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 succeeded in turning 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 find a job, and the earnings of median 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.[1]

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 four score years later to eliminate it. African Americans still are not fully integrated into the mainstream of American society. While progress has been made, our residences and schools are largely segregated by race, and African Americans as a whole are poorer than white folks.

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 to keep current African Americans from voting are active today. In addition, black people are far more likely to be arrested in our drug wars and sent to prison after arrest than white people. And black communities tend to be poorer than average as a result of the pressure put upon them.

Poor whites also have suffered in various ways, but they remained quiescent and invisible in political debates and decisions. They did not vote much, due to the restriction used to discourage black voting and the beliefs that political parties were all the same and politicians did not care about them. Their frustration at being left out of recent economic growth has resulted in self-destructive activities that recently raised their death rates, and their anger 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, shown here as Figure 1. The middle class, defined as households earning from two-thirds to double the median American household income, has gone from earning over three-fifths to earning only just over two-fifths of total national income.

Figure 1 shows that the income share lost by the middle class has gone 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 was increasing. 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 the way 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 story. Our troubled racial history of slavery and its aftermath also play 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 and Jamestown and spread along the Atlantic seaboard. They found abundant and fertile land to farm, but they did not have the manpower to farm as much land as they wanted. The resident Indians 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 intertwined 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 still lives in the minds of many white Southerners. European immigration was restricted after the First World War, and many African Americans moved north in a Great Migration as a result. Immigrants from Latin

America increased rapidly in recent years, and Latinos also are concentrated in the lower group in Figure 1. Public discussion of the working poor focuses on African Americans, but it sometimes refers to them simply as "them," which includes Latinos as well.

African Americans also have become objects of policy debates at both state and federal levels. Politicians who oppose government welfare expenses used to identify the recipients as black, and now—after the Civil Rights Movement of the 1960s—these politicians use code words to identify the recipients as black. While almost half of black people are in the poor group in Figure 1, most poor people are not black. There are not enough African Americans for them to be a majority of the poor. 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."[2]

Race and class are distinct, but they have interacted in complex ways from slavery long ago to Ronald Reagan announcing his 1980 presidential campaign in Philadelphia, MS, where three civil rights workers had been murdered, 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 their dark-skinned neighbors and not notice 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; it is 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 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*. 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 prevents 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 are varied, 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 these are the results—not the cause—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.

Even when black students get a good education, they 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 group—a leap that is doubly hard. It typically requires even more education, and there is resistance to hiring bright young black people for higher paying jobs. The changing shape of the economy appears to have locked 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, as African Americans moved North 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 following discussion is divided into three parts. I describe and adapt the Lewis model in the first part, 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 its expenses of delivering the paper. 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.[3]

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 this part with the effects of race and gender on our decisions and progress to the role of the richest Americans in our politics. The actions of the richest are most visible in a few Midwestern states. Hedge fund managers in Indiana drummed up support for a governor 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 the governor 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, the governor 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."[4]

This is the program of the very rich who have been allowed to dominate government policies by a succession of government decisions by legislatures and courts. The democracy that aspired to a 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.

The third part applies the insights of the first two parts 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 grew from the level of other modern democracies to a level previously seen only in totalitarian countries. By the twenty-first century, one in three black men can 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, twenty-two percent of black males aged 35 to 44 had been in prison in 2001, compared to ten percent of Hispanic males and four percent of white males in this age group.[5]

Every poor black family must possess or know a brother, cousin or neighbor who has gone to jail. Many black mothers are condemned to be single parents struggling to raise their children alone. And every black boy attending school knows he has a good chance of ending up in jail as well. How can he think of the future when the 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 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 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; they often 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 without recognizing this is only part of a system of mass incarceration and complex public funding arrangements. It is what Michelle Alexander has called *The New Jim Crow*.[6]

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 by comparing the American experience to that of other prosperous countries to show some 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 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.

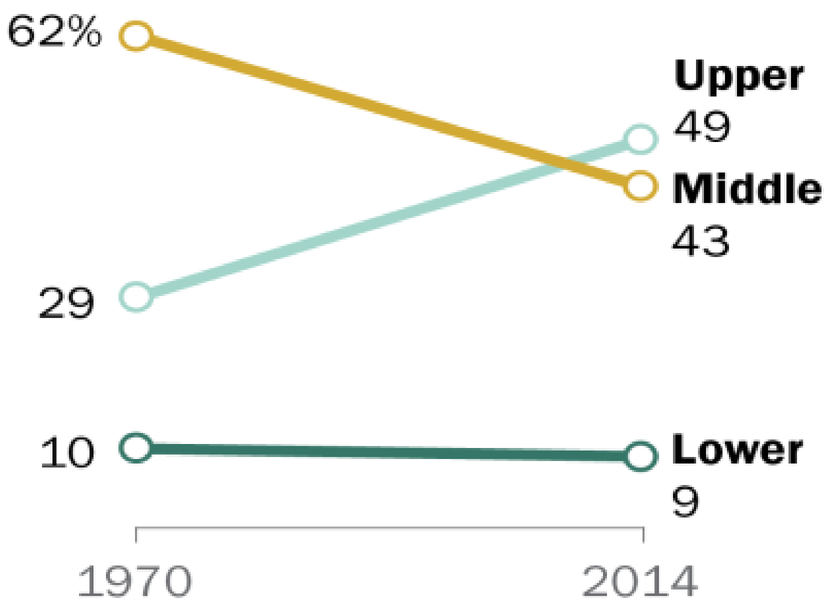
But in America, the Lewis model of a dual economy applies. It shows why the rich sector wants to keep wages low in the poor sector—and that is exactly what has been happening in the United States for the last forty years. This book draws on economics, politics and history to explain how our changing 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 knit our diverse nation into some kind of rough fabric sometime 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 I taught *The New Jim Crow* at the Harvard Institute for Learning in Retirement with my wife and formed a Racial Justice Group there. Now I unify these themes. I thank Robert C. Allen, Stanley L. Engerman, Thomas Ferguson, Rob Johnson, Linda K. Kerber, Frank Levy, 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 of Economic and Social Research (London), the Institute for New Economic Thinking Annual Meeting, and the Economic History Seminar at Columbia University for their helpful feedback. I also thank my editor at 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.[7]

Figure 1

Percent of Aggregate US Household Income



Source: Pew Research Center, 2015.

[1] What is the median? Consider a group of three people: the person who delivers your morning newspaper, a hedge-fund manager and you. These three people clearly have very different incomes. Ranking them by income, the median is the person in the middle. Most likely you. The median differs from the mean—or average—because the average is one-third of the sum of the incomes earned by the trio. Assume the hedge-fund manager earns about $10 million a year, a modest income for hedge managers. Then the average income of the trio is more than $3 million, far higher than your income as the median person—unless you are a hedge-fund manager. One-humped camels are dromedaries, and two-humped ones are Bactrian camels.

[2] Dylan, 1963; Case and Deaton, 2015.

[3] Levenson, 2015. This story was published as *The Globe* was trying to lower its delivery costs by hiring a new delivery company. The effort failed. Arsenault, 2016. See Edin and Shaefer, 2015, for more examples of jobs like this.

[4] Confessore, 2015; Kaufman, 2016; Smith, 2016; Eligon, 2016; Davey, 2016a.

[5] Bonczar, 2009.

[6] Alexander, 2010.

[7] Levy and Temin, 2007.