

Latin America's missing middle: Rebooting inclusive growth

Latin America used to be the world's most prosperous emerging region, but it is on the verge of being overtaken by other regions that were long considerably poorer. It has lost ground since the 1980s despite reform initiatives because of sluggish growth and the unequal distribution of the gains of that growth. In this report, which focuses mainly on Brazil, Colombia, and Mexico, we examine two “missing middles” holding the region back: a robust cohort of midsize companies and a solid middle class with growing spending power. Both middles will need to be filled if Latin America is to have a new chance of generating sustainable growth that benefits the broad base of the population.

- Latin America's average annual GDP growth of 2.8 percent between 2000 and 2016 has been slower than the 4.8 percent average of 56 other emerging economies, not including China. Almost three-quarters of Latin America's growth came from expanding the number of workers rather than through productivity gains, which averaged just 0.8 percent annually, or one-fourth the productivity gains in emerging-market peers. The expansion of the working population as a share of total population will soon reverse, meaning that growth will increasingly depend on finding sustained productivity gains.
- Dynamic and competitive companies propel growth and well-paid jobs, but Latin American firms have yet to overcome a persistent polarization between a few very large companies and a long tail of small, unproductive firms. The missing middle tier of companies reflects the lack of dynamism: Latin America has fewer firms that have scaled up revenues above \$50 million than higher-growth emerging economies do, which also translates into fewer large growth companies. The region needs more and larger companies willing to make bold investment in new technologies, including digital adoption, to boost productivity growth.
- The second missing middle is a cohort of upwardly mobile consumers whose rising incomes from productive jobs drive economic demand and investment. The poverty rate was halved to below 15 percent since 2000 but one-quarter of the region remains vulnerable because of high prices and a dearth of higher-productivity, higher-wage jobs. Rapid expansion of the workforce has held back wage growth, squeezing the middle class. In Mexico, average wage growth has been flat even in export-oriented sectors with rising productivity. In Brazil, the resource boom lifted wages, but taxes and the high cost of consumer goods have depressed purchasing power; cars retail for more than double their price in the United States. Latin America's bottom 90 percent of earners accounts for less than two-thirds of domestic consumption, the lowest of all regions.
- Filling in the missing middles will require a comprehensive commitment to growth and inclusion that none of our focus countries has so far achieved. Brazil has seen a higher share of income go to labor and has expanded credit but is constrained by limited access to global supply chains and a protected “Brazil cost” on firms and consumers. Mexico's market-opening reforms such as NAFTA boosted investment and productivity but did not translate into expanded domestic markets or sustained productivity growth. The region does have some success stories, including Chile, Colombia, and Peru, which have grown faster—albeit from a lower base for the latter two and a labor share of income growth that was no higher than the rest of the region.
- We estimate that Latin America could raise its GDP growth by 50 percent versus a baseline scenario to 3.5 percent annually in 2030, a gain of more than \$1,000 per capita and \$1 trillion in total, if the region converged toward the patterns of inclusive growth found among peers. Alongside more conventional policy approaches, digital adoption at scale could be a powerful new tool to achieve that goal, although it will not be a cure-all. Three priorities can help capture the productivity-enhancing opportunities. First is to establish a competitive business environment that reduces the cost of entry, improves access to finance, and cuts red tape, enabling small and middle-tier firms to thrive. Second is to spread productivity gains to the vulnerable and middle classes through better-paying jobs, longer-term investments, and more participatory labor and consumer markets. Third, governments could undergo digital transformation themselves, improving delivery of public services and being more experimental. Government and business leaders have no time to lose if they are to meet the aspirations of millions of Latin Americans impatient for a more prosperous middle-class life.

Latin America's two missing middles

Igniting inclusive growth requires addressing the “missing middle” of midsize firms and a solid middle class with growing spending power.

Latin America

Benchmark economies

China, India, Indonesia, Malaysia, Philippines, Poland, Russia, South Africa, Thailand, and Turkey

Supply

Average number of firms per \$1T GDP, grouped by revenue, 2016

Over \$5B



\$500M – \$5B



\$100M – \$499M



\$10M – \$99M



Less than \$10M



← Millions

Millions →

Latin America needs to expand the pool of modern, globally competitive firms to raise productivity and increase the number of high-wage jobs. Digital technologies provide a new opportunity.

Demand

Percent of population contributing per quintile of consumption

Upper quintile

4%

6%

Upper middle quintile

8%

12%

Middle quintile

14%

17%

Lower middle quintile

22%

24%

Lower quintile

51%

43%

Three-quarters of the population in Latin America accounts for just 40 percent of total consumption, compared to two-thirds in benchmark countries

More productive jobs with higher wages and rising middle-class prosperity increase demand and spur new investment. This can accelerate a virtuous cycle of inclusive growth.