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WORLD

Shrinking Middle Class Threatens Global Growth, Stability

Recruitment to the middle classes is in decline across developed countries, says the OECD

The Shibuya district of Tokyo, Japan. While 70% of baby boomers were members in their twenties, that has fallen to 60% of the generation known as millennials. **PHOTO:** TORU HANAI/BLOOMBERG NEWS

By Paul Hannon

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The middle class is shrinking and its economic power diminishing in the U.S. and other rich countries, a development that threatens political stability and economic growth, according to a report by the Organization for Economic Cooperation and Development.

At the peak of its powers in 1985, the aggregate income of the middle classes was four times that of the richest group. Three decades later, it had fallen to less than three times. And while income growth for the middle classes has been slow over that period, the cost of housing, education and health care has risen much more rapidly.

The result of that squeeze is that middle-income households have taken on more debt and feel less secure in their status, while younger generations are less likely to gain membership of a group once seen as accessible to all.

The notion that the middle class is under pressure isn't entirely new, and has become more politically salient since the financial crisis. But the OECD's report provides evidence to back up that sense of peril.

"It's not just a feeling," said Stefano Scarpetta, director for employment at the Paris-based research body, which provides policy advice to its member governments.

Among the steps it recommends to ease the squeeze are lower taxes on middle-income workers, and higher taxes on the rich to pay for that, as well as steps to limit housing, education and health costs.

The OECD defines the middle class as comprising households with incomes between 75% and 200% of the median. That varies widely by country. In the U.S., a single person would have to earn between $23,400 and $62,400 to be part of the group.

The proportion of the population in OECD member countries who are in the category has fallen over the last 30 years, from 64% to 61%. However, larger falls have been recorded in the U.S., Israel, Germany, Canada, Finland and Sweden.

Across developed countries, recruitment to the middle classes is in decline. While 70% of baby boomers were members in their 20s, that has fallen to 60% of the generation known as millennials.

Seita Omija, 26, an assistant director at a small media marketing agency in Japan, said he was aiming to enter the middle class.

"In Japan I don't feel there is as much disparity as there is in the U.S., for example," Mr. Omija said. "But entering into the middle class really feels impossible for many young people today—unless you have some kind of specialized tech knowledge, that is."

Mr. Omija said he has taken on some side jobs making marketing videos to boost his income. Altogether he said he made about 3 million yen, or slightly less than $30,000, a year.

"For many people about to head into their 30s, it feels impossible to enter into the middle class unless you work some kind of side job," he said.

The middle class share of the population now ranges from around 50% in the U.S. and Israel to around 70% in Nordic and some other European countries. The U.S. stands out in having a relatively small middle class given its high median income: among other countries, a higher median income tends to be associated with a larger middle class.

The loss of middle-class economic power has been driven by what the OECD describes as "dismal" income growth compared with top earners. At the same time, the cost of many of the goods and services that are key to middle-class life styles have risen much more rapidly.

That is especially true of housing, which now accounts for a third of middle-class spending, up from a quarter in 1995.

Rising city rents have squeezed the German middle class. Since 2012, rents in the country's largest cities have risen sharply—by 70% in Berlin and 43% in Munich. But real wages for employees in nonmanagement positions have increased just 8.4%.

Higher rental costs also stand in the way of another traditional route into the middle class: running a small business.

According to Mario Lombardo, rents have doubled since he set up his store producing and selling handmade perfumes and scented candles in a neighborhood that has developed into Berlin's fashion district.

"You need to be very creative to make money," he said. "Taxes are over 40% and the rents are simply skyrocketing here."

Since 2012, rents have risen by 70% in Berlin but real wages for employees in nonmanagement positions have increased just 8.4%. Demonstrators in Berlin, Germany, campaign "For Fair Wages." **PHOTO:** FELIPE TRUEBA/EPA/SHUTTERSTOCK

The OECD estimates that 20% of middle-income households spend more than they earn, and they are more likely to be highly indebted than rich or poor households, with one in eight owing more than 75% of their assets.

The OECD's report comes as Democratic lawmakers and presidential candidates outline a range of plans for boosting taxes on the wealthy to address economic inequality, while concerns about the retreat of the middle class have spread to billionaires such as Bridgewater CIO Ray Dalio, who in an essay published last week warned of "great conflict and some form of revolution" if it isn't halted.

The OECD said there is a clear link between the strength of the middle class and rapid economic growth, noting that in their "intolerance of corruption, and their trust in others and in democratic institutions they are the very foundations of inclusive growth."

"Political instability is an important channel through which a squeezed middle class may upset economic investment and growth," it warned.

— River Davis in Tokyo and Bojan Pancevski and Bertrand Benoit in Berlin contributed to this article

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