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# The Vanishing Middle Class

## Prejudice and Power in a Dual Economy

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## Introduction

Growing income inequality is threatening the American middle class, and the middle class is vanishing before our eyes. There are fewer people in the middle of the American income distribution, and the country is dividing into rich and poor. Our income distribution has changed from looking like a one-humped camel to looking like a two-humped camel with a low part in between. We are still one country, but the stretch of incomes is fraying the unity of the nation.

The middle class was critical to the success of the United States in the twentieth century. It provided the manpower that enabled the nation to turn the corner to victory in two world wars in the first half of the century, and it was the backbone of American economic dominance of the world in the second half. But now the average worker has trouble finding a job, and the earnings of median-income workers have not risen for forty years. (The median income is the middle income, where as many people earn more as earn less; it was about \$60,000 in 2014 for a family of three.) If America is to remain strong in the twenty-first century, something has to be done.<sup>1</sup>

This problem is complicated by the influence of American history. Slavery was an integral part of the United States at its beginning, and it took a protracted and bloody Civil War to eliminate it. Too many African Americans still are not fully integrated into the mainstream of American society. While progress has been made, our neighborhoods and schools remain largely segregated by race, and African Americans as a whole are poorer than white Americans.

The combination of inequality and racial segregation is problematic for the health of our democracy. For example, it should be the right of any citizen to vote in a democracy. Slaves of course did not vote, and attempts continue to this day to keep African Americans from voting, including a number of high-profile cases of alleged illegal obstruction

that have gone to the courts. In addition, black people are far more likely than white people to be arrested and sent to prison in the American War on Drugs.

Poor whites also have suffered in various ways, but they have remained mostly quiescent and invisible in political debates and decisions. Traditionally, poor white Americans have not voted much, due to the restrictions used to discourage black voting like requiring picture IDs, and widespread beliefs that political parties are all the same and politicians do not care about them. Their frustration and despair at being left out of recent economic growth has resulted in an array of stresses and self-destructive behaviors that have raised the death rates for middle-aged white Americans. Anger at their circumstances is being channeled into politics in 2016. This anger is likely to affect American politics for a long time.

These developments were revealed dramatically in a recent study by the Pew Research Center. The change is shown in figure 1, where total national income is divided into three groups: the middle class with upper and lower groups. The middle class, defined as households earning from two-thirds to double the median American household income, went from earning over three-fifths of total national income in 1970 to earning only just over two-fifths in 2014. The lines in figure 1 were horizontal before 1970, but they are continuing their movements after 2014.

Figure 1 shows that the income share lost by the middle class went to people earning more than double the median income. In short, the rich got richer, the poor did not disappear, and the middle class shrank sharply. We know from the work of Thomas Piketty in *Capital in the Twenty-First Century* that inequality has been increasing since 1970.<sup>2</sup> Now we see that the income distribution is hollowing out. We are on our way to become a nation of the rich and the poor with only a few people in the middle.

This book provides a way to think about this growing disparity of incomes between rich and poor. I argue that American history and politics have a lot to do with how our increasing inequality has been distributed. While our rapidly changing technology, prominently in finance and electronics, is an important part of this story, it is far from the whole tale. Our troubled racial history of slavery and its aftermath also plays an important part in how this growing divide is seen.

English settlers began coming to North America in the seventeenth century. They started in Plymouth, Massachusetts, and Jamestown, Virginia, and spread along the Atlantic seaboard. They found abundant and

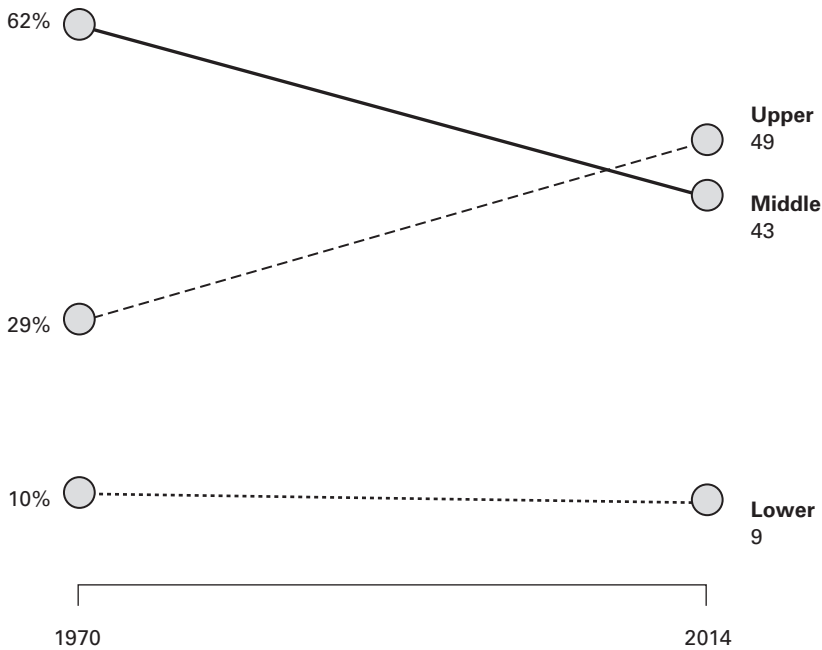


Figure 1

Percent of aggregate U.S. household income. *Note:* The assignment to income tiers is based on size-adjusted household incomes in the year prior to the survey year. Shares may not add up to 100 percent due to rounding.

*Source:* Pew Research Center 2015

fertile land to farm, but there were not enough settlers and labor to farm as much land as they wanted. The resident Native Americans resisted working for the English occupiers and were decimated by European diseases. The settlers encouraged other people to come farm their land, and European and African population movements were attracted in very unequal ways. Europeans were encouraged to come by themselves or as indentured servants who became independent farmers, while Africans were brought against their will by slave traders.

Europeans gained great prosperity first from agriculture and then from industry, while Africans were condemned to slavery. Cotton was the key to economic growth in the early nineteenth century—grown by African slaves in the South and manufactured into cloth by Europeans in the North. Slavery was abolished by the Civil War that remains unresolved in the minds of many white Southerners. European immigration was restricted after the First World War, and six million African Americans

moved north during what was called the Great Migration as a result. In recent years, immigration from Mexico and other nearby Latin American countries has increased rapidly, and Latinos also are concentrated in the lower group shown in figure 1. Public discussion of the working poor focuses on African Americans, but it sometimes refers to them simply as “them,” including Latinos as well.

African Americans also have become the focus of policy debates at both state and federal levels. Politicians who oppose government welfare expenses used to identify the recipients as black; however, since the Civil Rights Movement of the 1960s, politicians use code words instead. While nearly half of black Americans are included the “poorer” group in figure 1, most poor people in fact are not black. There are not enough African Americans for them to be the majority. Poor whites also are affected by the withdrawal of social services, but they have been largely invisible in policy discussions. As Bob Dylan said in a song at Martin Luther King’s 1963 March on Washington, “The poor white remains / On the caboose of the train / But it ain’t him to blame / He’s only a pawn in their game.”<sup>3</sup>

Race and class are distinct, but they have interacted in complex ways from the U.S. slavery era that ended in 1865; to Ronald Reagan announcing his 1980 presidential campaign in Philadelphia in Mississippi, where three civil rights workers had been murdered in 1964; to Donald Trump’s equally indirect claim to “Make America Great Again” in his 2016 presidential campaign—where “great” is a euphemism for “white.” The Civil Rights Movement changed the language of racism without reducing its scope. As incomes become more and more unequal, racism becomes a tool for the rich to arouse poor whites to feel superior to blacks and distract them from their economic plight.

Figure 1 is both simple and complex. It is simple because it summarizes a great deal of empirical research in a memorable way. It is complex because it is the result of economics, history, politics, and technology. To weave these varied strands into a coherent intellectual fabric, I use an economic model. A model is a simple version of a complex reality that reveals interactions between the strongest forces. It also facilitates the introduction of other forces into the model to make a more comprehensive representation of a complex reality.

I employ an economic model that was created over sixty years ago—and continues to be taught in economics classes today—to integrate the various strands of this narrative into a coherent story. This model continues to provide insights into the process of economic development even

though it is clear enough to be understood by those who are not students of economics.

Economists identify this model by its creator, W. Arthur Lewis; it is known as the Lewis model. More descriptively, it also is known as the original model of a *dual economy*. A dual economy exists when there are two separate economic sectors within one country, divided by different levels of development, technology, and patterns of demand. This definition reflects the use of the Lewis model in the field of economic development, and I adapt it in this book to describe current conditions in the United States, the richest large country in the world.

This is less paradoxical than it sounds because the political policies that grow out of our dual economy have made the United States appear more and more like a developing country. Anyone who stirs out of his or her house knows about the problems of deteriorating roads and bridges in our country. And if you are not rich enough to send your children to private schools or to live in an expensive suburb known for having good public schools, you may know also about the current crisis in education.

Education was the key to American prosperity in the twentieth century. It is not too much to claim that we lived through an “American Century” because we had a long tradition of education that was the envy of the world. Claudia Goldin and Lawrence Katz made that point in *The Race between Education and Technology*.<sup>4</sup> Education is doubly important in the story told here. First, education is the key path for people to move from the poorer sector of the dual economy to the richer. And second, anyone interested in the continued economic success of the United States in the twenty-first century must want to fix our schools to preserve the prosperity of the country and its growth over time.

While this seems compelling to most people, the politics that emerge from our dual economy prevent us from acting sensibly to reconstruct our ailing educational system. As we will see, we now have two systems of education, one for each sector of the dual economy. Schools for the richer sector vary in quality, and the best of them are well within the American historical experience. By contrast, schools for the poorer sector are failing. Attempts to fix these schools have been known primarily for their spectacular failures.

The legacy of slavery hangs over attempts to provide every child with an education. It was illegal to educate black people under slavery, and politicians today neglect education of the poor by implicitly invoking this racist history. Urban pockets of poverty are deprived of good education by



coded messages that invoke race to justify neglect or worse toward them. African Americans are condemned for violent actions, but they are largely the results—not the causes—of educational failure. Local school-district control was the key to good education during American expansion, but it has become a barrier to good education in recent decades.<sup>5</sup>

Even when black students get a good education, they often have trouble finding jobs that will move them up in the economy. Factory jobs have been disappearing for a generation; that is the main driver of the declining line in figure 1. The implication is that an educated black graduate in today's American economy has to make a leap to get into the higher-income group—a leap that is doubly hard. It typically requires even more education, and there is resistance to hiring bright young black people for high-paying jobs. The changing shape of the economy appears to have locked a large percentage of African Americans into a subordinate position, from which only the best and the brightest can hope to escape. Latinos who came to the United States seeking good jobs, like African Americans who left the post-Civil War South in the Great Migration, are in similar trouble.

This description will become clearer as we explore the implication of our model and history. We also will learn what the possibilities are for a political change that will make our efforts more fruitful. While no one can predict the future, we hope for changes that will improve the varied underpinnings of our economy and society. As we will see, the rich of the twenty-first century are trying to kill the goose that laid all those golden eggs in the twentieth century. The question is how we can alter the bad trajectory we are on.

The discussion in this book is divided into four parts. I describe and adapt the Lewis model in part I, showing both the implications of the model and its application to the United States today. One implication of the Lewis model is that the upper sector tries to keep wages low in the poorer sector. We can see that in many ways. For example, the *Boston Globe* recently tried to reduce the expense of delivering the newspaper. Most of us do not think about how the paper gets to our door in the morning, but paper delivery has evolved into a grueling nocturnal marathon for low-income workers who work invisibly at the edge of the economy. Delivery drivers are classified as independent contractors rather than employees; they therefore do not get guaranteed health care or retirement savings. They work 365 days a year for pay that makes ordinary jobs look good, and they have to find a replacement if they need to take a day off. Many of them work at another job during the day to

support their families. More and more working people are being forced into working conditions like these.<sup>6</sup>

I resolve an apparent paradox in the second part. How can one sector of the economy impose its will on the other part in a democracy? Why don't the numerous poor vote the fewer rich out of office? The Median Voter Theorem helps pose these questions more precisely and indicates where answers may lie. An alternate view known as the Investment Theory of Politics reveals how democracy operates in our dual economy.

I start part II with the effects of race and gender on our decisions and progress to the role of the richest Americans in our politics. Their actions are most visible in a few Midwestern states. Hedge fund managers in Indiana drummed up support for Governor Mike Pence who wants to cut government spending, abandon the state's pension system, and weaken or destroy public-employee unions. This agenda is more advanced in Wisconsin where Governor Scott Walker started earlier and has gone further to allow corporations to contribute directly to political parties and to replace the state's nonpartisan government accountability board with commissions made up of partisan appointees. And in neighboring Michigan, Governor Rick Snyder ignored warnings about lead in the drinking water of Flint, a town that is poor and black. Since the effect of lead poisoning of black kids will have harmful effects over many years, some observers have been calling Flint a case of "environmental racism."<sup>7</sup>

This is the program of the very rich who have been allowed to dominate government policies by a succession of legislative and court decisions. The democracy that aspired to guarantee the right to vote for every person has been undermined in the last generation by a political structure where income matters more than demography. Income matters in varied ways, and campaign spending affects both votes and who can vote. The decisions creating the new politics have been justified by indirect racism that castigates poor people as "others," meaning black or brown. Despite the absence of directly racist statements, it is worth noting that the states that rejected the free expansion of Medicare under the Affordable Care Act are mostly former members of the Confederacy.

Part III of this book applies the insights of parts I and II to specific policy areas, organized around two popular oxymorons: "majority minority" and "private public." The largest unseen policy is the growth of mass incarceration in the period demarcated in figure 1. Starting from President Nixon's declaration of a War on Drugs, the American rate of incarceration has grown from the level of other modern democracies to

one previously seen only in totalitarian countries. By the twenty-first century, one in three black men could expect go to jail. Blacks are not the majority of prisoners even so—one out of six Hispanic men and one out of seventeen white men can expect to go to jail—but the War on Drugs has eroded the black community. Phrased differently, 22 percent of black males aged 35 to 44 had been in prison in 2001, compared to 10 percent of Hispanic males and 4 percent of white males in this age group.<sup>8</sup>

Many poor black families have a member or know a relative or neighbor who has gone to jail. Too many black mothers are condemned to be single parents struggling to raise their children alone. And many black boys attending school know they have a good chance of being stopped by police, maybe even arrested, and ending up in jail. How can such a child think of the future when his present is so hard?

Families of single parents are poorer than intact families. They live in poor areas, typically in cities, where the schools are bad. Government decisions over the past generation have constructed a bifurcated school system, one for prosperous suburban whites who go on to college and one for urban black and brown people who are preoccupied with the threat of jail. The suburban schools are well funded from local taxes, while the urban tax base has shrunk under the economic burden placed on individuals and families by mass incarceration.

The combination of these policies has created a vicious cycle where black men are in jail, black women are under strain, and black children are deprived of a good education. The boys have few gainful opportunities and many contacts with the police; many may end up in jail, perpetuating this system. Politicians debate the value of investing more in urban schools if the students often drop out and go to jail—failing to recognize this is the outcome of a system of mass incarceration and complex public funding arrangements. This cycle is what Michelle Alexander called *The New Jim Crow*.<sup>9</sup>

Public investment in our cities also has been neglected. The infrastructure of cities, from roads and bridges to public transportation, has deteriorated to the point where it approaches the dilapidated conditions formerly found only in the developing countries that Lewis described. And debts of individuals, both from failed mortgages and bad education, have mushroomed to a size where they impede consumer spending and delay a full recovery from the financial crisis of 2008.

I close in part IV by comparing the American experience to that of other prosperous countries to show opportunities for change that are possible if we want to alter our current policies. Some countries have

followed our pattern of rapidly increasing income inequality. Other countries have moderated this development by instituting programs to help ordinary people keep up at least partially with the advancing income at the top of their societies. The trend of separating rich and poor within a country can be damped down by policies that address the problems outlined in this book.

But in America, the Lewis model of a dual economy applies. It shows why the upper sector wants to keep wages low in the lower sector—and that is exactly what has been happening in the United States for the last forty years. This book draws on economics, politics, and history to explain how our changing technology affects us all, and why we cannot design a better country as if our previous history had not taken place. Our initial economic growth was supported by slavery, and we fought a bloody Civil War to end slavery. The legacy of history has driven us to a position where American society has divided into two distinct sectors. We need to understand this existing economic structure to think how we can weave our diverse nation's disparate parts into some kind of unified fabric in the future.

I have been thinking about the issues raised here for a decade, ever since I wrote a paper on income inequality with Frank Levy. Then my wife and I taught a course titled *The New Jim Crow* at the Harvard Institute for Learning in Retirement and formed a racial justice group there. I wrote a paper on these themes, which I now have expanded into this book.<sup>10</sup> I thank Robert C. Allen, Stanley L. Engerman, Thomas Ferguson, Rob Johnson, Frank Levy, Linda K. Kerber, Michael J. Piore, and Robert M. Solow for useful comments on this book and the members of seminars at the Harvard Institute for Learning in Retirement, the Economics Department of the University of Michigan, the National Institute for Economic and Social Research (London), the Institute for New Economic Thinking, and the Economic History Seminar at Columbia University for their helpful feedback. I also thank my editor at the MIT Press, Emily Taber, for her detailed and excellent editorial comments and my assistant at MIT, Emily Gallagher, for the many large and small assignments she has helped me with. I thank the librarians at MIT's Dewey Library, named after Davis Rich Dewey, older brother of John Dewey, who I quote later in this book, for help finding the books I needed. Finally, I thank the Institute for New Economic Thinking for financial support and the Russell Sage Foundation for a fellowship as I started on the research that led to this book.<sup>11</sup>