 1.

2 To account for the possible endogeneity of the middle-class income share variable (i.e., the possibility that the causality goes from economic growth to the size of the middle class instead of the other way around), Easterly employs an instrumental variable estimation procedure, using the tropical location of a country and whether it is a non-oil commodity exporter or an oil exporter as identifying instruments.
Easterly finds that, after controlling for ethnic diversity and other control variables, the size of the middle class strongly influences (in the ‘correct’ direction) several variables. These include per capita income, growth of per capita income (over 1950–92), a host of health and educational outcomes (such as secondary and tertiary enrollment rates, life expectancy, infant mortality, and child immunization rates), physical infrastructure, several policy variables (e.g., financial depth, intensity of international trade, inflation, and exchange rate overvaluation), and indicators of democracy and political stability (e.g., civil liberties, political rights, and the incidence of revolutions and coups). His empirical results support the idea that elite-dominated societies typically accumulate less human and infrastructure capital, are less democratic, and formulate worse macroeconomic and trade policies than societies with a large middle class.

Sridharan (2004) makes a similar argument for India. The emergence of a 100–250 million-sized middle class during the 1980s and 1990s, he says, has dramatically changed India’s class structure—from one of a small elite and a large impoverished class—to one dominated by a large intermediate class. According to him, “… the elite-middle class cleavage tended to support a broadly socialistic ideology, while the elite-middle-class differentiation has created a broader base for capitalism—hence the increased support for economic liberalization.” That successive Indian governments since 1991, from across the political spectrum, have continued to support economic reforms and liberalization, supports his thesis.

Besides helping to reach consensus, Banerjee and Duflo (2008) have discussed three mechanisms through which a large middle class could promote development. First, the middle class may provide the entrepreneurs who create employment and productivity growth in a society. Second, “middle-class values”—that is, the values of accumulation of human capital and savings—are critical to economic growth. And third, with its willingness and ability to pay extra for higher-quality products, the middle class drives demand for high-quality consumer goods, the production of which typically presents increasing returns to scale. This encourages firms to invest in production and marketing, raising income levels for everyone.

Another reason often cited for the importance of a large middle class is that the poor are too liquidity-constrained to accumulate human capital, a key ingredient in sustained economic development (Galor and Zeira 1993, Alesina and Rodrik 1994). As the middle class grows it raises investment in human capital and, in turn, drives national economic growth. But the causality can also go the other way, with human capital accumulation (typically education) pulling more of the poor into the middle class.

The middle class is not easily defined as it is not necessarily a distinct or unique group in society that has very different attributes or values than other social classes. It may simply represent a range along the income continuum (a group that lies between the poor and the rich) and social class (a group lying between the working class and the ‘upper’ class). To the extent that variables such as consumer spending and education vary monotonically with income, the middle class will possess higher values of these attributes than the poor (but less than the rich).

Is an emphasis on the middle class inimical to the interests of the poor? Most researchers say no. Indeed, Birdsell (2010) argues that “… in the advanced economies the poor have probably benefited from the rule of law, legal protections, and in general the greater accountability of government that a large and politically independent middle class demands, and from the universal and adequately funded education, health and social insurance programs a middle class wants and finances through the tax system… A focus on the middle class does not exclude a focus on the poor but extends it, including on the grounds that growth that is good for the large majority of people in developing countries is more likely to be economically and politically sustainable, both for economic and political reasons.”

Asia’s large population and the rapid expansion of its middle class during a period of global economic rebalancing is fundamentally important as a driver not only of the Asian economy but also the global economy. However greater middle class wealth and consumption is only one factor in the region’s increasing importance. The rise of its middle class is likely to aid not only the growth process, but also result in substantial social, political, and environmental changes. Thus, the contention is that, building on strong growth and continued progress in reducing poverty in Asia, developing a stable middle class requires governments to formulate and implement middle class-friendly policies. In turn, this requires understanding and analyzing the characteristics of the middle class, the factors contributing to its growth, and the various implications—positive and negative—of its rise. These are some of the issues this special chapter addresses.

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3 Acemoglu and Zilibotti (1997) develop the analytical argument for this mechanism. However, based on analysis of household survey data from several developing countries, Banerjee and Duflo (2008) do not find that entrepreneurs are over-represented among the middle class (relative to the poor).

4 Deoke and Zilibotti (2005, 2008) develop this argument.

5 The analytical model for this argument is developed in Murphy, Shleifer and Vishny (1989).