

# The Role of Middle Class in Economic Development: What Do Cross-Country Data Show?

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## Abstract

This paper investigates the channels through which the middle class may matter for consumption growth. Using several different middle-class measures and a panel of 105 developing countries spanning the period 1985–2013, we find that a larger middle class influences consumption growth primarily through higher levels of human capital accumulation. There is also a significant direct effect of middle-class size on consumption growth, which is more pronounced in the latter half of the sample, the 2000–2013 period.

## 1. Introduction

Do countries with a larger “middle class” grow faster? A number of economists believe that the answer to this question is in the affirmative. For example, Kharas and Gertz (2010) compare the growth experience of Brazil and South Korea and suggest that the differential performance of the two countries can be explained by differences in the relative sizes of the middle class in the two economies.<sup>1</sup> Why should a larger middle class help foster growth? Banerjee and Duflo (2008) identify three arguments that are commonly made. The first argument is that the middle class is where entrepreneurs that foster innovation and growth emerge from. A second argument stresses middle-class “values” that encourage accumulation of human capital and savings. A third argument suggests the consumption power of the middle class leads to diversification and expansion of markets that allow for the exploitation of economies of scale in production (see Murphy et al., 1989). In addition, the middle class may play a key role in better governance, because unlike the poor, the middle class may have the ability and power to demand better public service delivery and greater accountability from public officials (Birdsall et al., 2000). These arguments suggest that the presence of a strong middle class in a country should have a significant positive influence on economic growth.

Nevertheless, while the middle class is often envisioned to have values, investments and consumption patterns that differ relative to poor and high-income classes, empirical examinations have been faced with the challenge of defining and measuring the middle class. A number of relative and absolute measures have been

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