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## THE CHICKEN LITTLE THEORY OF THE VANISHING MIDDLE CLASS

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### INTRODUCTION

Is America's middle class an endangered species? Yes say a number of vocal economists, politicians, and journalists who warn that growth of the U.S. service sector is destroying the middle class. They point to what they see as a decline in America's manufacturing base, with its concomitant loss of well-paid jobs. These jobs are being replaced, they say, by lower-paid service jobs. The result they predict is the polarization of the U.S. into a two-tier society of rich and poor. Although not linked directly to trade, such arguments fuel the pressure for protectionism to maintain traditional manufacturing jobs in steel, textiles, autos, and many other industries.

**Sky Not Falling.** Such warnings are as valid as Chicken Little's. The sky is not falling on America's middle class. For one thing, the movement toward services is a long-term trend that the U.S. shares with other nations, including Japan. For another, the service sector is not made up solely of low-paid jobs, nor does its growth come at the expense of manufacturing, which actually is doing quite well. And finally, there is no evidence at all that the middle class is eroding. The fact is that the middle three-fifths of the population, ranked by income, receive about 52 percent of total national income, a proportion that has been virtually unchanged since the Census Bureau began keeping such statistics in 1947. A

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1. See, for example, Jane Seaberry, "Middle-Class Dream Fades for Some," The Washington Post, January 4, 1987; The Polarization of America: The Loss of Good Jobs, Falling Incomes and Rising Inequality (Washington, D.C.: Industrial Union Department, AFL-CIO, 1986); "Is the Middle Class Shrinking?" Time, November 3, 1986, pp. 54-56; Katharine L. Bradbury, "The Shrinking Middle Class," New England Economic Review, September/October 1986, pp. 41-55; David Wessel, "U.S. Rich and Poor Increase in Numbers; Middle Class Loses Ground," The Wall Street Journal, September 22, 1986; Robert Kuttner, "A Shrinking Middle Class Is a Call for Action," Business Week, September 16, 1986, p. 16; and Barbara Ehrenreich, "Is the Middle Class Doomed?" The New York Times Magazine, September 7, 1986.

similar analysis of annual earnings by the Bureau of Labor Statistics indicates that the middle third of workers, ranked by earnings, make up almost exactly the same percentage of total employment that they did ten years ago. In short, despite anecdotal evidence to the contrary, there is nothing in the aggregate data to indicate that recent changes in the economy, such as the shift from manufacturing to services, are eroding the middle class.

Congress therefore should not fall for the false image of Americans being forced to exchange their well-paid jobs for positions as check-out clerks or short order cooks. While the U.S. economy faces some problems, a vanishing middle class is not one of them.

## **THE TREND TOWARD SERVICES**

Services have been the main source of job growth in recent years. Employment in manufacturing fell from 21 million in 1979 to 19.2 million in 1986, although this is an increase from the 1982 low of 18.4 million jobs. Total employment in goods-producing industries, including mining and construction but excluding agriculture, peaked in 1979 at 26.5 million jobs, falling to 24.9 million last year.

Although manufacturing employment continues to strengthen, virtually all of the net employment growth in the U.S. economy in the last few years has been in services, a broad category that includes transportation and public utilities, wholesale and retail trade, finance, insurance, and real estate, government, and wide variety of other occupations. Employment in this category has risen by more than 10 million jobs just since 1980, up from 64.7 million to 75.2 million in 1986. Thus 75 percent of all nonagricultural workers in America are employed in jobs classified as service producing. As Table 1 indicates, this is part of a long-term trend in the U.S. economy starting at least in the 1860s, when agricultural employment began its steep decline.

Why have services grown so rapidly? The simple answer is that, as an economy grows and matures, there is greater demand for services. As Table 2 illustrates, the consumption of services has increased dramatically over time, from 33 percent of total personal expenditure in 1950 to over 52 percent in 1986.

The reasons for this growth in service expenditures:

**1) The desire of people to consume more goods** seems limited as their income rises. Noted Adam Smith: "The desire of food is limited in every man by the narrow capacity of the human stomach."<sup>2</sup> Households do not typically buy more and more food as their income rises, for instance, but tend instead to consume food in restaurants rather than at home. Similarly, the demand for other basic goods tends to taper off once a certain level of wealth is achieved.

**2) Sophisticated goods create a demand for services.** Buying a car, for example, leads to years of maintenance and repair services.

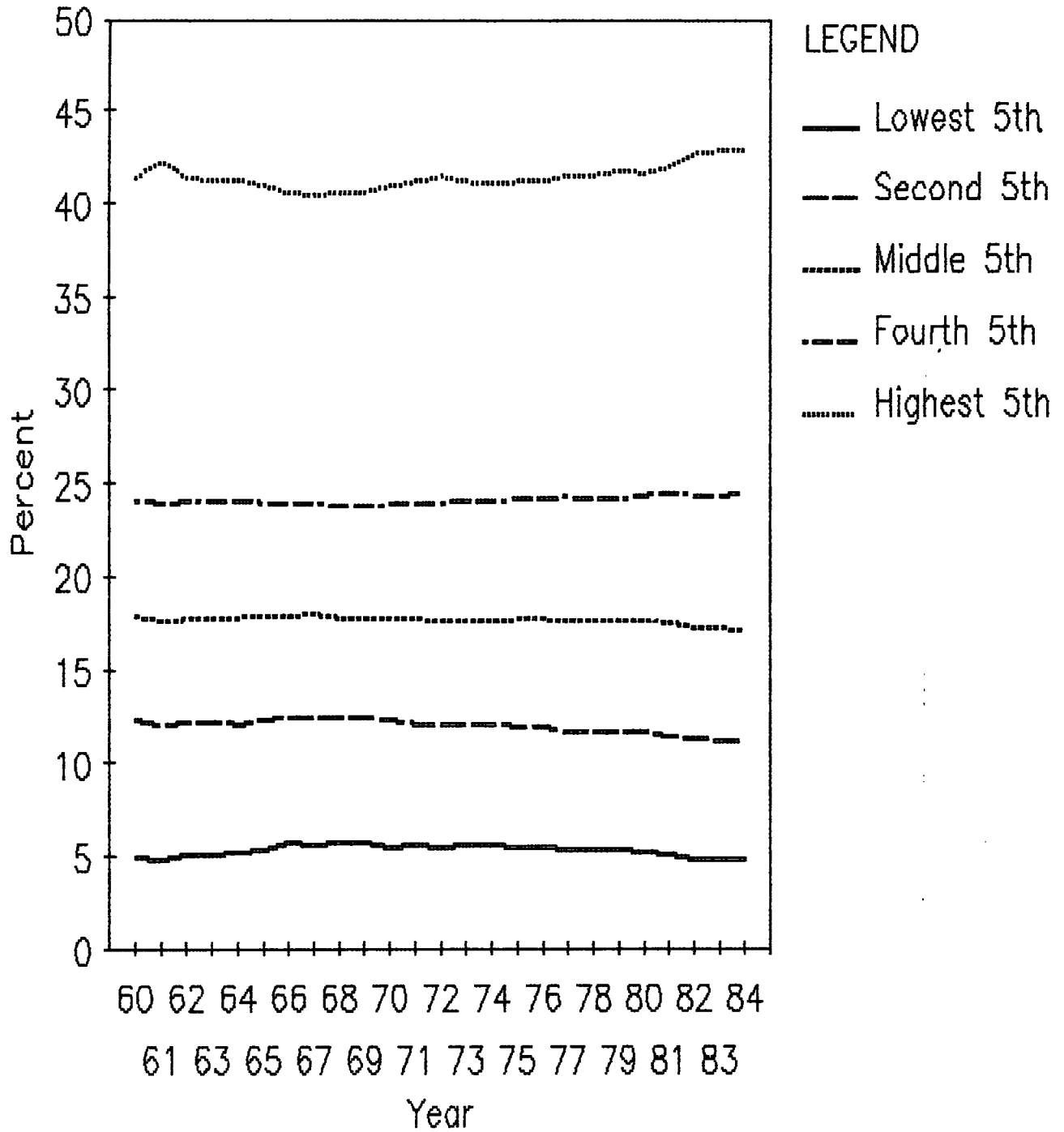
**3) A growing and more complex economy** increases the degree of specialization, with manufacturing firms contracting out such services as accounting, personnel, advertising, and data processing that formerly were taken care of in-house or simply neglected.

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2. Adam Smith, The Wealth of Nations [1776] (New York: Random House, Modern Library, 1937), p. 164.

3. Victor Fuchs, The Service Economy (New York: National Bureau of Economic Research, 1968), p. 4; Richard B. McKenzie and Stephen D. Smith, The Good News About U.S. Production Jobs (St. Louis, Missouri: Center for the Study of American Business, 1986).

Figure 1  
Distribution of Income in the U.S.



Source: Census Bureau

**Table 1**  
**Percentages of U.S. Labor Force Employed by Industry**

<u>Period</u>	<u>Agriculture *</u>	<u>Manufacturing **</u>	<u>Services</u>
1860-69	60	20	20
1870-89	50	25	25
1890-99	42	28	20
1900-09	37	30	33
1910-19	31	31	38
1920-29	27	34	39
1930-39	22	31	47
1940-49	17	31	52
1950-59	09	34	57
1960-69	06	32	62

\*Includes Forestry and Fisheries.

\*\*Includes Mining and Construction.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, Long Term Economic Growth, 1860-1970 (Washington, D.C.: U.S. Government Printing Office, 1973), p. 101.

**Table 2**  
**Services as a Share of Personal Consumption Expenditures**

<u>Year</u>	<u>Percent</u>
1950	32.8
1960	40.5
1970	44.4
1980	48.0
1981	48.8
1982	50.1
1983	50.5
1984	50.5
1985	51.4
1986	52.2

Source: Commerce Department, Bureau of Economic Analysis.

Indeed, business services have been one of the fastest growing areas of employment and are projected to be the fastest growing area of employment growth over the next ten years.<sup>4</sup>

The growth of services thus is a trend associated generally with economic development, rather than one unique to the United States. Predictably, therefore, the same pattern is found in other countries. As Table 3 illustrates, employment in services has grown sharply

**Table 3**  
**Employment in Services as a Share of the Labor Force**

<u>Country</u>	<u>1965</u>	<u>1980</u>
Spain	32	46
Ireland	41	48
Italy	34	48
New Zealand	51	56
United Kingdom	50	59
Belgium	48	61
Austria	36	50
Netherlands	50	63
France	43	56
Japan	42	55
Finland	41	53
West Germany	42	50
Denmark	49	61
Australia	52	61
Sweden	46	62
Canada	57	65
Norway	48	62
Switzerland	41	55
United States	60	66
Weighted Average	48	58

Source: World Bank and International Labour Office.

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4. Valerie A. Personick, "A Second Look at Industry Output and Employment Trends Through 1995," Monthly Labor Review, November 1985, pp. 27-28; Wayne J. Howe, "The Business Services Industry Sets Pace in Employment Growth," Monthly Labor Review, April 1986, pp. 29-36.

in every Western industrialized nation. In fact, between 1965 and 1980, the service jobs increase in Japan was over three times greater than the increase in the U.S.<sup>5</sup>

## THE QUALITY OF SERVICE JOBS

While there is no dispute that there has been a dramatic expansion in employment in the U.S., thanks to the increase in service jobs, there also has been concern about the nature and wage rates of service jobs. The popular conception is that millions of Americans have been forced to swap well-paid manufacturing jobs for cash register positions at fast food restaurants.

At first glance, this seems plausible, but the data hide more than they reveal. In 1986, earnings in manufacturing averaged \$396.01 per week compared with \$265.20 per week in services. Thus, to the extent that lower-paid service jobs "replace" higher-paid manufacturing jobs, many Americans would seem to have difficulty maintaining a middle-class standard of living. A recent report commissioned by the Democratic members of Congress's Joint Economic Committee has generated wide publicity for this argument. According to the JEC study, six out of ten new jobs created during the current expansion pay less than \$7,000 per year.<sup>6</sup> The problem is that this study is seriously flawed.

Simplistic generalizations about manufacturing versus services mask important distinctions about the quality of such jobs. Moreover, the relationship between wage rates and family incomes is more complex than might be imagined. Examining these issues in detail provides a very different picture of the economic impact of services.

**High Paid Services.** In the first place, services include not only traditionally low-paid jobs in the retail trade but also many of the highest-paid jobs available, such as those in law, computers, advertising, and medicine. In addition, it is the higher-paying service jobs rather than lower-paying unskilled service jobs that are expanding most rapidly. It turns out that much of the decline in manufacturing has been in the lower-paying manufacturing positions such as those in textiles and leather products. Moreover, the relative contraction of higher-paid jobs has been matched by a more than equal expansion in well-paid jobs, leaving the relative position of the middle class unchanged. For example, the proportion of total employment by workers classified as professional and technical will rise from 16.3 percent in 1982 to 17.1 percent by 1995. By contrast, the proportion of workers classified as laborers will decline from 5.8 percent to 5.5 percent.<sup>7</sup>

The pattern of service earnings, meanwhile, has been influenced strongly by the high proportion of part-time jobs in this sector. Example: Some 20 percent of service jobs are part-time, compared with less than 5 percent in manufacturing. Part-time jobs, in turn, generally pay less than equivalent full-time jobs in the same business. Obviously, a large number of part-timers pulls down the average level of wages, giving the false impression that typical full-time workers are suffering an erosion of income.

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5. Japan went from 42 to 55, an increase of 31 percent. The U.S. went from 60 to 66, an increase of 10 percent.

6. Barry Bluestone and Bennett Harrison, The Great American Job Machine: The Proliferation of Low Wage Employment in the U.S. Economy (Washington, D.C.: Joint Economic Committee, December 1986).

7. Neal Rosenthal, "The Shrinking Middle Class: Myth or Reality?" Monthly Labor Review, March 1985, pp. 3-10.

**Erroneous Study.** In a serious error of scholarship, the Joint Economic Committee study fails to distinguish between part-time and full-time employment in its analysis of service wages. Only at the very end of the study are part-timers broken out separately. When this is done, it turns out that only 22.5 percent of jobs created in the 1979-1984 period were in the low-paid category, rather than the 58 percent share indicated earlier in the study.<sup>8</sup>

The study made several other critical errors. Example: by comparing job growth between 1979 and 1984, Harrison and Bluestone chose the two most extreme years possible, thus obscuring the long-term trend, which indicates no change in the distribution of jobs. Using the Harrison-Bluestone data, Table 4 puts the numbers into a continuous series, instead of merely comparing two base periods, 1973-1979 to 1979-1984, as they did. From the underlying trend, it becomes clear that Harrison and Bluestone carefully selected only the periods that gave apparent support to their argument. An examination of the whole period decisively refutes their contention.

**Table 4**  
**Percentage Distribution of New Jobs by Earnings**

<u>Year</u>	<u>Low</u>	<u>Middle</u>	<u>High</u>
1973	31.8	51.6	16.6
1974	32.0	52.6	15.4
1975	32.2	52.6	15.1
1976	31.7	52.8	15.5
1977	32.2	51.6	16.2
1978	31.2	52.0	16.9
1979	30.6	53.0	16.3
1980	31.9	54.1	14.0
1981	33.0	53.0	14.0
1982	33.0	54.0	13.0
1983	32.1	53.3	14.6
1984	32.4	52.6	14.9
1985	31.4	52.6	15.9

Source: Congressman Daniel E. Lungren and Christopher Frenze, "The Chairman's Commentary," House Republican Study Committee, March 2, 1987, based on Harrison and Bluestone's data and categories of high, middle and low-paying jobs.

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8. Bluestone and Harrison, *op. cit.*, p. 41.

As can be seen, the proportion of jobs in the low-paid category actually has declined during the Reagan years from 33 percent of new jobs created in 1981 to 31.4 percent in 1985. Over a longer period, it is quite clear that there has been no basic change in the distribution of jobs--a fact ignored by Harrison and Bluestone. It appears that the principal goal of the JEC report was to embarrass the Reagan Administration, not to shed light on an important economic issue.

Table 4 also indicates the importance of cyclical factors in this form of analysis. Comparing a year during a cyclical peak in the economy with a year during a cyclical low point might well show an increase in the proportion of low-paid jobs in the economy. The number of low-paid jobs, however, likely will decline during the current upswing in the business cycle as more well-paid jobs are created. This was emphasized strongly by Janet Norwood, head of the U.S. Bureau of Labor Statistics, in a New York Times article attacking the conclusions of the Harrison-Bluestone study.<sup>9</sup>

**Ignoring Family Income.** Finally, Harrison and Bluestone chose to adjust their income data for inflation using the Consumer Price Index (CPI), rather than the more appropriate Personal Consumption Expenditure Index (PCE). It is widely recognized by economists that the CPI tended to overstate inflation during the 1970s. Thus using the CPI rather than the more accurate PCE index, tended to understate the real incomes of workers in the study. When the PCE deflator is used instead, the low-pay trend mainly disappears.<sup>10</sup>

The data do not indicate, moreover, that families generally are drifting downward out of the middle class, even when an individual takes a lower-paid job. Studies that purport to show such a drift otherwise rely almost exclusively on earnings, rather than family income data. Yet the relationship between wage rates and family income is tenuous, largely because of changing family size and the proliferation of two-earner families. Thus even if, for the sake of argument, the idea were accepted that low-wage jobs were replacing high-wage jobs, it would not necessarily imply that families with middle-class incomes were declining in number.

**High Productivity Services.** Another widely-held misperception is that service industries have low productivity and low capital intensity, contributing to an allegedly low-quality work environment. The service sector in fact is highly capital intensive, and the productivity growth of service workers compares well to manufacturing workers.<sup>11</sup>

Admittedly, the overall level of productivity appears lower in the service sector than in the manufacturing sector, but much of this may be due simply to the difficulty in measuring service sector productivity. It is theoretically easy to measure output in manufacturing,

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9. Janet L. Norwood, "The Jobs Machine Has Not Broken Down," The New York Times, February 22, 1987.

10. See Warren Brookes, "Low-Pay Jobs: The Big Lie," The Wall Street Journal, March 25, 1987.

11. Richard I. Kirkland, Jr., "Are Service Jobs Good Jobs?" Fortune, June 10, 1985, pp. 38-43; Ronald E. Kutscher and Jerome A. Mark, "The Service-Producing Sector: Some Common Perceptions Reviewed," Monthly Labor Review, April 1983, pp. 21-24; "A Productivity Revolution in the Service Sector," Business Week, September 5, 1983, pp. 106, 108.



since the number of units produced per worker can be counted. This task is much harder in services, where the product is less tangible. And there is no known way to measure productivity in government, a major area of service employment.

Finally, an employment shift away from manufacturing toward services improves the quality of life for most working Americans. Working in clean, air-conditioned offices generally would be considered an improvement over physical labor on a noisy assembly line. Although this is seldom mentioned by scholars, it is often stressed by workers themselves as a point in favor of services.

## **THE HEALTHY STATUS OF MANUFACTURING**

Virtually all discussion of the "decline" of the U.S. manufacturing sector concentrates on employment. But the real measure of manufacturing, of course, is output. This shows no decline. Manufacturing as a share of Gross National Product has held remarkably steady for decades, as Table 5 demonstrates.

Table 5

### **Real Manufacturing Output as a Proportion of Real GNP**

<u>Year</u>	<u>Percent</u>
1950	21.4
1960	20.4
1970	21.0
1980	20.9
1981	20.8
1982	20.1
1983	20.6
1984	21.4
1985	21.7

Source: Commerce Department, Bureau of Economic Analysis.

The reason for this is that rising productivity in the manufacturing sector allows more goods to be produced by fewer workers, just as rising productivity has allowed agricultural

employment to fall from 60 percent of the labor force in 1860 to less than one-tenth that number today. In fact, contrary again to what may be popular perception, U.S. manufacturing productivity is the highest in the world.

**U.S. Productivity Lead.** To be sure, the rate of U.S. productivity gains has lagged behind other countries in recent years, but this is more apparent than real and mainly is a function of measuring techniques. To take a hypothetical example: If the U.S. manufacturing output per worker were 100 units and another country's productivity were 50, and each country increased productivity by two percentage points during a year, then U.S. productivity would have grown 2 percent, while the other country's productivity would have risen 4 percent. This explains why America may seem to be lagging behind Japan, while in fact the U.S. is more productive. Japan suffered considerable destruction in World War II, while the U.S. was essentially undamaged, so Japan started the peacetime era from a much lower level of productivity. Thus Japan's amazing productivity growth rates can be explained mainly as "catching-up." Yet despite Japan's double-digit growth rates, its overall level of manufacturing productivity remains below the U.S., as Table 6 indicates.

Table 6

**Growth in Manufacturing Productivity, Selected Countries  
(Increase in output per hour at an annual rate)**

<u>Country</u>	<u>1960-73</u>	<u>1973-80</u>	<u>1980-84</u>	<u>1982-84</u>	<u>Productivity Level*</u>
U.S.	03.2	1.2	4.0	5.8	100.0
Canada	04.7	1.6	2.4	5.2	085.7
France	06.5	4.6	4.7	4.6	081.3
Germany	05.9	3.8	3.1	4.7	090.4
Italy	07.3	3.7	3.5	4.4	084.1
Japan	10.5	7.0	6.8	7.3	093.3
U.K.	04.3	1.0	5.3	5.3	059.3

\*1984

Source: Molly McUsic, "U.S. Manufacturing: Any Cause for Alarm?" New England Economic Review, Federal Reserve Bank of Boston, January/February 1987, p. 10.

The table indicates that in 1984, a Japanese manufacturing worker produced only 93.3 percent as much per hour as an American manufacturing worker, even though the rate of manufacturing productivity in Japan has grown more rapidly over the postwar period, raising the level of Japanese productivity closer to that of the U.S. Indeed, Princeton University economist William Baumol suggests that productivity levels in all countries eventually will converge as capital and technology spread throughout the world.<sup>12</sup>

12. William J. Baumol, "A Modest Decline Isn't All That Bad," The New York Times, February 15, 1987.

The table also shows that, although America's productivity growth lagged behind its major trading partners for most of the 1960s and 1970s, since 1980 the U.S. productivity growth rate in manufacturing compares well with competing countries. Indeed, several reports point to a new era of growth in U.S. manufacturing.

## **CONCLUSION: THE AMERICAN MIDDLE CLASS IS THRIVING**

A number of recent studies have examined the question of whether the middle class is declining and concluded, in contrast to the popular mythology, that the middle class is alive and well.<sup>14</sup> Newsweek economics columnist Robert Samuelson, for example, observes: "Most popular notions about job polarization dissolve on close examination....[T]here's no pronounced trend for jobs to cluster at the top and bottom of the pay scale."<sup>15</sup> Similarly, Brookings Institution Senior Fellow Robert Z. Lawrence concludes: "Contrary to the common perception, the proportion of full-time workers with middle-class earnings in the production of goods is exactly the same as the proportion of workers with middle-class earnings in the rest of the economy...."<sup>16</sup> And an examination of the data by U.S. Bureau of Labor Statistics economist Neal Rosenthal also found no evidence of middle-class decline.<sup>17</sup>

The growth of the service sector is, in fact, a natural development in the U.S. economy, and it is associated with rising, not declining wealth. America is experiencing erosion neither in the manufacturing sector nor in the middle class. Those who make such arguments seem determined to ignore the evidence to further their own political agenda.

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13. U.S. Department of Commerce, International Trade Administration, 1987 U.S. Industrial Outlook (Washington, D.C.: U.S. Government Printing Office, 1987); Barnaby J. Feder, "Production Returning to U.S.," The New York Times, February 18, 1987; "Manufacturing--Dead or Alive?" The Global Spectator, Bear, Strauss & Co., January 29, 1987; "Why Manufacturing Will Revive," Business Week, January 12, 1987, pp. 66-68; and Robert J. Samuelson, "Glimmers of Manufacturing Revival," The Washington Post, November 12, 1986.

14. "The Shrinking Middle Class and Other Myths," Research Reports, American Institute for Economic Research, September 15, 1986, pp. 77-79; Patrick J. McMahon and John H. Tschetter, "The Declining Middle Class: A Further Analysis," Monthly Labor Review, September 1986, pp. 22-27; William Baldwin, "Chicken Little's Income Statistics," Forbes, March 24, 1986, pp. 68-69; Sar A. Levitan and Peter E. Carlson, "Middle Class Shrinkage?" Across the Board, October 1984, pp. 55-59; Robert Z. Lawrence, "Sectoral Shifts and the Size of the Middle Class," The Brookings Review, Fall 1984, pp. 3-11; "The Myth of the Vanishing Middle," Business Week, July 9, 1984, pp. 83, 86; and Robert J. Samuelson, "Middle-Class Media Myth," National Journal, December 31, 1983, pp. 2673-2678.

15. Robert J. Samuelson, "The Myth of the Missing Middle," Newsweek, July 1, 1985, p. 50.

16. Robert Z. Lawrence, "The Middle Class is Alive and Well," The New York Times, June 23, 1985.

17. Rosenthal, op. cit.