RENEWING THE PROMISE OF THE MIDDLE CLASS:

Evidence and Insights from Research

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Summary

This framing document for the Federal Reserve System Community Development Research Conference, "Renewing the Promise of the Middle Class," considers facets of middle-class economic security using evidence and insights from academic and policy research.

We make three observations about the evidence. First, rising income inequality has coincided with declining economic mobility. Only half of children today earn more than their parents did, making it harder for children from low- and middle-income families to make it into the middle class as adults.

Second, in the labor market and beyond, college graduates have fared better, on average, than those without a college degree. Today, jobs and other markers of economic security are more widespread among college graduates, which underscores how going to college provides a pathway to the middle class. However, high college tuition and student loan debt point to important challenges in attending and paying for college.

Third, families, schools, communities, and public policies play an important role in promoting an individual's economic mobility. In other words, a person's economic trajectory depends in part on factors beyond his or her own talents and hard work. Rates of college attendance are higher for students with richer parents. Also, different but nearby neighborhoods can feature large differences in rates of upward mobility, likely reflecting the role of labor markets, schools, communities, and public policies.

Introduction

To many Americans, living the "American Dream" is associated with economic security and being a part of the middle class. The American Dream also represents a path to upward mobility for those born into circumstances without means. Conceptions of the middle class, economic security, and upward mobility are often self-defined but can feature a secure job, owning a home, being able to save and invest in the future, going to college, and providing economic opportunities for one's children.

In today's ever-changing economy, however, many Americans confront challenges and uncertainties as they endeavor to find economic security for themselves and their families. Indeed, over 80 percent of American middle-class adults (as they identified themselves) report that it is harder today than 10 years ago to maintain their standard of living (Pew Research Center 2012). Between 2008 and 2012, a growing share of middle-class Americans doubted that their children's standard of living will exceed their own (Pew Research Center 2012).

This framing document for the Federal Reserve System Community Development Research Conference, "Renewing the Promise of the Middle Class," considers facets of middle-class economic security using evidence and insights from academic and policy research. Notably, our observations are threefold. First, widening income inequality has coincided with a decline in economic mobility. Only half of children today earn more than their parents did, making it harder for children from low- and middle-income families to make it into the middle-class as adults. Second, college graduates have fared better in the labor market and beyond. Across many measures, college graduates appear to have more economic and financial resilience to withstand an unexpected expense or loss of income. However, high college costs and student loan debt point to important challenges in attending college as a pathway to the middle class. Third, families, schools, communities, and public policies play an important role in promoting economic mobility. Rates of college attendance are higher for students with richer parents. Also, different but nearby neighborhoods can feature large differences in rates of upward mobility, likely reflecting the role of labor markets, schools, communities, and public policies. Indeed, new research sheds new light on the factors outside of one's own choices that affect economic mobility.

The discussion that follows explores these observations in greater detail and explains why they are features of our economy. We focus on established results and explanations in the literature that are common across multiple studies and appear unlikely to be idiosyncratic. As we explain to the right, there are many different ways to measure and assess economic security and mobility as these concepts pertain to the middle class. In the spirit of framing and fostering the Conference discussion, this framing document focuses on areas where the conclusions reached in the literature seem robust across many different measures and definitions.

Who are the Middle Class?

When discussing and identifying the pathways to the middle class, a reasonable place to begin is by defining what it means to be a part of middle class. Across scholars, community development practitioners, and ordinary people, there is a multitude of definitions, in part indicating that being middle class reflects not just economic, social, and psychological factors, but also a set of values, ideas, and feelings. For example, some definitions focus on economic considerations such as freedom from poverty, achieving a certain level of income or wealth, or being able to save for retirement. Other definitions emphasize having enough savings to cover emergencies, having health insurance, or being able to buy the right goods and services to project a certain level of status. Along still other dimensions, some definitions emphasize certain markers of achievement, like a secure job, going to college, owning a home, getting married, or having children. Other definitions focus on identity and feelings of security or belonging.

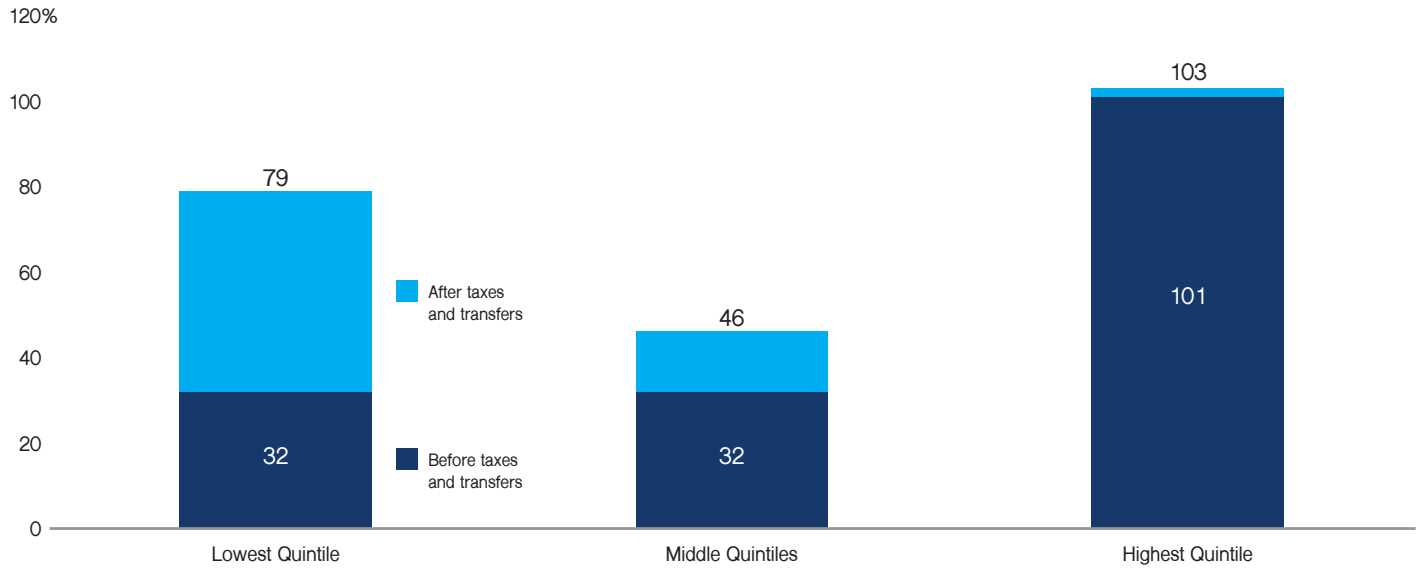
Each of these approaches to defining the middle class is complex and, at times, conflicting. For instance, income-focused definitions, such as being within a certain distance from median income, may emphasize material well-being but miss the security that comes from wealth-centric definitions, such as net worth, home ownership, and savings. Consumption-based measures may capture a family's long-term prospects better than income- or wealth-based measures, but may simultaneously ignore the insecurity of excessive indebtedness from keeping up with the Joneses (Cutler and Katz 1991). This framing document applies many definitions of what it means to be middle class to promote a common conceptual understanding. Importantly, we focus on aspects of the middle class that can be measured and analyzed over time because these data can help inform policymakers' deliberations over ways to strengthen Americans' economic security and upward mobility.

Observation 1: Since the 1970s, rising income inequality has coincided with declining economic mobility.

By some measures, incomes among middle-class households have grown more slowly than for the richest households since the 1970s, reflecting widening income inequality. Meanwhile, successive cohorts of children have become less and less likely to out-earn their parents. Rising income inequality and declining economic mobility mean that it is now more difficult for children from low- and middle-income families to reach the middle class – as measured by income – when they are adults.

Figure 1. Cumulative Growth in Real Average Household Income, 1979-2015

After taxes and transfers, households in the middle three quintiles of the household income distribution experienced lower cumulative income growth than the lowest and highest quintiles.



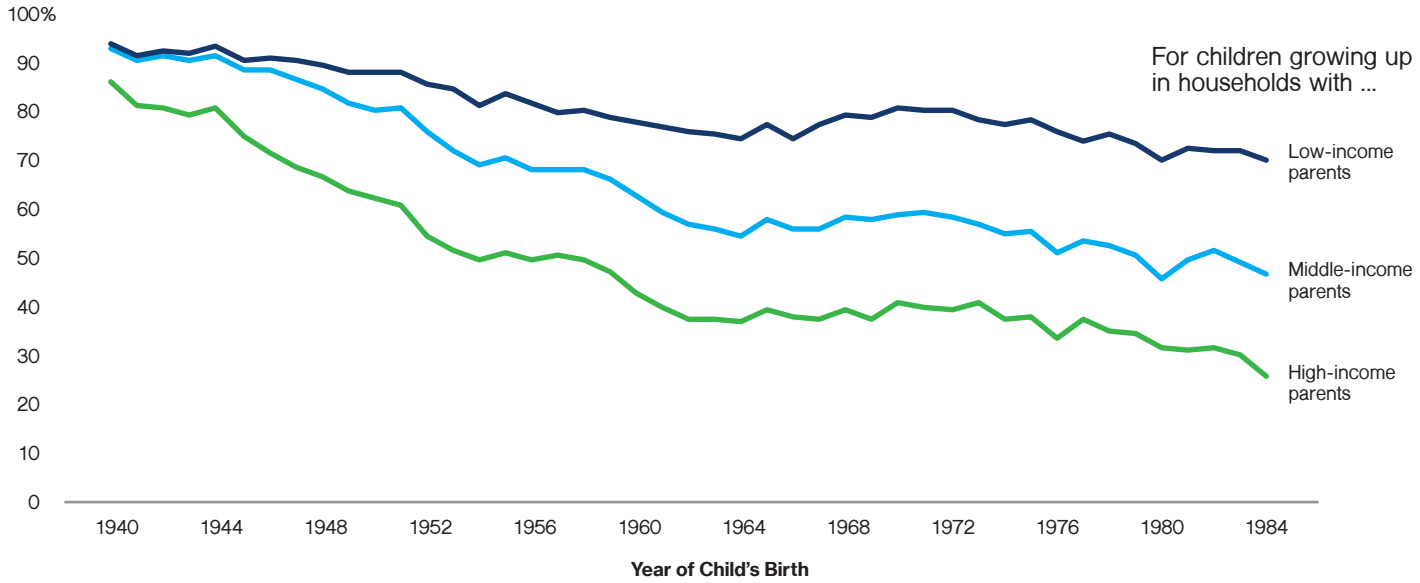
Sources: Congressional Budget Office 2015.
Note: Quintiles assigned by size-adjusted household income. See the technical appendix for further details.

Since 1979, average household income growth among middle-income households has lagged that of the poorest and richest households once inflation, taxes, and transfers are taken into account. For middle-income households, average real household income after taxes and transfers increased 46 percent between 1979 and 2015 to approximately $67,000. Household income growth provides one measure of how quickly households' economic well-being is improving over time. That it lags among middle-income households means that their economic well-being has not improved by as much as for other income groups.

In addition, households at the top of the distribution have seen the largest gains in average income, doubling over this period to an average of $215,000 (after taxes and transfers, in 2015 dollars). A higher pace of growth among this group means that income inequality increased between 1979 and 2015. Indeed, for the top one percent of households (not shown), average household income after taxes and transfers increased 242 percent over this period to $1,238,000 (CBO 2018).

Among the poorest households, means-tested income transfer programs, such as benefits from Medicaid and the Children's Health Insurance Program, the Supplemental Nutrition Assistance Program (formerly known as the Food Stamp program), the Earned Income Tax Credit, and Supplemental Security Income have helped support relatively modest growth in average household income. Taking these programs and federal taxes into account, average household income for households in the lowest income quintile increased 79 percent between 1979 and 2015, much more than the 32 percent average growth before accounting for these benefits. Indeed, in 2017, tax and transfer programs helped lift 36 million people out of poverty (CBPP 2018).

Figure 2. Share of Children Earning More Than Their Parents, 1940-1984
Children born in 1984 are less likely to out-earn their parents by age 30 than children born in 1940.



Sources: Opportunity Insights 2017; authors' calculations.
Note: See the technical appendix for further details.

Over time, successive cohorts of children have become less likely to out-earn their parents. By age 30, children born in 1940 were very likely to earn more than their parents had at the same age. For children born in 1984, however, the odds were more balanced. Knowing how children fare compared to their parents informs our understanding of upward mobility between two generations. If children are not doing as well as their parents, it speaks to challenges in achieving and maintaining similar standards of living across generations.

The decrease in the likelihood of out-earning one's parents is more pronounced for children from middle- and upper-income families than for the poorest families. In other words, it has become more difficult for children of middle- and upper-middle-class families to achieve their parents' standard of living. In addition, this decline in economic mobility has not been geographically even across the U.S. (not shown). In particular, the industrial Midwest (Michigan, Indiana, Illinois, and Ohio) has experienced particularly sharp declines while the smallest declines have occurred in places like Massachusetts and New York (Chetty et al. 2017).

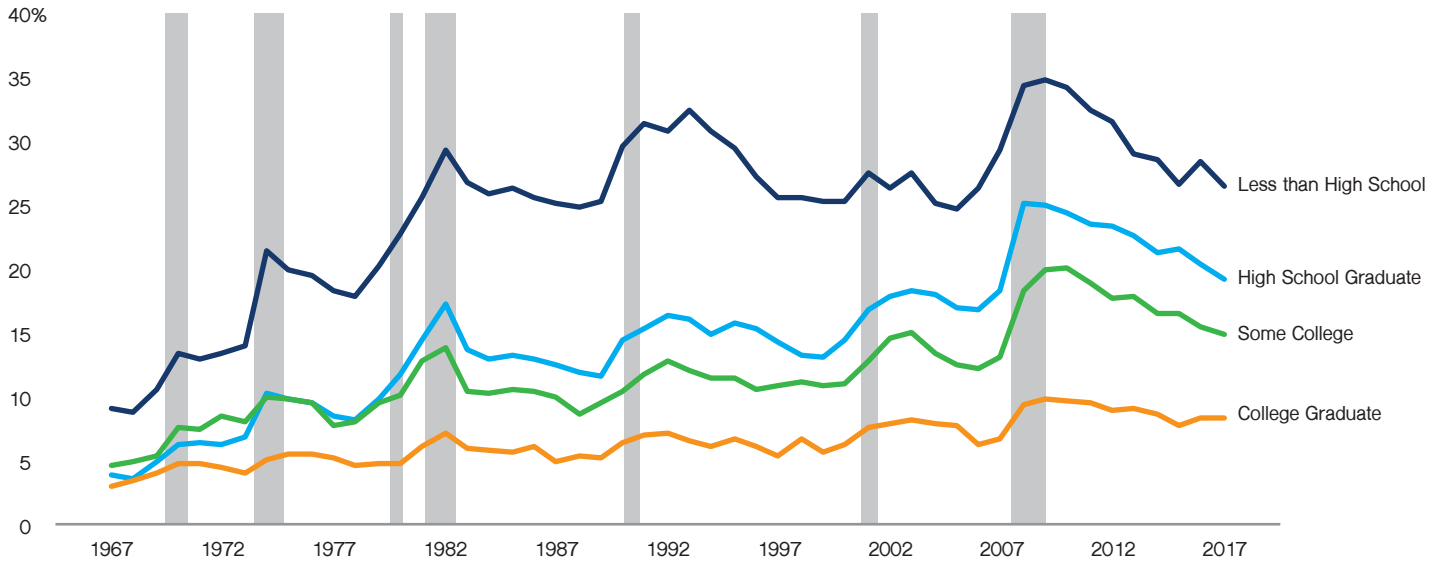
At least two factors can account for this decline in economic mobility (Chetty et al. 2017). First, and more importantly, income inequality has widened (Piketty and Saez 2003). As a result, the gains from economic growth have become less widespread, and it has become more difficult for successive cohorts of children to achieve a certain level of income. Second, economic growth has slowed notably since 1940, owing to a decline in productivity growth. The slowdown in economic growth has magnified the effect of widening income inequality on children's economic opportunity. On its own, however, it explains only a small portion of the decline in economic mobility (Chetty et al. 2017).

Observation 2: In the labor market and beyond, college graduates have fared better than those without a college degree, on average.

In 1967, virtually all working-age men – regardless of educational attainment – could be expected to have a job. But by 2017, only an overwhelming majority of college-educated men have a job. Because most Americans need a job to avoid poverty, the path to economic security for workers without a college degree is more challenging. Looking at indicators beyond employment, college graduates appear better equipped to withstand shocks, owing to greater economic and financial resources, on average. However, attaining a college education is not without its own risks.

Figure 3. Rates of Not Working among Working-Age Men by Educational Attainment, 1967-2017

The increase in the share of working-age men who are not working has been larger for those without a college degree.



Sources: Current Population Survey, *Annual Social and Economic Supplement,* authors' calculations. Recession data are from the National Bureau of Economic Research.
Note: Shaded areas indicate NBER recessions. Individuals classified as not working include those reporting not doing any work at all for pay or profit or not working at least 15 hours without pay in a family business or farm, as well as those who are not currently seeking work. Working-age refers to ages 25-54.

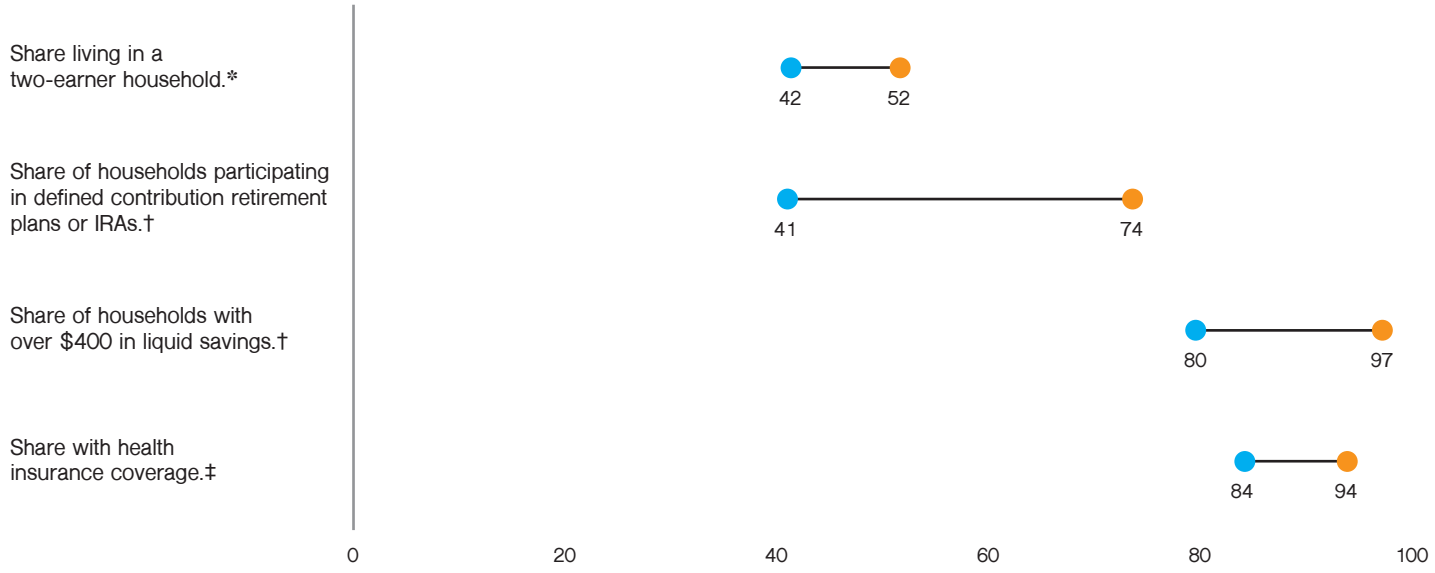
In 1967, virtually all working-age men – regardless of educational attainment – could be expected to have a job. By 2017, only an overwhelming majority of college-educated working-age men have a job.[1] Between 1967 and 2017, there is an increase in the share of working-age men, defined as those between the ages of 25 and 54, who report they are not working for either voluntary or involuntary reasons. Among those without a college degree, rates of "non-employment" have increased more. Rising rates of non-employment focus attention on how the challenges of securing a job and avoiding poverty may be evolving, particularly for less-educated workers.

Diagnosing the labor market challenges for non-college workers and why non-employment has risen so much for them is complex and the subject of much discussion (see Abraham and Kearney (2018) for a summary). Research points to how advances in technology and globalization have lowered the demand for less-educated workers by automating work or substituting lower-wage labor from abroad (Autor et al. 2013, 2015). These forces have also displaced routine, "middle-skill" jobs, which have supported middle-class incomes and are more likely to be held by workers without a college degree (Autor et al. 2006). Over time, reduced demand for less-educated workers has resulted in lower real wages for these workers, and has increased the "skill premium" for college-educated workers.

There is less consensus among researchers on the many other explanations for rising rates of non-employment, and there are wide-ranging views on why workers have dropped out of the labor market altogether instead of taking on new jobs

with lower pay. For example, researchers debate the importance of rising rates of incarceration, rising disability insurance, an increase in the attractiveness of leisure, changing social norms about work, and greater opioid use and "deaths of despair" as potential explanations (Abraham and Kearney 2018, Case and Deaton 2017, Aguiar et al. 2017, Krueger 2017). There are also questions about the decades-long increase in not working as automation and globalization appear to be developments affecting employment trends only since around 2000. Over the five decades shown in the figure, many other social and economic changes occurred, such as a decline in unionization, changes to the federal minimum wage, immigration policy developments, and so on. Going forward, being able to more robustly diagnose the labor market challenges of non-college workers would help design and target effective policies to promote the economic security that comes with a job.

Figure 4. Outcomes for High School Graduates Compared to College Graduates (Percentage Points)
College graduates appear better equipped to withstand economic shocks than those with a high school degree.



Sources: *Current Population Survey, *January* 2019 Basic, †2016 Survey of Consumer Finances, ‡Current Population Survey, 2018 *Annual Social and Economic Supplement*; authors' calculations.
Note: Based on individuals ages 25 and over. See the technical appendix for further details.

Looking at indicators beyond employment, college graduates appear better equipped to withstand economic, financial, and health shocks, on average. First, they are more likely to live in two-earner households, which provides a source of insurance against one person losing their job. Second, they are more likely to have financial assets to tap into – either a retirement savings account or liquid savings – should a hardship arise. Lastly, they are more likely to have health insurance to deal with the financial repercussions of a health shock. These different indicators inform our understanding of how prepared households are for dealing with an unexpected expense or loss of income.

The precise channels by which college graduates appear better-equipped to withstand shocks are not well-established. Higher incomes among college graduates likely play a role (see technical appendix). Moreover, a college education may impart skills that help graduates assess and manage their financial risks, such as by building savings or budgeting expenses. Marriages and long-term cohabitations among college graduates also tend to be more durable, and this stability may extend to other outcomes (Stevenson and Wolfers 2007).

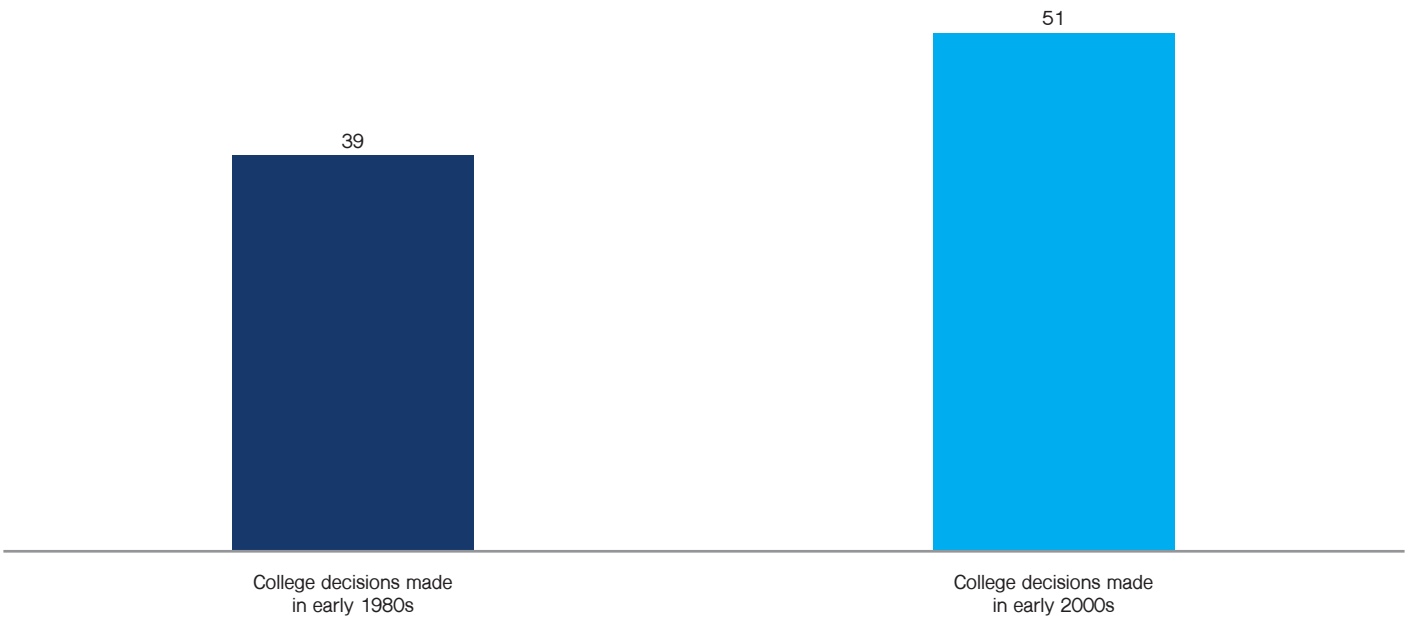
Nevertheless, attaining a college education is not without its own risks. For example, approximately 40 percent of students enrolled at four-year colleges do not graduate (NCES 2018). Student loan borrowers who do not graduate are less likely to repay loans on time, reflecting the difficulties of repaying debt with their earnings (College Board 2015).

Observation 3: Families, schools, communities, and public policies play an important role in promoting economic mobility.

Research suggests that someone's economic trajectory and joining the middle class depend on factors beyond talent and hard work. Being born into a low- or high-income family has important implications for whether one goes to college, with greater odds for children of more affluent families. Also, patterns of upward mobility vary across the U.S. It is lower in the Southeast but higher in parts of the Northeast, Midwest, and Great Plains. The geographic differences in upward mobility highlight how children's exposure to places and specific features of places affect their life trajectories.

Figure 5. Difference in College Attendance Rates Between Students from High- and Low-Income Families (Percentage Points)

Students of parents with incomes in the top quartile of the income distribution are more likely to attend college than those with parents in the bottom quartile.



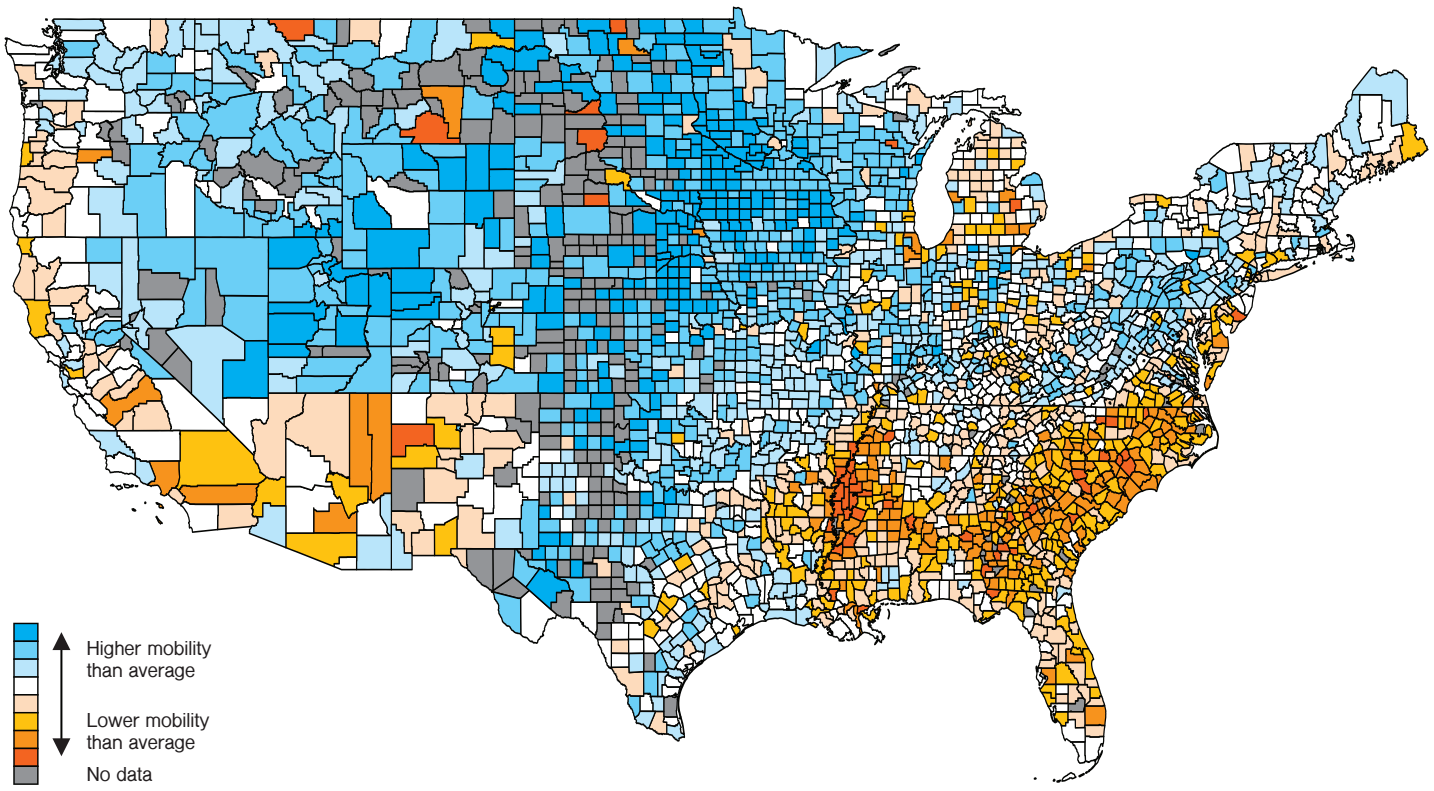
Sources: Bailey and Dynarski 2011.
Note: See the technical appendix for further details.

Children from high-income families are more likely to attend college than those from low-income families. In other words, being born into a low- or high-income family has important implications for whether one goes to college. Different rates of college attendance between children with different backgrounds highlights the inequality children face in accessing post-secondary education and the associated upward mobility. Moreover, research documents important differences in both staying in college and graduating from college for students with high- and low-income parents (Bailey and Dynarski 2011, Hotz et al. 2018).

Over time, college attendance rates among children from high-income families has pulled farther ahead of that for low-income families (Kane 2007; Belley and Lochner 2007; Lochner and Monge-Naranjo 2011; Bailey and Dynarski 2011). In particular, rising college attendance among women with high-income parents accounts for a large portion of this widening gap (Bailey and Dynarski 2011). This increase implies that more affluent families disproportionately contributed to the rise in college enrollments between the 1980s and early 2000s.

Figure 6. Economic Mobility for Children from Lower-Income Families by County

Children from lower income families in areas of the Northeast, Midwest, and Great Plains are more likely to experience upward mobility than children in the South and Southwest.



Sources: Opportunity Insights 2018.

Note: This map reflects the change in a child's mean percentile rank in the national household income distribution at age 26 from spending one additional year of childhood in the county, relative to the average county in the United States. Estimates are for children with parents in the 25th percentile of the national household income distribution. Counties colored blue produce positive estimated effects on a child's percentile ranking and increases in household income relative to the national mean, and counties colored orange produce negative estimated effects and decreases in household income relative to the national mean. See the technical appendix for further details.

Economic mobility rates are important for children because they represent how easy or difficult it is to move up the income ladder. When economic mobility is low, children face low odds of moving up the income distribution, and family background and financial resources have greater influence in determining an individual's adult outcomes. When it is high, children from low-income families face better odds of moving up the income distribution.

Economic mobility varies across the U.S. and is lower in the Southeast but higher in parts of the Northeast, Midwest, and Great Plains. For each county, the map shows how far up the income distribution a child from a low-income family can expect to go. Darker blue-shaded counties correspond to places with larger gains in income and thus more upward mobility; that is, each additional year that a child spends in darker blue-shaded counties results in more upward mobility when s/he is a young adult. In darker orange-shaded counties, children can expect

less income mobility. More granular estimates at the neighborhood level (not shown) point to important differences in economic mobility for children who grow up in nearby neighborhoods in the same region (Chetty and Hendren 2018).

The geographic differences in economic mobility highlight how children's exposure to neighborhoods and specific features of neighborhoods affect their life trajectories (Wilson 1987; Massey and Denton 1998; Chetty et al. 2016; Chetty and Hendren 2018). In particular, research finds that lower income inequality, better-performing schools, and less childhood exposure to concentrated poverty appear to improve children's prospects. In contrast, there is a weaker relationship between children's upward mobility and their neighborhoods' labor market conditions and number of jobs, suggesting that there may be important tradeoffs to consider when contemplating investments in neighborhoods (Chetty and Hendren 2018).

Renewing the Promise of the Middle Class: Insights for Policy and Looking Ahead

To conclude, we discuss some insights for policy that emerge from our three observations about the research and evidence on middle class economic security. First, policies that reduce income inequality are likely to promote upward economic mobility. So too would policies that increase economic growth. Second, policies that broaden opportunities to graduate from college are also likely to extend the economic security that comes from having a job and the resources to withstand economic, financial, and health shocks. Third, because most Americans need a job to avoid poverty, policies that strengthen employment opportunities for workers without a college degree would help spread economic security more broadly. Fourth, policies that steer greater investments into families and neighborhoods would likely influence the trajectories of children.

Our three observations also raise important questions for how research may guide the design of future policy. For example, how can research further our understanding of the tools available to policymakers for reducing income inequality or increasing economic growth? Will policies that reduce income inequality also reduce economic growth, or can growth be broad-based across the income distribution? Are there proven interventions that broaden the opportunity to graduate from college? And what is the evidence on the types of investments in families and neighborhoods that promote economic mobility?

Answering these questions – and more – provide opportunities for research to guide the development of policies that promote middle class economic security for more Americans.

Note

1. Today, non-employment rates among prime-age women show similar disparities across levels of educational attainment but, in the interest of simplicity, are not a focus of this discussion.

Technical Appendix

Figures

Figure 1. Cumulative Growth in Real Average Household Income, 1979-2015
Sources: Congressional Budget Office (CBO), *The Distribution of Household Income,* 2015.
Note: To create income groups, the CBO ranks households by income before taxes and transfers after adjusting for household size using equivalence scales. Households are then divided into five groups of equal size (quintiles), with "Middle Quintiles" comprising the 2nd, 3rd, and 4th quintiles. An average income figure is generated within each quintile and adjusted for inflation by the CBO using the Personal Consumption Expenditures Index to 2015 dollars. The CBO defines income before taxes and transfers as market income plus social insurance benefits. Income after taxes is pre-tax income plus means-tested transfers, minus federal taxes.

Figure 2. Share of Children Earning More Than Their Parents, 1940-1984
Sources: Opportunity Insights 2017, *The Fading American Dream: Trends in Absolute Income Mobility Since 1940,* Online Data Table 1: Baseline Estimates of Absolute Mobility by Parent Income Percentile and Child Birth Cohort.
Note: Estimates are from Chetty et al. (2017), which uses historical data from Census, the Current Population Survey cross-sections, and de-identified tax records to estimate rates of absolute income mobility. Figure 2 plots the fraction of children in a birth cohort who earn more than their parents at age 30. For each birth cohort, we construct mobility estimates for children with low-, middle-, and high-income parents by averaging mobility rates for children in the bottom, middle three, and top quintiles of parental income, respectively.

Figure 3. Rates of Not Working among Working-Age Men by Educational Attainment, 1967-2017
Sources: Current Population Survey, Annual Social and Economic Supplement, authors' calculations. Recession data are from the National Bureau of Economic Research.
Note: The sample for figure 3 includes men ages 25–54. For each educational level, the employment to population ratio is calculated by dividing the total employed individuals in that group by the total number of individuals in the group. Non-Employment is derived by subtracting the employment to population ratio from one. Employed individuals in the CPS reported doing any work at all for pay or profit or working at least 15 hours without pay in a family business or farm. Individuals who did not work in the previous week but acknowledged a temporary absence are also classified as employed. High school graduate includes equivalency. Some college includes associate's and vocational degree programs, as well as less than four years of college credit.

Figure 4. Outcomes for High School Graduates Compared to College Graduates (Percentage Points)
Sources: Current Population Survey, January 2019 Basic, 2016 Survey of Consumer Finances, Current Population Survey, 2018 Annual Social and Economic Supplement; authors' calculations.
Note: For each outcome and data source, we restrict the sample to individuals ages 25 and over for individual samples and households with heads ages 25 and over for household samples. For outcome 4, we restrict the age range to individuals ages 25–64.
Outcome 1: Two-earner households include households with two or more earners in the same household.
Outcome 2: Participation in defined contribution plans or IRAs is measured at the household level. Participation consists of households contributing to or entitled to receive benefits from an account balance type retirement plan such as a 401(k), or having an IRA account with a non-zero balance.
Outcome 3: Liquid savings is derived as the total of transaction accounts, cash, prepaid cards, directly held stocks, bonds, and mutual funds for each household.
Outcome 4: Health insurance includes both private and government health insurance coverage. Individuals covered by private health insurance include those with coverage through an employer or union, coverage purchased directly from an insurance company, or coverage from an individual outside of the household. Government health insurance sources include Medicare, Medicaid, and coverage through the Department of Veterans Affairs or the military including TRICARE and CHAMPVA.

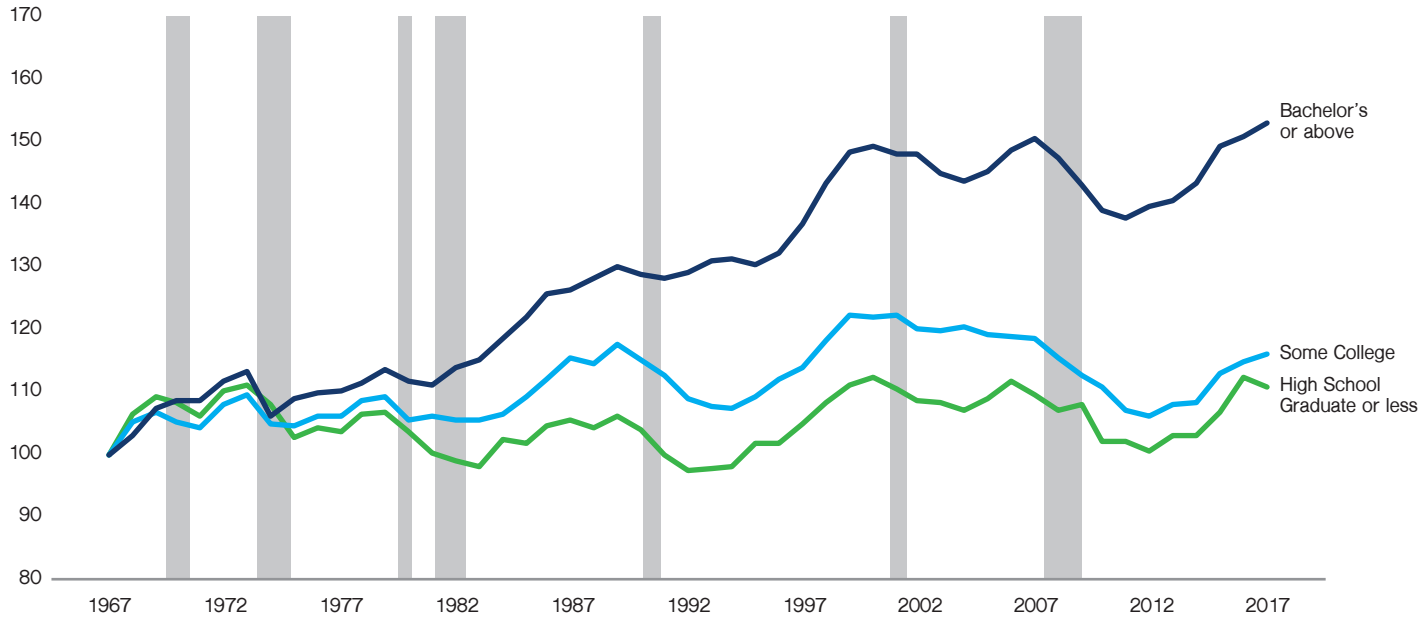
Figure 5. Difference in College Attendance Rates Between Students from High- and Low-Income Families (Percentage Points)
Sources: Bailey and Dynarski 2011, *Inequality and Postsecondary Education,* Figure 2.
Note: Using panel data from the National Longitudinal Survey of Youth 1979 and 1997 Cohorts, Bailey and Dynarski (2011) document the relationship between household income, measured when a child is between 15 and 18 years old, and the corresponding college entry rate by age 19. Bailey and Dynarski (2011) present their results in figure 2 as the college entry rates for students from each quartile of family income. Figure 5 shows the increase in college entry rates for students with parents in the fourth quartile relative to the first quartile for both the 1979 and 1997 cohorts labeled as the time college decisions were being made by students within the cohort.

Figure 6. Economic Mobility for Children Growing Up in U.S. Counties
Sources: Opportunity Insights 2018, The Impacts of Neighborhoods on Intergenerational Mobility II: County-Level Estimates, Online Data Table 2: Preferred Estimates of Causal Place Effects by County.
Note: Estimates are from Chetty and Hendren (2018). This paper uses de-identified tax return data to estimate counties' causal effects on children's ranks in the national income distribution at age 26. Results are presented in Online Data Table 2 as the effect of spending one additional year of childhood in a county on a child's percentile ranking in the national household income distribution at age 26, relative to average county. In figure 6, we plot these effects for children from low-income families in the 25th percentile of the national household income distribution. Blue shades represent counties that have higher-than-average effects on a child's ranking. Orange shades represent counties that have lower-than-average effects.

Supplemental Figures and Data

Growth in Real Median Household Income by Educational Attainment, 1967-2017

College graduates saw the highest rates of real median household income growth, while high school graduates and households with a less than high school education saw little to no growth.



Sources: Current Population Survey, *Annual Social and Economic Supplement*, authors' calculations. Recession data are from the National Bureau of Economic Research.
Note: Shaded area indicate NBER recessions. Data includes all households with positive income, adjusted for inflation using the Personal Consumption Expenditures Index to 2017 dollars and indexed to 100 in 1967. High school graduate includes equivalency. Some college includes associate's and vocational degree programs, as well as less than four years of college credit.

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Observations

Observation 1: Since the 1970s, rising income inequality has coincided with declining economic mobility.

Observation 2: In the labor market and beyond, college graduates have fared better than those without a college degree, on average.

Observation 3: Families, schools, communities, and public policies play an important role in promoting economic mobility.

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