



## **PRIME Analytical Reports**

*Unlocking Business Potential for Growth*

**Issue: 5, Vol: 1**

December 2015

# **Rising Middle Class: Exploring Business Potential**



PRIME Analytical Reports are independent evidence based studies on the investment climate, economic policies and demographic changes in Pakistan, prepared to improve understanding of business and policy challenges faced by the country's private sector to help it steer path of growth. To find out more please visit

<http://www.primeinstitute.org/prime-analytical-services.html>

Office No. 401, 4th Floor, Muhammad Gulistan Khan House, 82-East, Fazal-e-Haq Road, Blue Area, Islamabad.

[www.primeinstitute.org](http://www.primeinstitute.org) | [research@primeinstitute.org](mailto:research@primeinstitute.org)

## Table of Contents

Executive Summary .....	3
Introduction.....	4
Defining the Middle Class.....	5
Rising Global Middle Class .....	7
Rising Middle Class of Pakistan .....	8
Wealth in Pakistan.....	11
Consumption and its Impact on Growth.....	11
Consumption Patterns in Pakistan .....	12
Changing Consumption Trends – an Opportunity for the Business World .....	17
Conclusion.....	20
Annex A .....	21
Annex B:.....	22

## Executive Summary

The world is in the phase of a major expansion vis-à-vis increase in the middle class population, particularly in Asia. According to research, global middle class is projected to grow from under two billion consumers today to nearly five billion within two decades.

The rising middle classes are considered important key driver of growth given their high income elasticity especially for durable goods and services. Hence, increase in income of middle class leads to a higher level of consumption. Therefore, the world economy can be expected to increasingly rely on the middle classes as key sources of global demand.

Pakistan has also begun to see the effects of middle class expansion and it is expected that this expansion will continue till 2030. It can be ascertained that this expansion shall be accompanied with rise in consumption and change in preferences of the middle class. This report explores the current data on middle class size and consumption and presents expected trends of consumption which can be useful for business decisions regarding production and investment.

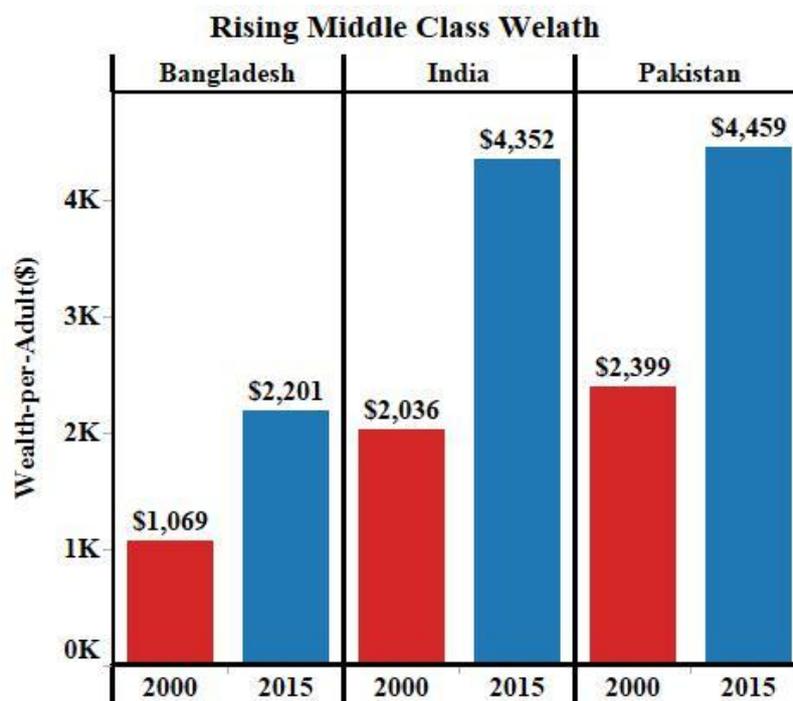
## Introduction

“Middle Class” is a faction of people that lies in the middle of a social hierarchy. In economic terms, middle class is a broad group that exists in the middle of the rich and the poor in terms of their income and spending.

The rise in the Global Middle Class is evident in every region of the world. Several Asian countries, in particular China and India, have reached a stage where a large number of people will enter the middle class and drive consumption. By 2021, assuming continuation of present trends, there could be more than two billion Asians included in the middle class households. In China alone, there could be over 670 million middle class consumers, compared with only 150 million today! Similarly by 2030, economist believe two-third of the global middle class will live in the Asia-Pacific region, up from just under one-third in 2009 where China and India have the most rapidly growing middle class population.

Pakistan is also in line with the Asia-Pacific regional middle class transformation, although the pace of transformation is a bit slower than the others (shown in Figure 1). According to the Global Wealth Report 2015, Pakistan has the 18th largest middle class in the world and out of 111 million adults in Pakistan, 5.7% (6.27 million) are classified as middle class.

Figure 1: Rising middle class of Pakistan compared to India and Bangladesh



Source: Global Wealth Report 2015

The income of this particular class is also increasing. As estimated by Pakistan Bureau of Statistics, the income of the middle class has almost quadrupled from 2001 to 2014 (from Rs. 5,963 in 2001 to Rs. 24,188 in 2014). On the other hand, the wealth per adult in Pakistan has increased by 85% in the past 15 years (from \$2399 in the year 2000 to \$4459 in 2015).

Moreover, the consumption expenditure per household in Pakistan has increased almost 300 times in the past 15 years and it will almost double till 2030 which clearly shows that the whole economy is in a phase of transformation.

This increase in wealth of adults and simultaneous rise in income and population of middle class implies not only higher purchasing power but also changing trends in consumption. There is now a beginning of a cross-over from the West to the East in the products, fashions, tastes, and designs oriented to the mass middle class. According to some estimates, in the coming years, the number of Asian middle class consumers will equal the number in Europe and North America for the first time.

These changing consumption trends and rise in middle class present new business opportunities. Deeper research into these trends and potential prospects for businesses has been presented in this report.

## Defining the Middle Class

There has been no consensus on a clear definition of middle class. Although we can say that the definition of middle class is not only a social designation but also an economic classification. Most economists choose to measure it in terms of income or consumption levels; defined in relative or absolute terms. Easterly and Birdsall and Graham and Pettinato take a relativist approach, defining the middle class as those between the 20th and 80th percentile of the consumption distribution and between 0.75 and 1.25 times median per capita income, respectively<sup>1</sup>.

There are also those who take absolute figures to define middle class, such as annual incomes and per-capita expenditures. According to the Global Wealth Report by Credit Suisse, the measure of 'personal wealth' – or a 'wealth band' instead of an 'income range' – has been used to determine the size and wealth of the middle class around the world.

---

<sup>1</sup> Homi Kharas and Geoffrey Gertz "The New Global Middle Class: A Cross-Over from West to East" Published by Wolfensohn Center for Development at Brookings

*Credit Suisse considers an adult to be part of the middle class if they have wealth between \$50,000 and \$500,000 valued at mid-2015 prices, taking US as the benchmark country.*<sup>2</sup>

Durr-e-Nayab (2011) states in her paper “Estimating the Middle Class in Pakistan”<sup>3</sup> that the term middle class has a certain multidimensionality to it, therefore, any definition attempting to explain this should capture all these dimensions.

“The middle class has certain intellectual, political and social connotations, along with economic ones, that differentiate it from the middle-income. While middle income is purely an economic term, the middle class falls more in the sociological domain. The concept of class has many dimensions, including: economic, like wealth, income and occupation; political, including status and power; and cultural, such as values, beliefs, lifestyle, and education.”

All these factors are therefore considered in order to come up with a refined measure of estimating the middle class using a “weighted composite index”. The components of this index include Education, Income, Housing, Lifestyle and Occupation. She uses this index to come up with seven different classes and then analyzes the sector wise distribution of these classes – which have also been shown later in this report.

Durr-e –Nayab (2011) also asserts the significance of the middle class. She explains that middle class plays a stabilizing role in the economy since it has a buffer role between the polar tendencies of the lower and upper classes. Higher share of income for middle class is linked with higher growth, more education, better health and less political instability and poverty in a society. Middle class is also a group that is empowered with high political influence. Her paper also lists three reasons why middle class should be considered crucial for economies:

- 1) Employment and opportunity of growth of the society is created by new entrepreneurs emerging from the middle class
- 2) Middle class stresses on the accumulation of human capital and savings given its strong values
- 3) Middle class encourages investment in better quality production and competitive marketing since it is willing to pay a little extra for quality. This increases production and leads to higher income for all.

---

<sup>2</sup> Global wealth Report 2015, Credit Suisse

<sup>3</sup> Durr-e-Nayab (2011), “Estimating the Middle Class in Pakistan”. Pakistan Institute of Development Economics.

## Rising Global Middle Class

Middle class of the developing countries are increasing in each continent. The swiftest rise is expected in Asia with a growth rate of a staggering 84 percent, followed by Africa with almost 60 percent growth rate (see Figure 2).

Figure 2: Expected % Change of World's Middle Class



Source: OECD<sup>4</sup>

This bulging trend brings with it a massive opportunity for businesses. As people become wealthier over time, their consumption becomes diversified in terms of commodities and services. This implies boon for businesses especially of those goods that are not currently available in the countries with burgeoning middle class.

Consider, for example, the case of Africa, where connectivity – especially digital connectivity – was nowhere to be found. This vacuum was exploited by western telecommunication companies which introduced this technology. Now seven in every ten young African adults use mobile phones.

Similarly, the economic liberalization of Deng Xiaoping in 1978 opened China to the world, making it the ultimate destiny of multinational production powerhouses with the aim to provide hitherto un-introduced products. Resultantly, China has become the largest markets for luxury brands. For instance, it has become the largest market for BMW and the second largest for Mercedes.

<sup>4</sup> [http://www.huffingtonpost.com/andre-bourque/is-your-business-ready-fo\\_b\\_6376056.html](http://www.huffingtonpost.com/andre-bourque/is-your-business-ready-fo_b_6376056.html)

The Indian example also substantiates this hypothesis. With a simultaneous increase in its middle class, India became the center of global business activity after experiencing economic liberalization in 1991. Most of the top world brands are now housed in India.

The global rise in income has led to an exponential growth of the middle class. The opportunities that are masked in this budding trend of middle class in the world generally arise because of increased consumption across the board, and exploitation of the non-existent markets for luxury items in these countries.

## Rising Middle Class of Pakistan

As per Credit Suisse's definition of middle class, a Pakistani adult can be considered a part of the middle class if s/he has a personal wealth of Rs. 1.5 million up to Rs. 15 million<sup>5</sup>. Accordingly, a share of 5.4% of the population constitutes as middle class. At \$14,413, Pakistan has the third lowest "middle-class lower bound wealth" for 2015, followed by India (\$13,662) and Ukraine (\$11,258). This suggests that Pakistan has lower prices in general, enabling people to join the middle class by crossing a relatively lower threshold of wealth band.

According to an Asian Development Bank report titled "Asia's Emerging Middle Class: Past, Present, And Future"<sup>6</sup>, Pakistan's middle class growth from 1990 to 2008 was at 36.5%, much faster than India's 12.5% growth for the same period.

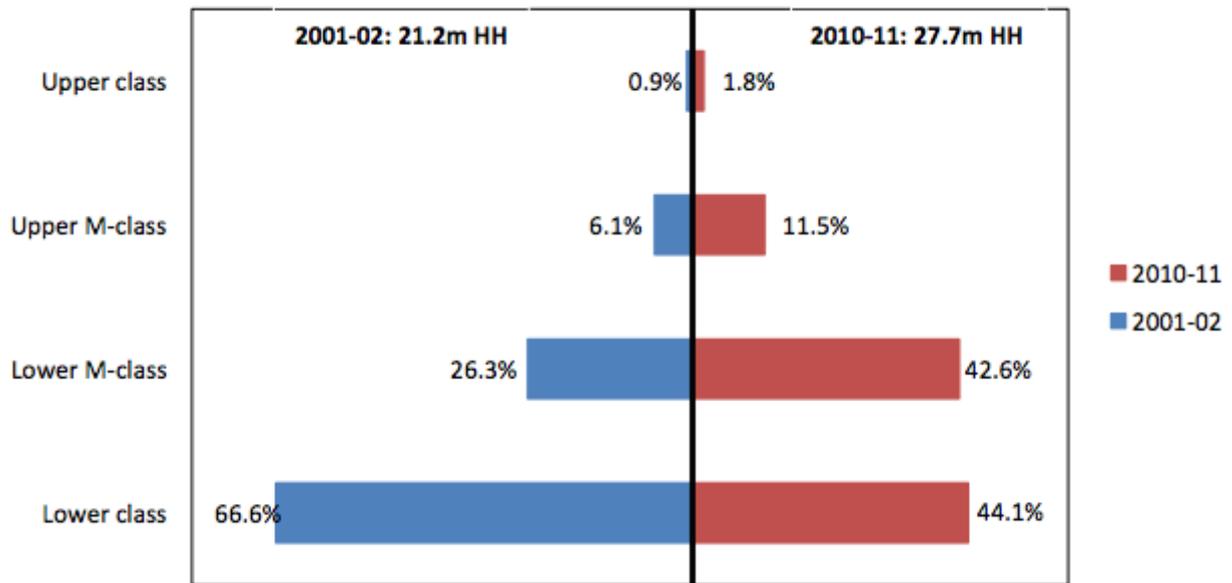
The breakdown of households by economic class is given in Figure 3, which shows that from 2001-02 to 2010-11, the share of households in Lower Middle class has increased the most (26.3% to 42.6%)

---

<sup>5</sup> Provided the PPP holds and the exchange rate of \$1= Rs104

<sup>6</sup> <http://www.adb.org/sites/default/files/publication/27726/ki2010-special-chapter.pdf>

Figure 3: % Households by Economic Class



Source: The Emerging Middle Class in Pakistan: How it Consumes, Earns, and Saves<sup>7</sup>

Investigation between class and occupation presented by Durr-e-Nayab (2011)<sup>8</sup> shows that in Pakistan, lower classes confine to working in sectors like Agriculture and Fishery and other Elementary Occupations while the lower middle class comprises mostly of Service Workers and Shop/Market Sales Workers and somewhat Professionals, Technicians and Associate Professors as well as Clerks. The Upper Class are predominantly Professionals and Legislators, Senior Officials and Managers. Details are shown in Table 1:

<sup>7</sup> Dr. Jawaid Abdul Ghani. "The Emerging Middle Class in Pakistan: How it Consumes, Earns, and Saves". Institute of Business Administration.

<sup>8</sup> Durr-e-Nayab (2011), "Estimating the Middle Class in Pakistan". Pakistan Institute of Development Economics

Table 1: Occupational Distribution within Classes by Weighted Composite Index (%)

Occupation	Classes through Weighted Index						
	Lower Lower	Middle Lower	Upper Lower	Lower Middle	Middle Middle	Upper Middle	Upper
Armed Forces	0.0	0.8	0.7	1.1	0.6	1.3	3.2
Legislators, Senior Officials Managers	0.0	0.3	0.9	2.9	8.2	20.7	30.6
Professionals	0.0	2.9	4.6	18.3	15.7	26.4	37.1
Technicians and Associate Professionals	0.0	7.0	10.0	19.3	14.2	21.3	9.7
Clerks	0.0	3.6	7.6	14.5	11.8	12.9	1.6
Service Workers and Shop/Markets Sales Workers	0.0	31.0	34.1	30.0	28.9	17.1	17.7
Agriculture and Fishery Workers	33.2	17.0	14.9	5.9	8.6	0.1	0.0
Crafts and Related Trade <u>Workers</u>	9.0	8.5	8.5	2.6	5.0	0.0	0.0
Plant and Machine Operators and Assemblers	11.9	9.2	7.1	2.1	3.1	0.0	0.0
Elementary Occupations	45.9	19.6	11.7	3.3	3.9	0.0	0.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: "Estimating the Middle Class in Pakistan". Pakistan Institute of Development Economics

The corresponding table for Industrial Distribution within Classes is shown in Table 2, which shows that lower classes are associated with Agriculture, Forestry, Hunting and Fishing while all classes above are associated largely with Community, Social and Personal Services and to some extent the Wholesale and Retail Trade and Hotels.

Table 2: Industrial Distribution within Classes (%)

Occupation	Classes through Weighted Index						
	Lower Lower	Middle Lower	Upper Lower	Lower Middle	Middle Middle	Upper Middle	Upper
Agriculture, Forestry, Hunting, and Fishing	42.9	19.4	15.5	6.2	8.9	1.4	1.6
Mining and Quarrying	0.8	0.5	0.0	0.8	0.5	0.9	1.6
Manufacturing	9.3	8.8	9.3	7.6	9.7	11.6	12.9
Electricity, Gas and Water	0.6	1.5	2.4	2.6	2.6	2.7	1.6
Construction	19.1	8.3	5.1	2.5	2.7	2.1	1.6
Wholesale and Retail Trade and Hotel/Restaurants	4.5	24.5	29.4	25.6	27.0	15.5	22.6
Transport, Storage and Communication	12.0	9.1	6.9	4.3	4.8	4.9	1.6
Financing, Insurance, Real Estate and Business Services	0.2	0.8	2.1	3.6	6.9	9.4	14.5
Community, Social and Personal Services	10.5	27.1	29.1	46.8	36.8	51.5	41.9
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: "Estimating the Middle Class in Pakistan". Pakistan Institute of Development Economics

## Wealth in Pakistan

Global Wealth Report 2015 estimates that Pakistan ranks as the 18<sup>th</sup> largest middle class nation worldwide with an estimated middle class population of over 6.27 million. Total wealth in Pakistan amounted to \$495 billion in 2015. Given that the figure stood at \$170 billion in 2000, total wealth in Pakistan has increased at an annual rate of 7.4% for the last 15 years. On the other hand, the total wealth of the world increased on average by 5.2% annually over the same 15-year period, showing a higher than average annual rate of increase in total wealth for Pakistan.

In 2015, 90% of Pakistani adults had a wealth of less than USD 10,000 whereas 9.8% of adults possessed wealth between USD 10,000 and USD 100,000. Only 0.1% of the adults owned wealth between USD 100,000 and USD 1 million.

Hence, in the coming years, more people will be coming out of poverty and raising the consumption demands of Pakistan's economy. This implies that the companies planning to serve the emerging middle class markets need to revisit their business models, strategies and product mix to be able to capture the much anticipated high demands of goods and services.

To have a deeper insight on the preferences and increase in consumer demands, the following section covers the consumption patterns of Pakistani domestic consumers along with the projected consumption rise.

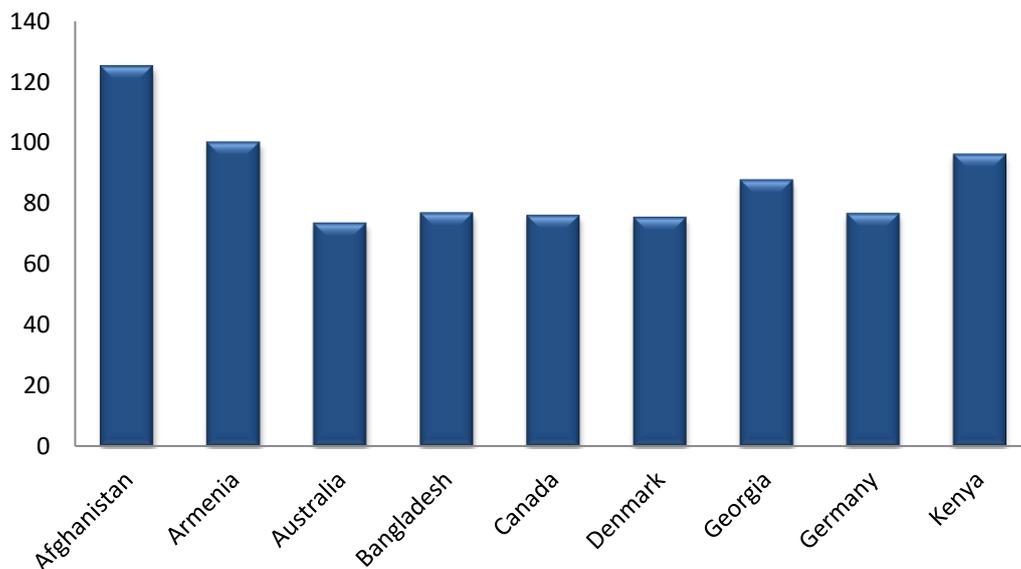
## Consumption and its Impact on Growth

Consumption is a substantial part of the total size of the economies around the globe. This fact can be easily discerned from the total consumption (private plus public) as a percentage of total GDP, which is shown in the following figure<sup>9</sup>.

---

<sup>9</sup> <http://data.worldbank.org/indicator/NE.CON.TETC.ZS>

Figure 4: Consumption per GDP of different countries (2014)



Source: World Bank

The graph shows that the developed countries like Germany, Canada and Australia, spend less of its income on consumption. In contrast, although Afghanistan is considered an under-developed country given its low per capita income, its consumption expenditures are higher than its total recorded GDP.

However, this high consumption in developing countries is not accompanied by higher savings. Lower level of savings tend to retard economic growth since lower levels of financial resources tend to inhibit investment (private plus public) which is critical for short, medium and long term prospects for an economy's expansion. Ultimately a country has to resort to contracting loans, for which, the payback (principal plus interest) acts as a drag on fiscal resources. One of the reasons that rich countries are rich, and thus have a lower portion of consumption to their GDP, is due to their higher levels of savings. These savings help not only in propelling economic growth, but also in maintaining a steady level of aggregate consumption. Thus, in an ideal situation, an economy would be enjoying higher consumption plus substantial savings, providing a vibrant base for future economic growth.

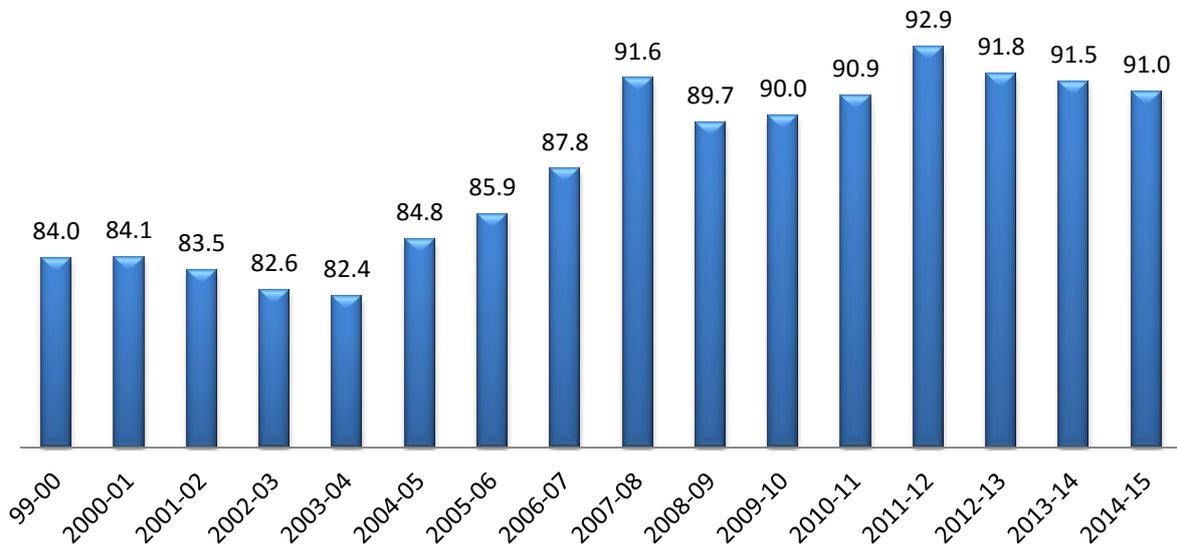
### Consumption Patterns in Pakistan

Given its low GDP per capita, not surprisingly, Pakistan has a high consumption to GDP ratio<sup>10</sup>. In this respect, the figures reported by World Bank (WB) are in line with the statistics of Pakistan Bureau of Statistics (PBS). The percentage of

<sup>10</sup> Ibid.

consumption in GDP, as per the PBS statistics<sup>11</sup>, shows a steady increase. In 2011-12, consumption as a percentage of GDP reached a high of 95 percent. The following figure depicts the consumption per GDP growth (at nominal/market prices) over the last 16 years.

Figure 5: Total Consumption per GDP (1999-2015)



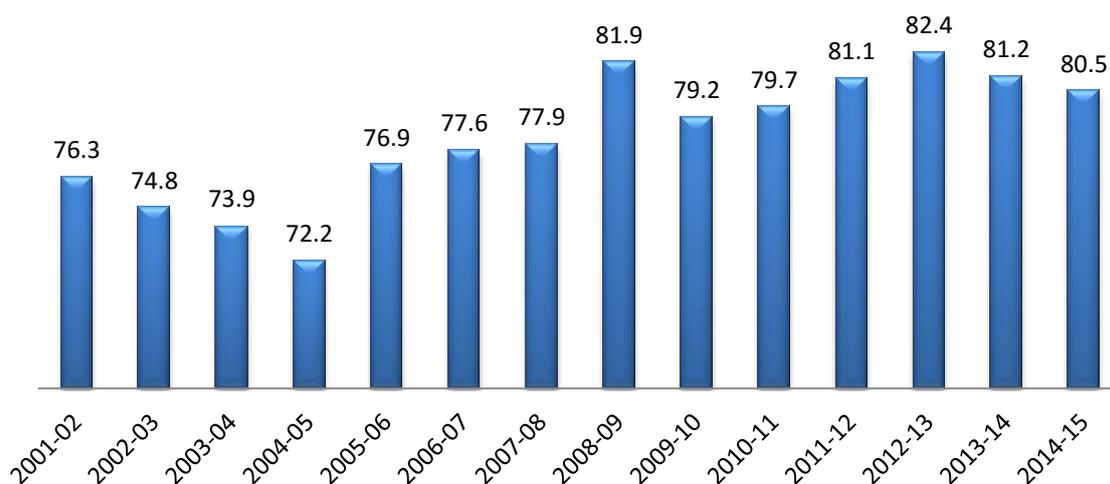
Source: Pakistan Bureau of Statistics

The figure shows that the total consumption in Pakistan is overall quite high. If total consumption is further bifurcated into private and public components, private/household consumption forms a substantial part of the total consumption. Private consumption expenditures in Pakistan as a percentage of GDP in Pakistan are illustrated as follows:<sup>12</sup>

<sup>11</sup> [http://www.pbs.gov.pk/sites/default/files/national\\_accounts/tables/table2.pdf](http://www.pbs.gov.pk/sites/default/files/national_accounts/tables/table2.pdf)

<sup>12</sup> Data taken from WB household consumption (as a percentage of GDP) stats, available at [http://data.worldbank.org/indicator/NE.CON.PETC.ZS?order=wbapi\\_data\\_value\\_2011%20wbapi\\_data\\_value%20wbapi\\_data\\_value-first&sort=asc](http://data.worldbank.org/indicator/NE.CON.PETC.ZS?order=wbapi_data_value_2011%20wbapi_data_value%20wbapi_data_value-first&sort=asc)

Figure 6: Household Consumption Expenditure as a percentage of GDP (2001-2015)



Source: World Bank

PBS conducts various surveys in order to come up with various socio economic statistics of diverse nature. One of them is the Household Integrated Economic Survey (HIES), which is being conducted since the 1960s in order to gauge the average monthly expenditures, average monthly income and percentage wise expenditures on different categories of consumption. The following table summarizes the average monthly household income and expenditures overtime.

Table 3: Average Monthly Household Income and Expenditure (Rs)

	2001-02	04-05	05-06	07-08	10-11	11-12	13-14	% change (2001-14)
<b>Expenditure</b>	5751	7440	8564	10445	16537	18901	23718	312.4
<b>Income</b>	5963	7488	9788	11172	16841	19928	24188	305.6

Source: HIES

It is evident that the average monthly consumption expenditures and income have significantly increased by 312% and 305% respectively from 2001 to 2014. The breakdown of this consumption expenditure by commodity group is given in the following Table.

Table 4: Average Consumption Expenditures by Commodity Group

Commodity	2001-02	05-06	10-11	13-14	% Change (2001-2014)
Food, Drinks and Tobacco	48.3	43.0	48.9	43.6	-9.67
Apparel, textile and Footwear	6.6	5.7	5.1	6.5	-1.82
Transport and communication	3.9	6.2	6.0	7.0	<b>81.65</b>
Cleaning and Laundry	3.8	3.6	3.7	3.6	-6.32
Recreation and Entertainment	0.5	0.7	0.4	0.4	-6.38
Education	3.6	3.7	3.5	5.1	<b>40.88</b>
Housing (rent plus cost)	13.2	15.2	13.9	13.1	-0.68
Fuel and Lighting	7.9	7.9	7.6	7.3	-7.49
Miscellaneous (like Health)	12.2	14.0	10.8	13.3	<b>9.08</b>

Source: HIES

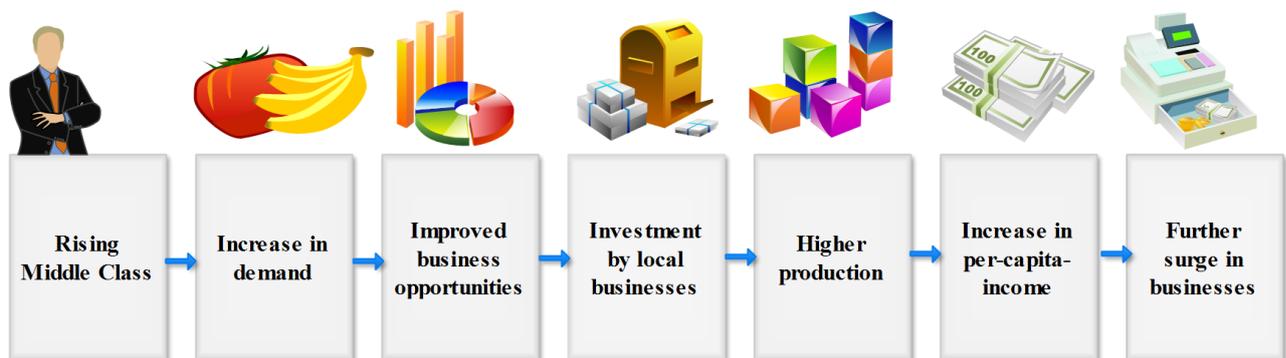
In terms of category wise expenditures, 'Education' and 'Transport and Communication', and 'Miscellaneous (including Health)' show substantial gains. In fact, the Transport and Communication category's gain is much higher than the others. Rest of the categories e.g. 'Food, Drinks and Tobacco' show a declining trend.

Change in consumption patterns has been explained by a recent research conducted by Ashfaq H. Khan and Nadeem Burney. For the research, disaggregated micro level data has been collected, and the consumption pattern in Pakistan has been analyzed by differentiating between rural and urban consumption<sup>13</sup>. The findings show that in general, the rural households spend a higher percentage on food and drinks compared to urban households while the urban households spend more on transport, communication, education and leisure. Increase in income leads to more expenditure on education, communication and transport, housing and durables for both rural and urban households.

Therefore, the overall results lend support to the Engel curve hypothesis, i.e., as incomes increase, the expenditures on items like food and clothing consumes a lower portion of income, while education, health, transport, leisure and communication

<sup>13</sup> 'Household Consumption patterns in Pakistan: An Urban-Rural comparison using micro level data', Ashfaq Khan and Nadeem Burney, in Pakistan Development Review (PDR), Summer 1991.

tend to consume a higher share of income. The research also suggests that as income increases, consumers switch to higher quality of the same product.



Dr. Adiq Kiyani's study<sup>14</sup> looked at the consumption patterns of households from 1997-2009 and estimated the elasticities. It was found that food and housing/rent, transportation and communication are relatively inelastic to changes in income. Health, Education and Clothing were found to have positive elasticity of 3.04, 7.07 and 8.31 respectively. Farkhanda Shamim, following the pattern of Ashfaq Khan and Nadeem Burney's research, studied the consumption patterns of urban and rural households using HIES 2011-02 data<sup>15</sup>. The consumption patterns were further disaggregated by sex and age. The results indicated that in urban areas, grains, dairy, education and health are luxury items while in rural areas, poultry, fruit, electricity, entertainment and durables appear as luxury items.

Outcomes of both studies show that the consumption patterns in Pakistan are in consonance with what the Engel law predicts. The consumption patterns between rural and urban household may differ to a certain extent and there may be different factors affecting the rise or decline of consumption patterns.<sup>16</sup> Yet consumption of education, communication, transport and health seems to rise with the rise in income.

<sup>14</sup> 'Forecasting the future consumption: A case study of Pakistan', by Dr. Adiq Kiyani, Euro Asian Journal of Economics and Finance, 2013.

<sup>15</sup> 'Understanding Household Consumption Patterns in Pakistan', by Farkhanda Shamim, Journal of Retailing and Consumer Services, 2013.

<sup>16</sup> For example, rural area incomes see a jump when international commodity prices or government support prices see an increase (it has the opposite effect in urban areas). In urban areas, service sector expansion and growth in remittances are two factors that affect income and hence consumption decisions.

The overall rise in consumption can be associated with the rise in middle class over the past few years. As explained by Dr. Ghani<sup>17</sup> in his report on emerging middle class in Pakistan, of the \$60 billion increase in real aggregate national consumption, \$55 billion was accounted for by the increase in consumption of the middle class i.e. 90% of increase in national consumption from 2002-11.

## Changing Consumption Trends – an Opportunity for the Business World

The business world is highly vulnerable to the subtleties of consumer choices. The ability to anticipate the trends in consumer consumption patterns is vital to any company desiring to be a market leader. Millions of dollars are spent each year in research and analysis to determine not only who the company's potential customers, but also to understand the preferences of these customers. Therefore, the consumption patterns and statistics provide a roadmap for the producers and investors to respectively produce and invest in accordance with the upcoming trends. To determine these consumption patterns (and hence understand business prospects), estimates of the future growth rates of GDP (and hence total income)<sup>18</sup> and the Marginal Propensity to Consume (MPC)<sup>19</sup> are required.

The following presents how we can arrive at these estimates.

If the history of GDP growth rates is indicative of the future, then Pakistan's future growth rates will be a mixture of growth spurts and relatively subdued growth. If we consider the decade wise pattern, then a rate of 4 percent of GDP growth rate per decade would seem to be a reasonable estimate. This number will be used in calculating the level of consumption growth per year till 2030.

For MPC, there are various estimates that have come courtesy of academic research studies and analytical reports e.g. the study by Ashfaq Khan and Nadeem Burney<sup>20</sup> has already been mentioned above. A more recent report that estimates the MPC in Pakistan is SBP's Annual Report for 2010-11, which gives MPC estimates for

---

<sup>17</sup> Dr. Jawaid Abdul Ghani. "The Emerging Middle Class in Pakistan: How it Consumes, Earns, and Saves". Institute of Business Administration

<sup>18</sup> The 2012 paper by M. Ali Kemal and Waqar Qasim gives an astonishingly high estimate of 91 percent as the size of informal economy relative to formal one. So in order to capture the probable effect of informal economy, it is safe to assume that it is considered at least 35 percent of the size of the formal economy.

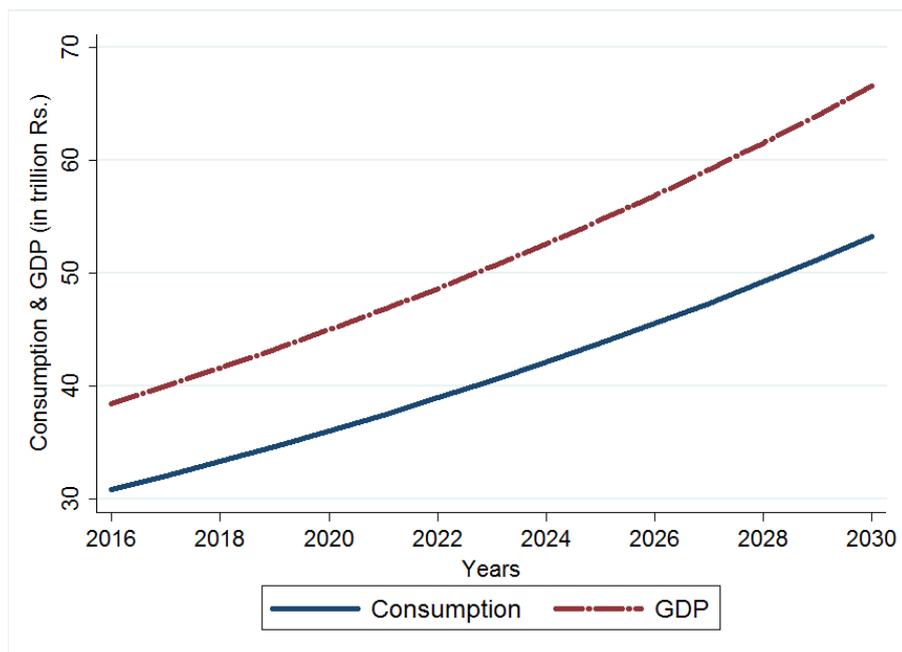
<sup>19</sup> The MPC is the amount spent on consumption out of every additional unit (like rupee or dollar) of earning.

<sup>20</sup> 'Household Consumption patterns in Pakistan: An Urban-Rural comparison using micro level data', Ashfaq Khan and Nadeem Burney, in Pakistan Development Review (PDR), Summer 1991.

various decades and for 2011<sup>21</sup>. From 1960s to 2011, the SBP estimates show that the MPC has increased from 72.5 (on average) to 97, which is an extremely high number. This indicates a strong preference of consumption given the growth in income. If the MPC from 1960s till 2011 is taken and averaged out, the figure turns out to be 79.27<sup>22</sup>. However, if the data for MPC from 2001 to 2011-12 is considered, the average of MPC calculation comes to be 86.30. This shows an increase in the MPC over the two decades.

This trend of increasing MPC is likely to continue since lowering MPC requires higher level of incomes and steady economic growth rate. Since Pakistan is still a developing country with relatively low level of growth rate, it can be assumed that the MPC will remain on the higher side in the years to come. For the purpose calculations in this report, a MPC of 0.80 will be used. The calculations, hypothesizing a 4 percent GDP growth rate and an MPC of 0.80, are given in Annex A, table A1. The corresponding figure showing the expected trend of consumption and GDP is as follows:

Figure 7: Expected Future GDP and Consumption (2016 – 2030)



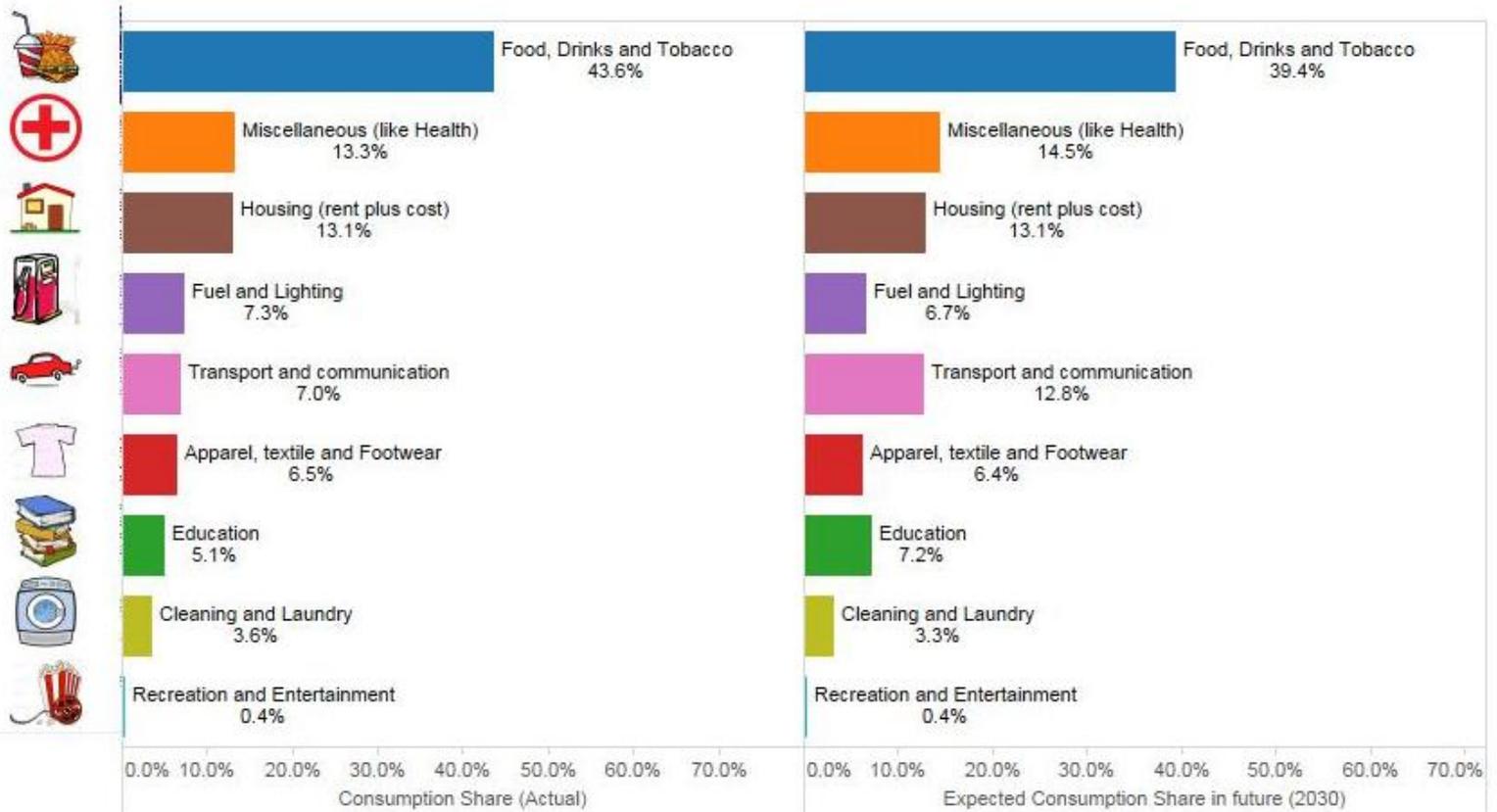
Now that we have an estimate of the probable consumption at 4 percent GDP growth and an MPC of 80 percent, we can calculate the category wise expected consumption expenditures. Details of the methodology of this calculation are

<sup>21</sup> SBP Annual Report 2010-11, Table 4.1 and 4.2.

<sup>22</sup> In other words, for every additional rupee earned, Pakistanis on average spend 79 paise from this additional income on consumption

provided in the Annex B. The following figure shows the current and expected average consumption by commodity group for Pakistan.

Figure 8: Average Consumption Expenditures by Commodity Group



Since transport/communication and education seem to be popular in terms of increase in future consumption, the data presented predicts that businesses may do well by investing in these particular sectors since these will be in high demand in the future, especially by the middle class since these changing patterns owe to the rise in middle class.

It may be instructive to compare the historical consumption trends and projections with the current sectoral growth rates from production perspective. According to the Economic Survey of Pakistan (2014-15), if production approach is considered, then services sector stands out in terms of consistently supporting the GDP growth rates. Since 2007, on average, the services sector has contributed 2.30% points in the GDP growth- taking care of almost half of the growth.

After observing high, erratic and negative growth rates over 2007-2012, the construction sector has started posted a healthy 7% growth rate since 2013. The sector of Transport, Storage & Communication has witnessed a steady growth rate of

4% on an annual basis since 2007. On the other hand, the agriculture growth rate in terms of production has remained volatile, and on average, has contributed 0.52% points in GDP growth rate. The industry sector is hardly better with contribution of 0.58% points.

This comparison shows that at the going level of GDP growth rates, the demands from the services sector (such as Transport & Communication and Construction) are more likely to be met than the demands from the agriculture and industrial sectors. This points out to the need of relatively more investment in both agriculture and the industrial enterprises. Thus modernized farming practices as well as more efficient methods of production of industrial goods will have greater economic returns on investment due to the visible gaps between supply and demand.

## Conclusion

This report presents statistical data showing a rise in middle class across the globe and evidence that suggests a continuation of this trend over the next years. For Pakistan, the rise in middle class is accompanied with increase in overall wealth and an increase in income of the middle class. It has been argued that this rise in middle class population brings with it immense prospects for businesses since increase in middle class can increase not only the level of consumption but also a change in consumption patterns. Businesses therefore have the potential of investing in unexplored markets and indulge in new ventures. Higher investment can in turn lead to overall growth of the country.

There may, however, be a downside to this argument. Durr-e-Nayab (2011)<sup>23</sup> explains that increase in aggregate demand and the subsequent growth in the economy through consumer spending may just be a short run phenomenon. The resultant growth may not be sustainable since many at times high level of consumption may not be accompanied by savings, hence eventually lowering the investment.

Whether or not the increase in middle class can lead to growth will not change the fact that consumption level is increasing and will continue to increase with changes in consumption patterns. Research into these patterns, similar to that presented in this report, can be immensely helpful in making decisions about production and investment for businesses.

---

<sup>23</sup> Durr-e-Nayab (2011), "Estimating the Middle Class in Pakistan". Pakistan Institute of Development Economics

## Annex A

Table A1: Future Consumption levels (2016-2030)

<b>Years</b>	<b>Total GDP (Million Rs)</b>	<b>MPC</b>	<b>Total Consumption (Million Rs)</b>
2016	38446746	0.8	30757397
2017	39984616	0.8	31987692
2018	41584000	0.8	33267200
2019	43247360	0.8	34597888
2020	44977255	0.8	35981804
2021	46776345	0.8	37421076
2022	48647399	0.8	38917919
2023	50593294	0.8	40474636
2024	52617026	0.8	42093621
2025	54721707	0.8	43777366
2026	56910576	0.8	45528460
2027	59186999	0.8	47349599
2028	61554479	0.8	49243583
2029	64016658	0.8	51213326
2030	66577324	0.8	53261859

## Annex B:

### Estimating Average Consumption Expenditure by Commodity

We will use the same categories as used by HIES (Table 4), and the same percentages as gauged by the last HIES survey. The methodology to be used is as follows: the percentage change from 2001 to 2014 is taken into account (given in Table 4). If it is negative, the 13-14 number is lessened by that percentage to arrive at share for next 15 years (and vice versa). For example, the category '*Food, Drinks and Tobacco*' shows a decline of 9.66 percent from 2001 to 2014. This 9.66 percent is multiplied by the 13-14 percentage, and the resulting number is then subtracted from 13-14 percentage.

For Example:  $(43.63 * 0.096) = 4.18$ ;

$$43.63 - 4.18 = 39.41 \text{ percent}$$