Covering the Uncovered: Labor Informality, Pensions and the Emerging Middle Class in Latin America

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Innovative social policy instruments, notably conditional cash transfers, have been effective in reducing poverty in many Latin American countries. As a result, many households have recently succeeded in moving out of poverty and joining the ranks of the so-called emerging middle classes. This chapter will demonstrate, however, that many of these middle-class workers are still vulnerable to significant downward mobility if they are hit by negative shocks, such as illness, disability, job loss or a significant decline in income after retirement.

From an occupational viewpoint, the middle class is often characterized as the group within society that has a stable job, either as a white-collar employee, a qualified independent worker or a small business owner (Banerjee and Duflo, 2008). In developed countries, people with these employment profiles are generally less vulnerable to falling into poverty because of sufficiently high levels of income and assets (financial and non-financial), but also due to access to social-protection networks. However, it is far from obvious that this situation is the same for the emerging middle classes in developing countries, such as Latin America.

Defining the middle class is not an obvious task. While sociologists and political scientists generally approach this issue from a multidimensional viewpoint that combines social status, occupation and other characteristics beyond income, economists traditionally use a single-dimensional monetary metric based on some definition of household income to define the middle class. Furthermore, even when restricting
the criteria to income, there are many important differences in establishing the relevant thresholds to classify the population into a middle class and those below and above. For example, while some studies focus on the relative position within the countries’ income distribution, others define lower and upper income boundaries for the middle class based on absolute monetary values of income.

Each relative or absolute definition has its advantages and disadvantages, depending on the particular subject of analysis. Some papers in the literature loosely associate the middle class to the households in the middle of the income distribution. For example, Easterly (2001), followed by Bosch, Melguizo and Pages (2013), use the middle three quintiles of the income distribution, while Birdsall et al. (2000) use the households that have incomes above 75 per cent and less than 125 per cent of the country’s median income (see Castellani and Parent, 2011, and Castellani, Parent and Zenteno, Chapter 5 of this volume). Of course, these definitions have the advantage of being easy to implement across countries, but also the disadvantage that the resulting middle class might include households that have income levels below the relevant national poverty lines: that is, 50 per cent of median household income could well lie below a relatively poor country’s poverty line, and some households would then be simultaneously classified as both middle class and poor. Other studies use absolute income levels to define the middle class in developing countries. Most of these studies try to justify these income thresholds, especially the lower bound, in terms of some measure of poverty.3 For example, Banerjee and Duflo (2007) use between $2–10 per day and Ravallion (2009) uses $2–13 per day, adjusted for purchasing power parity (PPP).4 Clearly, these income levels are very low boundaries for middle-income countries, such as most Latin American economies, where national poverty lines often imply a significantly higher level of income. One shared problem of these definitions is that they are somewhat arbitrary. A recent study by the World Bank tries to address some of these problems by defining the lower boundary of the middle class in Latin America based on the household probability of falling back into poverty (Ferreira et al., 2013). Using panel household data for a few countries in the region where this information is available, they estimate $10 per day of per capita income to be the income threshold above which the probability of falling back into poverty is sufficiently low. They also define a group of the population as the ‘vulnerable’ (strugglers in their terminology), which includes those who are not poor (above $4 per day) but have incomes below $10 and therefore have a higher likelihood of falling back into poverty.