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Quick Takeaways on the American “Middle Class”

Late last year, the Pew Research Center released an in-depth study on the changes in lower-, middle-, and upper-income classes over the past several decades. Researchers found that the middle class has shrunk compared to the growing lower- and upper-income classes, down to 50% in 2015 from a 61% majority in 1971. This would appear to be true especially in the aftermath of the recent recession. According to a recent Gallup poll, 51% of Americans surveyed identified themselves as middle class, up a percentage point from 2012, but down significantly from the greater than 60% response last seen in 2008. However, it is important to keep several considerations in mind when discussing the changes that have occurred in the distribution of income over time.

- **The income metric matters.** Income commonly refers to more than just wages earned, and is one measure among others, such as net worth and consumption patterns, in determining the financial well-being of Americans. Moreover, such metrics can be measured by person, household, or even family. In the Pew study, income was measured by household using the Census definition of money income, which excludes certain money receipts, tax payments, dues and deductions, and benefits like foods stamps, health insurance, subsidized housing and energy assistance. The income measure used to determine who falls into the middle class matters to the entire framing of the discussion. Different definitions, such as using only the middle-fifth of income or excluding the top and bottom quintiles, will yield different results than the Pew-defined size-adjusted households that fall between two-thirds to double the median U.S. household income. In addition, the Pew-defined threshold for middle income has not only broadened over time, but risen in real terms, suggesting a rising standard of living. In fact, middle-income household advancement has been stronger in the past several decades than the oft-cited statistics indicate because the data tends to overstate increases in the disparities between the income groups.

- **Location plays a significant factor in what it means to be middle class.** There may be other reasons for identifying as middle class that may not fit the report’s criteria, including the fact that national-level data tends to obscure the variations across America. For example, a household earning the national median income of $53,657 may be considered lower-income in Frederick County, MD, but upper-income in Harlan County, KY. Given the cost of living variations across America, what it means to be middle class varies by state and even metropolitan area.

- **The upper-income group grew at a faster pace than the lower-income group.** As Pew reported: “From 1971 to 2015, the number of adults in upper-income households increased from 18.4 million to 51 million, a gain of 177%. During the same period, the number of adults in lower-income households increased from 33.2 million to 70.3 million, a gain of 112%.” By comparison, middle-income households grew by 51% from 80 million to 120.8 million. The fact that the upper-income group broadened—meaning that a relatively larger share of households frequent the upper-income group today than had in the past—is a positive trend and should ameliorate some of the concern regarding the “concentration” of income in the upper-income group. Such concern is misplaced if income mobility keeps to its historical pace or strengthens.

- **Mobility still matters: the makeup of income groups is anything but static, with people frequently moving among the lower-, middle-, and upper-income groups.** The distribution of households in each income group at any given moment is a snapshot of a dynamic flow (i.e. mobility) of households between income groups over time. Mobility is most commonly measured in both absolute terms, whereby a child is better off than his or her parents regardless of origin in the distribution, and also in relative terms, whereby a child moves up or down depending on where in the distribution he or she originated (i.e. a child in the bottom group could still be better off than his or her parents in the bottom group, suggesting upward mobility in the absolute sense, but immobility in the relative sense). Many would likely be surprised to learn that, contrary to recently developed conventional wisdom, economic mobility in America has not lagged that of its international peers, and mobility in America has remained largely unchanged over the last 20 years. Relatively new research delves into a mobility-related measure known as intergenerational elasticity, which measures the relationship between a person's income and that of his or her parents. The findings suggest that roughly half of parental income advantages are passed down to children. Income immobility, the ability to "move to opportunity," and the relationship between child and parent earnings will continue to play a prominent role in the changes to distribution in income over time.
- **Growth in the lower- and upper-income groups may continue for some time.** With the oldest Baby Boomers only just recently eligible for full Social Security benefits in 2012, this generation's retirement will continue for at least the next two decades. In fact, Baby Boomers most commonly comprise the upper-income group because many are still in their highest earning years. Though Boomers are retiring at a slower rate than previous generations, as the labor force participation rate for Americans age 55 and older is rising while younger age cohorts' participation is falling, their retirement will not only leave a lasting impact on the labor force, but it also means more Americans living on relatively lower retiree incomes than they earned in their working years.

The Pew study additionally points out that young adults age 18 to 29 were among the biggest "losers with a significant rise in their share in the lower-income tiers." Economist Tyler Cowen argues that does not bode well for our economic future. This is particularly concerning if the economy is giving way to a "Great Reset" that, in a low-productivity growth environment, will offer far less favorable long-run wage prospects and slower growth in living standards, borne most clearly by the young entering into the workforce. Ultimately, it remains to be seen whether young adults will surmount the challenges they face today.

Furthermore, as longer-term technological trends continue, labor market polarization will continue to affect the types of jobs demanded in the economy as middle-skill jobs are replaced by automation. Policies that negatively alter work incentives, including examples like the Affordable Care Act's 30-hour full-time work threshold and the pending increase in the Department of Labor's income threshold for overtime pay eligibility, will reduce work opportunities, flexibility, and hours. Regulatory barriers to entrepreneurship, specifically the cumulative burdensome requirements imposed at the federal level and occupational licensing laws at the state level, will continue to impede the creation and development of businesses and the jobs that come with it. Altogether, these shifts in technology and policy will ultimately be reflected in the income earned, the number of earners, and the hours worked by individuals in these households, regardless of distribution.