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It's no accident that the United States has always been an economic paradise for the middle class—that class was invented and reinvented by the government. Now the government needs to reinvent it again—before it's too late

In 1909 Herbert Croly, the founding editor of *The New Republic* and one of the patron saints of the twentieth-century progressive-liberal tradition, published his manifesto, *The Promise of American Life.* "The Promise of America," he wrote, "has consisted largely in the opportunity which it offered of economic independence and prosperity." According to Croly,

> The native American, like the alien immigrant, conceives the better future which awaits himself and other men in America as fundamentally a future in which economic prosperity will be still more abundant and still more accessible than it has yet been either here or abroad .. .With all their professions of Christianity their national idea remains thoroughly worldly ... The Promise, which bulks so large in their patriotic outlook, is a promise of comfort and prosperity for an ever increasing majority of good Americans.

The idea that the promise of American life lay in widespread material prosperity as much as in civil liberties or political democracy is an old one. As Croly pointed out, in 1782 Hector St. John de Crevecoeur wrote in his *Letters From an American Farmer,*

> What, then is the American, this new man? ... Wives and children, who before in vain demanded of him a morsel of bread, now, fat and frolicsome, gladly help their father to clear those fields, whence exuberant crops are to arise to feed and to clothe them all; without any part being claimed, either by a despotic prince, a rich abbot, or a mighty lord ... From involuntary idleness, servile dependence, penury, and useless labor, he has passed to toils of a very different nature, rewarded by ample subsistence. This is an American.

The equation of America with widespread middle-class prosperity persists today. Of the millions of people who came to the United States following the resumption of large-scale immigration in the last third of the twentieth century, a few were refugees from political or religious persecution. Most, however, wanted what previous generations of European immigrants had sought: "America has been peopled by Europeans primarily because they expected in that country to make more money more easily," Herbert Croly wrote.

America, then, is not simply the land of political liberty. It has always also been an economic paradise for the middle class—at least until now.

A History of the Middle Class

What exactly does it mean to say that the United States is a middle-class society?

In the pre-modern societies of Europe the terms "burgher" (German) and "bourgeoisie" (French) referred to the minority of largely urban merchants and professionals who were above the peasant majority and below the minority of landholding aristocrats. But when Americans talk about the middle class, they are not talking about burghers or the bourgeoisie. What makes the United States and similar societies middle-class is the economic predominance of the middling sort, no matter what their major source of employment happens to be.

Thus the American middle class has migrated from sector to sector over the past two centuries. The "fat and frolicsome" yeoman farmers of Crevecoeur and Jefferson became the well-paid factory workers of William McKinley and Henry Ford, and then moved to the suburbs to become white-collar "organization men" (or, less frequently, women) after World War II. Over the years the social prestige of various economic sectors rose as the middle-class center of gravity passed through them. In medieval England "clown" and "villain" were words for the farmer who later became the symbol of middle-class rural America. In the eighteenth century yeoman farmers and aristocrats alike despised the "greasy mechanic," who by the early twentieth century had been promoted to middle-class factory worker. In the fiction of Victorian Britain and Gilded Age America the office worker was a miserable, stunted figure—Scrooge's assistant Bob Cratchit, or Bartleby the scrivener. But after World War II the cringing, bleary-eyed clerk became the confident professional who left his suburban home armed with a briefcase—Ward Cleaver, *of Leave It to Beaver.*

To most of us, the transition from farmer to industrial worker to service worker—sometimes within three generations of one family—appears in retrospect to have been inevitable, like some geological process. Indeed, many conservatives and libertarians seem to believe that a mass middle class is an inevitable by-product of capitalism. The truth is that each of America's successive middle classes has been artificially created by government-sponsored social engineering—a fact that is profoundly important for us to admit as we think about the future of middle-class America.

Consider the first American middle class, composed of yeoman farmers. There could never have been a mass agricultural middle class in the United States without vast quantities of cheap farmland, divided up into small farms.

From 1800 to 1848 the U.S. government acquired more than two million square miles of territory, much of it arable, by purchase or negotiation (the Louisiana Territory from France in 1803; Florida from Spain in 1819; Oregon from Britain in 1846), by annexation (Texas, 1845), or by conquest (the Mexican Cession in 1848). Populists sought to ensure that this land went to small farmers rather than large landowners or speculators. The danger of European-style feudalism in the United States was neutralized by the land ordinance of 1785, which guaranteed that the federal domain would be broken up into "fee simple" properties, with no complex web of multiple ownership. And the Homestead Act of 1862 provided 160 acres of free public land to settlers who would live on it and improve it for at least five years. Meanwhile, the federal government subsidized continent-crossing railroads, and the Army Corps of Engineers built much of the country's rural infrastructure. This was social engineering on a colossal scale.

The story was similar for the second American middle class, made up of prosperous urban industrial workers. From Abraham Lincoln to Herbert Hoover, American politics was dominated by a bargain between capitalists and workers; high tariffs on imports served the interests of both, by protecting goods from foreign competition. In addition, the dominant industrial labor force successfully lobbied the government to protect it from competition with other groups. In the late nineteenth century Congress cut off "Oriental" immigration, and after World War I—with the support of organized labor—it cut large-scale European immigration. Before World War I informal discrimination prevented southern black Americans from moving to the Northeast and the Midwest to compete for industrial jobs. Finally, child-labor laws removed children from the work force, and "family wage" or "breadwinner" systems—which paid married fathers more than unmarried, childless men—encouraged married women to become homemakers. Today nostalgic conservatives attribute the prosperity of the 1920s to free enterprise. In reality the market was rigged.

A product of the early industrial era, the second American middle class was largely limited to the industrial states of the Northeast and the Midwest. Unlike the factory workers in those states, the rural majority in the South and the West did not share in the income gains from industrialization; tariffs were, in effect, a tax imposed on them to subsidize urban workers and capitalists. The protectionist system also hurt the professional elite, because it raised prices on high-end consumer goods. Economics goes a long way toward explaining why elite progressives from the North teamed up with southern and western populists in the New Deal coalition that lasted from 1932 until the 1960s. The New Dealers created the third American middle class.

Whereas the second American middle class was founded on high wages for workers in the industrial sector, the third American middle class was founded on the supplementation of wage income by government benefits that collectively constituted a "social wage." The social wage included not only private-sector benefits encouraged by the tax code, such as employer-provided health insurance, but also subsidies such as the home-mortgage-interest deduction and government entitlements such as Social Security and Medicare (which freed many middle-class families from the bankrupting burden of caring for elderly parents), the GI Bill for higher education, and student loans. As the Yale political scientist Jacob Hacker has pointed out, when the hidden welfare state is counted along with the visible welfare state, the United States has a system of social provision as generous as those in Western Europe—though in this country much of that system extends only to the middle class and the professional elite. The social-wage system had many flaws—for example, it failed to provide health insurance for tens of millions of Americans. Nevertheless, the third American middle class, the product of Franklin Roosevelt's New Deal, Harry Truman's Fair Deal, and Lyndon Johnson's Great Society, was larger and more inclusive than the earlier two. From the 1930s to the 1970s income inequality in America shrank dramatically, producing what the economic historians Claudia Goldin and Robert Margo have called the Great Compression.

Fear of Falling

By the beginning of the twenty-first century, however, economic changes were threatening the third American middle class. In the 1970s an increasing number of U.S. corporations started to transfer production jobs and certain service jobs to low-wage workers abroad. This process accelerated through the 1980s and 1990s, as the demise of communism and the rise in many Third World countries of export-oriented development strategies greatly enlarged the global market for both skilled and unskilled labor. Although globalization helped the middle class in some ways, reducing the cost of such imports as toys from China and shoes from Indonesia, it destroyed the jobs— and undermined the bargaining power—of workers in sectors from automobile production to back-office services. Even if the United States had used protectionism to shield workers in every sector from foreign competition, an ever growing number of manufacturing and service jobs would still have been eliminated by technological innovations—a trend that will probably prove even more important than globalization over time.

> ***The middle class is not a fact of nature. It is partly the product of social engineering by the government.**
>
> ***There have been three successive middle classes in American history: The yeoman farmer; the industrial worker; and today's middle class, created by the "social wage" of the New Deal and the Great Society.**
>
> ***The number of high-paying middle-class jobs is shrinking while the number of low-paying service jobs is increasing. Meanwhile, the cost of living for the middle class is rising.**
>
> ***We face the possibility of a new feudalism, in which most Americans provide personal services for the rich few.**
>
> ***The solution may be to supplement the "social wage" with a "capital wage."**

Nevertheless, thanks to technologically driven increases in productivity, life has steadily gotten better for the majority of Americans. Advances in manufacturing and automation have slashed the prices of consumer appliances such as televisions and personal computers. At the same time, however, this kind of productivity growth threatens the middle class in three ways: by raising the costs of certain labor-intensive services necessary for a middle-class lifestyle; by changing the occupational structure; and by increasing inequality.

The disparity between rapid productivity growth in mechanized sectors and slow productivity growth in human-service jobs produces Baumol's disease—named after the economist William J. Baumol. According to Baumol, in a technological economy falling prices for manufactured goods and automated services eventually increase the relative cost of labor-intensive services such as nursing and teaching. Baumol has predicted that the share of gross domestic product spent on health care will rise from 11.6 percent in 1990 to 35 percent in 2040, while the share spent on education will rise from 6.7 percent to 29 percent.

The shifting of relative costs need not in itself be a problem. If Americans in 2050 or 2100 pay far more (as a percentage of their spending) for health care and education than they did in 1900, they may still be better off—if they pay correspondingly less for other goods and services. The problem is that as the relative cost of services like education and health care rises, more and more Americans will find themselves in service-sector jobs that, unlike the professions, have historically been low-wage.

Technology is changing the job market by shoving people out of sectors that can be mechanized or automated-factory production, data processing, clerical work—and into sectors requiring a human touch, from nursing to law. As the twenty-first century began, most jobs created were in non-unionized service sectors where wages were low because of a glut of labor and where the prospects for long-term productivity gains were minimal. According to the Bureau of Labor Statistics, the following are among the occupations with the largest projected job growth from 2000 to 2010: combined food-preparation and serving, including fast food; customer-service representative; registered nurse; retail salesperson; computer-support specialist; cashier, except gaming; office clerk; security guard; computer-software engineer, applications; waiter; general or operations manager; truck driver, heavy and tractor-trailer; nursing aide, orderly, or attendant; janitor or cleaner, except maid or housekeeping cleaner; postsecondary teacher; teacher assistant; home health aide; laborer or freight, stock, and material mover, hand; computer-software engineer, systems software; landscaping or groundskeeping.

Some economists assert that increases in productivity will inevitably translate into higher wages throughout the economy. But this is a matter of faith, not fact. Baumol’s analysis tends to undermine such easy optimism. Most productivity advances occur in mechanized and automated sectors, which employ a shrinking number of Americans; so how will the growing number of Americans in service jobs share the gains of high productivity growth?

In the absence of some system of private or public redistribution, then, there is no guarantee that rising national productivity will spontaneously and inevitably produce rising incomes and wealth for most Americans, rather than just windfalls for the fortunate few.

Since the 1970s inequality of both income and wealth in the United States has increased dramatically. As Paul Krugman has observed in *The New York Times,* a Congressional Budget Office report shows that from 1979 to 1997 the after-tax income of the top one percent of families climbed 157 percent, while middle-income Americans gained only 10 percent, and many of the poor actually lost ground. The share of after tax income that goes to the top one percent of Americans has doubled in the past three decades; at 14 percent, it roughly equals the share of after-tax income that goes to the bottom 40 percent. The concentration of wealth at the upper levels of the population has been even more extreme.

To some degree, the explosion of inequality in both income and wealth has resulted from private and public policy, such as lavish compensation for CEOs, the reduction of taxes on the rich, and the immigration laws that permit a large influx of poor and unskilled workers. But more to the point, the productivity gains in heavily automated, capital-intensive sectors such as manufacturing, agriculture, banking, and other routine services have gone almost entirely to the investors who own the machines and the software, not to the workers who remain, and certainly not to the workers displaced into other sectors. Such an outcome would be likely even if all CEOs and wealthy investors were generous and public-spirited.

This is where economics turns into politics. It is doubtful that in any society with universal suffrage the majority is going to sit on the sidelines and watch, generation after generation, while a handful of investors and corporate managers reap almost all the benefits of technological and economic progress.

One way to prevent this is through labor protectionism—restricting immigration and restricting imports. Neither is likely to be politically feasible. Protectionism would raise the price of goods for working Americans. Restricting immigration, while raising the wages of those who compete with immigrants for jobs, would also make nursing and many other personal services prohibitively expensive for all but the affluent. Higher wages produced by a much higher minimum wage or by the unionization of the service sector (politically unlikely as these scenarios are) might backfire by encouraging a black market in goods and services.

The Next Middle Class

If we reject both a new feudalism (under which most Americans provide personal services for the rich few) and a regime of protectionism and immigration restriction (which would benefit some workers at the expense of others), then some system of redistribution will be necessary to ensure that the middle-class majority benefits from long-term productivity growth. This can take two forms: redistributing income and encouraging the widespread ownership of income-producing assets.

The most obvious way to share the gains from technological progress is to tax the owners of high-productivity industries at high levels and spend the proceeds on the rest of the population. To varying degrees in different countries—more so in Sweden, less so in the United States—this is the system that now exists.

This "social wage" can take different forms. Some Americans prefer that the government provide universal services such as public schools and public health care. Others prefer voucher systems that permit a degree of individual choice. The social wage can likewise be either a supplement to incomes or a subsidy for goods. The earned-income tax credit, which has bipartisan support, supplements the incomes of low-wage workers to lift them out of poverty, and provides an alternative to raising the minimum wage. But there is also bipartisan support for tax breaks for homeowners, and for other subsidies on middle-class consumption.

In their groundbreaking book *The Two-Income Trap: Why Middle-Class Mothers and Fathers Are Going Broke,* Elizabeth Warren, of Harvard Law School, and her daughter Amelia Warren Tyagi demonstrate that fixed costs for the typical American middle-class family—home-mortgage payments, car payments, health insurance, child care, education, and taxes—have risen more rapidly than income over the past thirty years, eating up many of the gains from having two parents in the work force. According to the authors' analysis of government data, even when a two-earner family today brings in almost twice the income of a one-earner family in the 1970s (in inflation-adjusted constant dollars), the 1970s family had more discretionary income than today's.

If middle-class income does not grow as rapidly as middle-class costs, then one option is to further subsidize the rising relative costs of labor-intensive goods and services that are necessary to a middle-class lifestyle, such as education, child care, and health care. And the government will certainly be pressured to provide such subsidies. But taxing fewer and fewer rich people to subsidize more and more middle-class people would increase incentives for the rich to avoid taxation or even to leave the country. An alternative is to increase the number of people who own income-producing assets.

"Universal capitalism," the idea that everyone should own income-producing financial assets, was originally championed by Thomas Paine, in the eighteenth century, and variants of the idea have been proposed in more recent years by Louis Kelso, Mortimer Adler, Jeffrey Gates, and Bruce Ackerman. Today about half of American households, and roughly 70 percent of registered voters, own stock through pension funds and similar vehicles. But money set aside for retirement does no good during one's working life. Proposals for government-funded savings accounts for all children that would be restricted to a few purposes, such as college education or a first-home purchase, have been made by the Washington University professor Michael Sherraden and the former IRS commissioner Fred T. Goldberg Jr. Ray Boshara, of the New America Foundation, has proposed a similar system of American Stakeholder Accounts. And last April, British Prime Minister Tony Blair announced the establishment of child trust funds in the United Kingdom.

Like retirement savings invested in the stock market, child trust funds would be earmarked for particular purposes. But it is possible to imagine a future in which middle-class Americans would receive part of the returns on their investments during their working lives (a small part at first, but more with each generation), which they would be free to save or to spend without any restrictions. Of course, a nation that confiscated private financial wealth and redistributed it among its citizens would wreck its economy and send not only capital but also capitalists fleeing across its borders. Thus any plausible program of universal capitalism must start small, by planting seeds capable of growing along with the economy over time.

For example, one can imagine a means-tested program of private, regulated investment accounts in which the government matched the contributions of low-income workers. The seed money might come from spending cuts elsewhere, or from new taxes. Alternatively, citizens could all begin receiving modest amounts of money from the sale or lease of the airwaves and other public assets. In this way, even though most new middle-class jobs would not contribute to productivity growth in the way that farm and factory labor did in the past, universal capitalism could ensure that the fourth American middle class, like its predecessors, would be able to share directly in the long-term growth of the nation's economy.

This may seem a radical change. But only in recent generations have Americans begun to receive most of their income in the form of wages. The yeoman farmer didn't rely on wages. And only in the twentieth century did the New Deal add the social wage to the market wage. In the course of the twenty-first century what may be called the "capital wage" could be added to these, so that middle-class Americans—not merely an affluent minority—might derive income from three sources rather than just two.

In their own ways, with methods appropriate to their own times, Thomas Jefferson, Abraham Lincoln, Franklin Roosevelt, and their allies provided the institutional frameworks that permitted successive versions of middle-class America to grow and flourish. Their success set a high standard for the leaders of today. Every presidential candidate claims to want to help middle-class Americans. The challenge, though, is not to repair the current American middle class but to create a new one.