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The Strugglers: The New Poor in Latin America?

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Summary. — We identify a group of people in Latin America that are not poor but not middle class either—namely "strugglers" in households with daily income per capita between $4 and $10 (at constant 2005 PPP). This group will account for about a third of the region's population over the next decades; as the size and income of the middle class rises, they could become increasingly marginalized. The cash transfers they receive are largely offset by indirect taxes; the benefit of schooling and other in-kind transfers they receive is questionable after adjusting for quality. We discuss implications for the social contract.

Key words — income distribution, poverty, inequality, fiscal incidence, Latin America

1. INTRODUCTION

In this article we use an income-based classification of households (as in Ferreira, Messina, Rigolini, López-Calva, Lugo, & Vakis, 2012, a World Bank report on economic mobility and the middle class), to identify and characterize a group of people in Latin America who are not poor by international standards but not yet part of the income-secure middle class. We call them "strugglers," people living in households in which daily income per capita falls between $4 and $10 (at constant 2005 purchasing power parity (PPP) dollars). [1] We also refer to them using the word vulnerable, because of evidence that they are at substantial risk of falling into poverty, for example if any household member falls ill or suffers a drop in income because of an economic downturn. [2]

We project that in Latin America the struggler group, today between 35% and 40% of the population in most countries, will decline slowly as a share over the next four decades—still constituting about 30% in 2040. Using country-specific future rates of economic growth and assuming equally shared rates of growth within countries and thus no changes in their current distributions of income, we show that in the upper-middle income countries including Argentina, Brazil, and Chile, the absolute gap in income between the strugglers and the under $4 poor on the one hand, and the income-secure middle class on the other hand, will increase in each of the next three decades. That raises the risk of greater social stratification between the middle class and what could become the increasingly marginalized group that we refer to in the title as the "new poor."

Adding to the risk of stratification is our finding that the struggler group benefits little if at all from the current fiscal system. The modest cash transfers they receive are offset by the indirect taxes they pay. They do benefit from in-kind transfers for schooling and health services. But evidence that up to 50% of middle class households in some countries, and even some struggler households, are opting out of public schools and paying for private schooling suggests that the fiscal incidence analysis overstates the true value of the in-kind benefits. Given these findings, we call for greater attention to the needs and interests of the strugglers in the design and implementation of growth and distribution-friendly social and economic policies.

The rest of this article is structured as follows. In Section 2, we explain the logic behind setting absolute income thresholds to identify "classes," set out the empirical basis for the income thresholds of $4 to $10, and present basic socio-economic characteristics of those households. In Section 3 we present projections of the size of the $4–$10 group through 2050 in selected countries of Latin America and explore the implications of the projected increase in their absolute and relative size compared to the secure middle class. In Section 4 we use harmonized household survey data from several Latin American

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countries to assess the relationship of the strugglers to the state as taxpayers and beneficiaries of government spending and social insurance programs. We report estimates of the taxes they pay and the benefits they receive, including cash transfers, access to social insurance, and the monetary value of health, schooling, and other public services. We compare the strugglers on these dimensions to the poor below them and the secure middle class and rich above them, as information potentially relevant to their economic and political interests. In Section 5, we speculate on the implications of our analysis for the politics of the evolving social contract in Latin America.

2. IDENTIFYING LATIN AMERICA'S VULNERABLE STRUGGLERS

(a) *Why $4 to $10?*

The $4 to $10 per capita per day thresholds are meant to identify people that are unlikely to be poor in absolute terms using the conventional international poverty lines of $1.25 for extreme poverty and $2 for moderate poverty, but are not yet in the middle class. We set our thresholds in absolute terms (rather than in relative terms for each person or household within his country) for two reasons. First and foremost, absolute thresholds make it possible to study changes within countries over time in what might be called the income composition of a society or country, looking at both population and income shares of specific groups identified in real income terms. Second, as Birdsall (2010) argues, an absolute threshold (in that case for identifying the minimum income to be middle class) allows comparisons across countries, and makes sense to the extent that in the relatively open economies of most developing countries today, consumption potential is determined in part by global prices, including of food and fuel. In addition, it is possible that consumption standards and preferences, or the consumption basket itself, are set at the global level, at least for households that have escaped absolute poverty.

The $4 threshold at the bottom is meant to exclude households that are in some absolute sense poor in most middle-income developing countries. It is below the national poverty lines in countries of Latin America, but above the national extreme poverty (indigence) lines in the region. It is also above the poverty lines in most countries of other developing country regions. Ravallion, Chen, and Sangraula (2009) make the point that national poverty lines rise markedly across developing countries with average income; that reflects the reality that security with respect to basic needs is difficult to define in absolute terms (as Adam Smith famously noted, it is about the proper shirt that makes a man feel presentable in his community). $4 is also sufficiently above the international absolute poverty lines to avoid including many households that are only temporarily above those lines.

There is considerable evidence from developing countries that the number of people that live below the poverty line is substantially greater over several months or years than the number that are poor at any one moment. Pritchett, Suryahadi, and Sumarto (2000) use two panel datasets from Indonesia to estimate that 30–50% of households above a given poverty threshold face a risk of 50% or more of falling below it. Dercon and Shapiro (2007) summarize the empirical evidence on poverty mobility from longitudinal data. Similarly, Kanbur, Lustig, and McLeod (2000) and Lustig (1995, 2000) record substantial increases in "poverty" conventionally defined during crises, in part because a high proportion of the non-poor lives so close to the poverty line—where they are vulnerable during a downturn, presumably because their permanent income is too low for them to have accumulated the precautionary savings or assets typical of middle class households. [3]

Our $10 threshold at the top is meant to exclude households likely to be in the secure (or consolidated) middle class. Birdsall (2010) suggests $10 per capita per day as the absolute minimum income in the developing world for a person to have the economic security associated with middle class status in today's global economy—and therefore the incentives and the potential to exercise political rights in his or her own interests. Others including Kharas (2010), Milanovic and Yitzhaki (2002), and Ferreira *et al.* (2012) have also used a threshold of $10 or around $10 as a starting point for membership in the middle class.

For Latin America in particular, the $10 threshold as the lower bound for the middle class is well-grounded conceptually and empirically—which in turn justifies it as the upper bound for the strugglers. First, López-Calva and Ortiz-Juarez (2011) show that at income per capita below $10, households in Peru, Chile, and Mexico were much more vulnerable to falling into poverty over a five-year period (about 2001–06) than households at or above $10. At or above $10 per capita, households only had a 10% probability of falling below their national moderate poverty lines ranging from $4 to $5.

However, households with slightly lower income were as much as two times more likely to fall into poverty. In Mexico, households at $6 per capita per day had a 22–24% probability of falling into poverty. In Chile, which has a much lower poverty incidence and is about 40% richer at the median, households at about $6 per capita had a 24–40% probability of falling into poverty; even in the richest country of the region, households commonly perceived as "not poor" were highly vulnerable to declines in their income.

These results are consistent with the more general finding that many households above the national poverty lines in Latin America have been vulnerable to major declines in income during the region's periodic banking crises, and more recently in the case of externally-driven food, fuel, and external financial crises (as in 2008 and 2009). During Argentina's 2001–02 financial crisis, the share of poor people below $2.50 a day rose from 14% in 2000 to almost 30% in 2002. In Mexico, the share rose from 20% in 1994 to 34% in 1996 following the 1995 financial crisis. [4]

To help us assess more closely the probability of households already above $4 a day falling back below $4 a day, and the relevance of economy-wide and household-specific shocks, López-Calva undertook his vulnerability analysis focused specifically on the strugglers using the same panel data from Mexico, Peru and Chile. In Mexico 23.3% and in Peru 18.7% of the households that were in our struggler group in 2002 had transitioned into the poor group by 2005 (by 2006 in Peru). [5]

Considerable vulnerability of households in the $4–$10 group in the face of major economy-wide shocks of the type that drove people below the poverty line in Mexico in 1995 and Argentina in 2001–02 is not surprising. The panel data suggest the relevance of household-specific shocks as well. In Mexico those without any form of social insurance to cover health and old age pensions (probably because none of their adult members is employed in the formal sector) were systematically more likely to have fallen into poverty in the five-year period studied. Not surprisingly another factor that seems to matter is income from work; in all three countries an increase in the number of workers in a household of a given size