

United States: Challenges Faced by the Middle Class

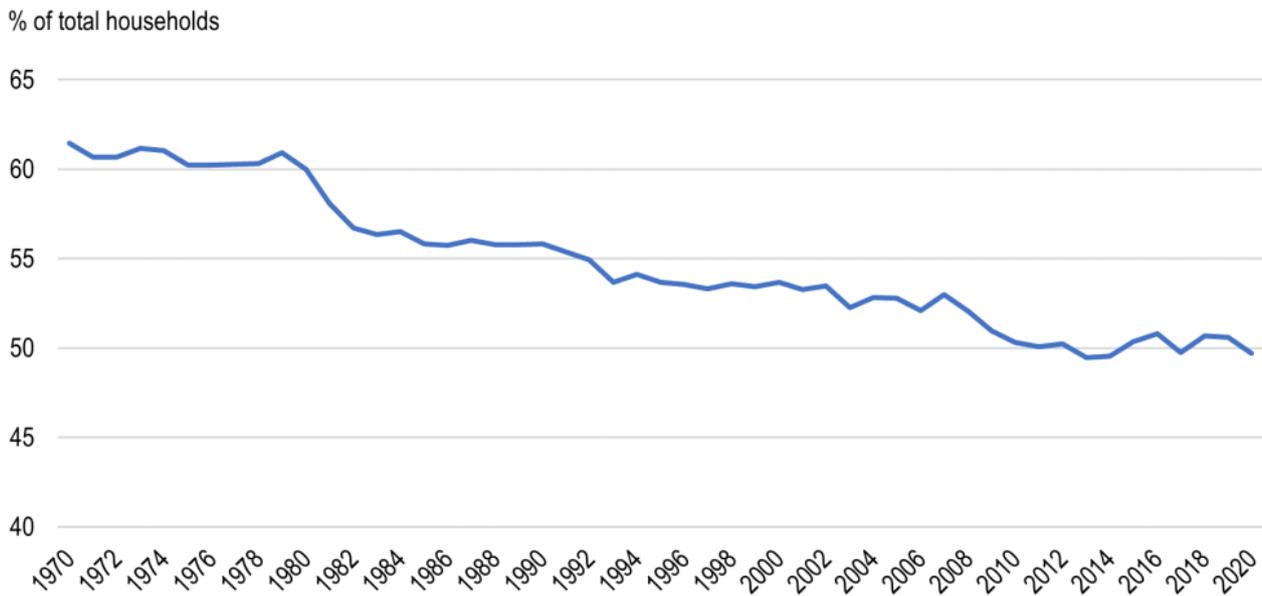
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According to Aristotle, “The most perfect political community is one in which the middle class is in control, and outnumbers both of the other classes”. Almost 2400 years later, policymakers around the world still believe that a strong and prosperous middle class is the key to economic and political stability. In fact, many studies show that countries with a strong middle class tend to enjoy higher levels of wellbeing and trust in institutions, and better governance.

It is therefore no surprise that the struggles of the United States middle class and its shrinking size have been front and centre of the economic policy discussions in the country. Indeed, as shown in the 2022 OECD Economic Survey of the United States, low intergenerational mobility and rising income inequality have been accompanied by a rise in the polarisation of the United States income distribution, or a “hollowing out” of the middle class. Whereas more than 60% of US households earned between 66 and 200% of the median income in the 1970s (a common definition of the middle class), this proportion shrank to 50% by 2020. Taking a narrower definition, the proportion of households earning between 75 and 150% of median income shrank from 43% in 1970 to 33% in 2020.

Figure 1. The US middle class has been shrinking

Share of US households earning between 66% and 200% of median national income 1970-2020

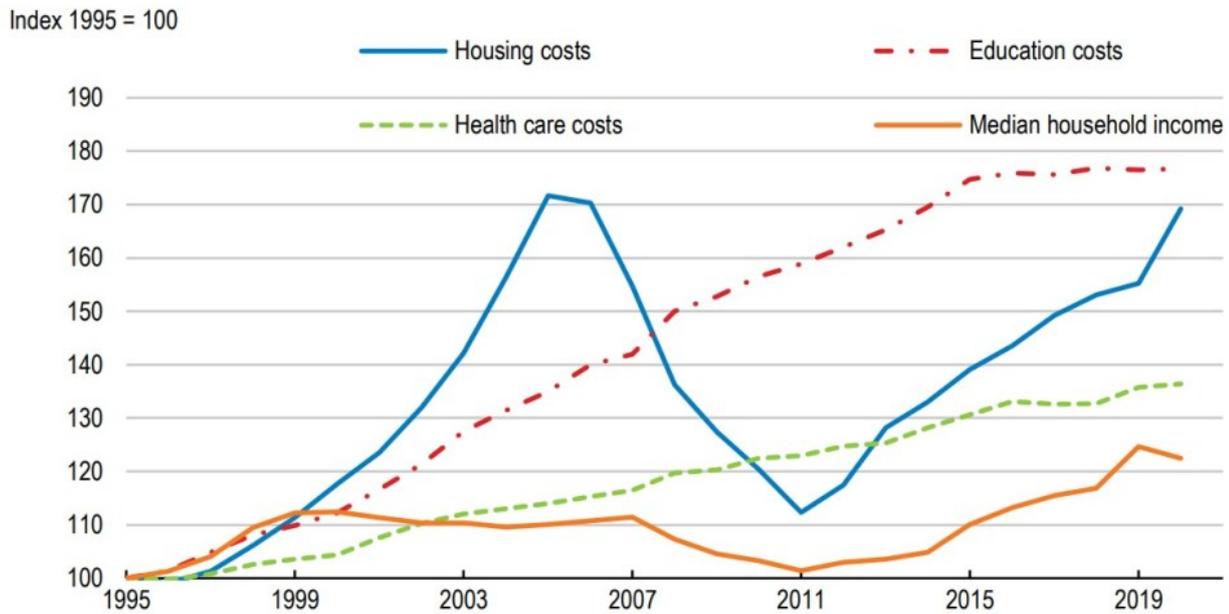


Source: Annual Social and Economic Supplement of the Current Population Survey

Those remaining middle class households have faced stagnating incomes and rising costs of important goods and services. According to the Congressional Budget Office, growth in incomes of the US middle class has lagged those of higher- and lower-income households during the past decades after accounting for taxes and transfers. From 1979 to 2018, the average income after taxes and transfers rose by 53% for the middle three quintiles of the income distribution, while it rose 91% and 120% for the lowest and highest quintiles, respectively.

Figure 2. The middle class has faced stagnating incomes and rising costs

Median household income and selected costs



Source: Bureau of Labour Statistics

Improving access to affordable and high-quality child care

While the high costs of health care, higher education and housing in the United States have received much attention, reported child care costs are also very high by international comparison, and have risen significantly in recent years. Additionally, financial aid for child care is very limited, with only a fraction of eligible households receiving public aid despite it being targeted towards the poorest households.

Both poor and middle-class families with young children spend significant amounts of their disposable income on child care, which has led the Biden administration to propose a programme that would cap household spending on child care to 7% of income. Such a programme would require significantly increasing public child care funding, which is very low in the United States compared to other OECD countries. Doing so would bring multigenerational benefits: for children, attending high quality early childhood education contributes to better outcomes later in life in terms of educational attainment, employment, health, earnings and wellbeing, with larger effects for children from disadvantaged socioeconomic

backgrounds; for parents, easy access to affordable child care can boost lifelong earnings by increasing labour market participation and human capital accumulation.

Supporting lower- and middle-income households through the climate transition

The administration has announced ambitious policy targets for reducing greenhouse gas emissions. The 2030 Nationally Determined Contribution is to reduce greenhouse gas emissions by 50-52% below 2005 levels. In addition, the United States has committed to a goal of achieving net zero greenhouse gas emissions by 2050.

These targets imply that carbon cuts need to accelerate significantly, a considerable endeavour that will have large macroeconomic and redistributive consequences. The pace of the transition towards net zero emissions and the ambition of the policies required to achieve it will inevitably have important economic implications for the middle class. The transition entails a large reallocation of jobs and capital from high-carbon to low-carbon activities, which has already started to occur. Housing and transportation, which account for a large part of US greenhouse gas emissions, will have to rapidly decarbonise. Improving the energy efficiency of their housing and transportation will entail significant costs for lower- and middle-income households.

The Inflation Reduction Act passed in August this year is a major achievement. It includes significant investments and tax credits to improve the US energy system, which are estimated to significantly contribute to reducing net greenhouse gas emissions, while means-tested consumer tax credits and rebates will reduce the burden on lower- and middle-income households. However, more action across all levels of government will be needed to achieve the climate pledges of the United States. For example, state and local governments will have to adopt updated building energy codes and plan and execute renewable

energy projects. In achieving the transition in the residential sector, middle income households should be further assisted to invest in greater home energy efficiency, possibly by further expanding home weatherisation and retro-fitting programmes. Well-designed policies in this area and in child care can support the re-emergence of a thriving middle class.

References:

OECD (2022), *OECD Economic Surveys: United States 2022*, OECD Publishing, Paris, <https://doi.org/10.1787/eeb7cbe9-en>.