From Middle to Shaky Ground

The Economic Decline of America's Middle Class, 2000-2006

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BY A THREAD REPORT #3

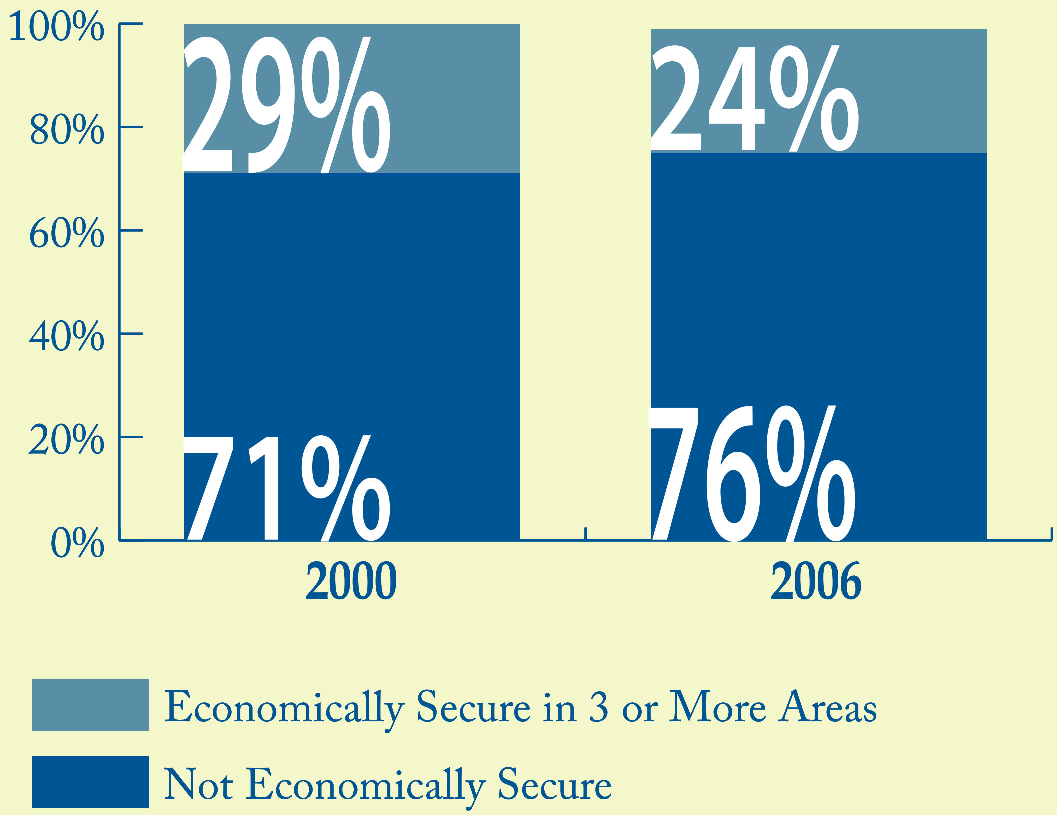
Summary: Middle Class Standard of Living Slipping

A middle-class standard of living requires that families have adequate financial security to meet current obligations, invest in the future, and access opportunities. The most recent findings from the Middle Class Security Index show that between 2000 and 2006—even before the most recent economic downturn—the economic well-being of middle-class families slipped noticeably.

Between 2000 and 2006 an estimated 4 million middle-class families lost their financial security, bringing the total number of middle-income families on shaky ground to 23 million.

These worrisome changes in the overall financial health of the middle class were driven by a decline in assets, rising housing costs, and a growing lack of health insurance.

Graphic 1. Declining Middle-Class Economic Security, 2000-200



*See "What Makes a Middle-Class Family Financially Secure?" for more detail on what constitutes economic security.

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Between 2000 and 2006:

- The median financial assets held by middle-class families declined by 22 percent. This means that for every dollar in median assets that middle-class families held in 2000, they held just 78 cents in 2006.[1] These figures do not include home equity and therefore do not reflect additional losses families may have experienced due a decline in their home values.

- Monthly housing expenses for the middle class rose by 9 percent. As a result, the percentage of middle-class families who match the Department of Housing and Urban Development's definition of housing burdened rose from 31 percent in 2000 to 37 percent in 2006.

- The number of middle-class families in which at least one member lacks health insurance grew from 18 percent in 2000 to 25 percent in 2006.

New Challenges for the American Dream

When we think of the middle class, we think of a comfortable standard of living, one that provides opportunities and the capacity for well-being. Such a standard of living requires financial security to be able to pay for essential living expenses, invest in and build a solid future, receive good healthcare, and retire in comfort.

Americans expect, reasonably so, to achieve these basics if we work hard and live modestly. This is part of the expectation behind achieving the American Dream.

Through the Middle Class Security Index, Dēmos and the Institute on Assets and Social Policy at Brandeis University measure how well middle-class families are doing in attaining the basics of financial security.[2] Specifically we look at whether families have:

- Sufficient financial assets to develop a safety net for unforeseen crises and a nest egg for current and future generations;

- The education necessary to find a good job that allows them to move ahead economically and thrive in today's competitive global economy;

- Incomes that make it possible to afford quality housing and other essential living expenses; and

- Access to comprehensive, high quality, affordable healthcare.

If families are not secure in the majority of these areas, the foundation of their economic security is weak, and therefore their opportunities and capacity for well-being are challenged.

The Middle Class Security Index shows that millions of middle-income Americans do not have the basic factors in place to support the well-being and opportunities associated with a middle-class standard of living. What's more, when we compare data collected in 2000 to data collected in 2006 (the most recent available data), we find considerable slippage, with fewer middle class families financially secure and more families financially at risk.

In 2000, 71 percent (an estimated 19 million) of middle-income families experienced ongoing threats to their standard of living because their lack of assets, education, ability to cover housing costs and meet basic expenses, and access to healthcare weakened their financial security.[3] By 2006—even before the most recent housing meltdown and economic slump—that number had grown to 76 percent. As of 2006, more than 23 million middle-income families did not enjoy the financial security associated with being middle class.[4]

(continued on page 4)

What Makes a Middle-Class Household Financially Secure?

The Middle Class Security Index, created by Dēmos and the Institute on Assets and Social Policy at Brandeis University, focuses on five interrelated factors that in combination describe the security or vulnerability of middle-class families—assets, education, housing, budget and healthcare. For each of these factors measured by the Index, researchers established an optimal threshold for overall financial security as well as one for economic vulnerability.

Factors Influencing Middle Class Economic Security

	Optimal for Financial Security	Risk to Financial Security
Assets Number of months able to live at 75 percent of current living expenses using net financial assets	> 9 months	< 3 months
Education Academic degree	Bachelor´s degree or higher	High school diploma or less
Housing Percent of after-tax income spent on housing	< 20% monthly income	> 30% monthly income
Budget Amount left at the end of the year after paying taxes and covering living expenses	> $25,000 left at end of year (about $480/week)	< $5,000 left at end of year (< $100/week)
Healthcare Number of family members covered by private or government health insurance	All family members covered	At least one family member not covered

These thresholds were then used to determine what percentage of families that are considered middle-class by income are economically secure or at risk. They can also be used to identify the areas where middle-class families are most vulnerable. This provides insights into leverage points for policy changes that can increase the number of families that are securely in the middle class and reduce the number of families that are at risk of falling out of the middle class.

Families were considered to have middle-class incomes if their household earnings fell between 200 and 600 percent of the federal poverty level. Incomes were adjusted for household size.

Defined in this way, the middle class incorporates about the middle 50 percent of all households. Families with substantial personal wealth were excluded, and the sample was restricted to working-age adults between the ages of 25 and 64.

Middle Class Sample, Defined

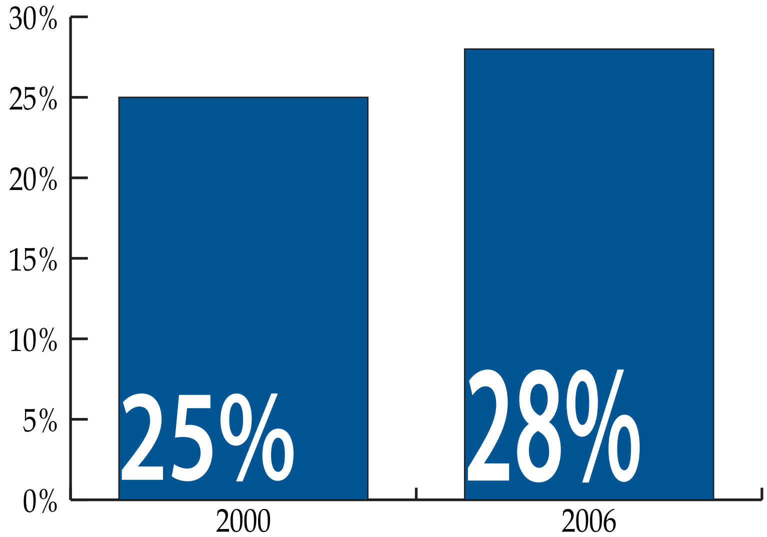
Income Range	Household income at least 2X but not greater than 6X Federal Poverty Guideline for family size. (Under 2006 Guidelines, $40,000–$120,000 for a family of 4.)
Age Range	Head of household age 25–64
Assets Cut Off	Families whose net financial assets placed them in top 1% of holders were eliminated. (Greater than $500,000 in net financial assets.)

If three or more of the factors in a family's profile met the threshold for financial security, that family was considered to be securely middle class. If three or more of the factors in a family's profile met the standards for high insecurity, the family was considered to be at high risk of slipping out of the middle class. In-between these two groups there is a middle ground where families are not at immediate and high risk for falling out of the middle class but still lack the basic components for safeguarding their financial security.

Between 2000 and 2006, the small fraction of the American middle class that achieved a stable, middle-class standard of living reversed direction and slipped by 5 percentage points. In 2000, 29 percent of middle class families had the level of assets, education, income and healthcare necessary to ensure economic security. By 2006 that number had declined to 24 percent.

Meanwhile the number of middle-class families living on the edge, in danger of losing their grasp on any financial security whatsoever, has grown. In 2000, 25 percent of middle-class families were vulnerable in terms of their assets, education, income or healthcare. By 2006 that figure had grown to 28 percent.

Graphic 2. Percent of Middle-Class Families Vulnerable in 3 or More Factors, 2000-2006



Graphic 3. Defining Middle-Class Vulnerability—What Puts a Family on the Edge?

Education	Family head or spouse has high school diploma or less
Assets	Family does not have enough net financial assets to cover 3/4 of essential expenses for at least 3 months
Budget	Family has less than $100 per week left over after meeting expenses
Housing Costs	Family spends 30% or more of income on housing
Healthcare	At least 1 member of family lacks health insurance

Our results show that the stories which appear daily in newspapers chronicling the misfortunes of members of the middle class—who are losing homes, who cannot afford to support their children's education, who cannot afford health insurance, who are living in two-earner households and still not able to make ends meets—are not just isolated instances of individual families facing tough times.

Millions of families have been affected, signaling a major downturn for the middle class and the largest challenge to the American Dream since the Great Depression.

Why Is the Middle Class Worse Off?

Middle-class families show significant vulnerabilities in each of the factors measured by the Middle Class Security Index. Below we highlight areas where already bad circumstances have gotten worse.

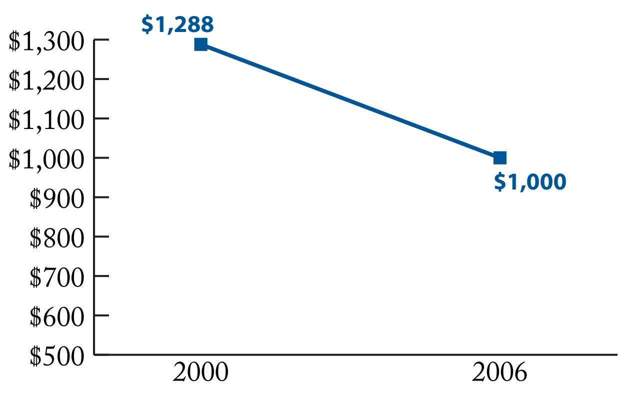
Dwindling Assets, Rising Debt

Financial assets undergird a middle-class standard of living and give a family access to opportunities. A family with assets is better able to support children in every aspect of their education. A family with assets is better able to make a down payment on a house, to invest, and to weather unpredictable economic circumstances such as job loss or illness. A family with assets is also better able to pass these abilities along to future generations.

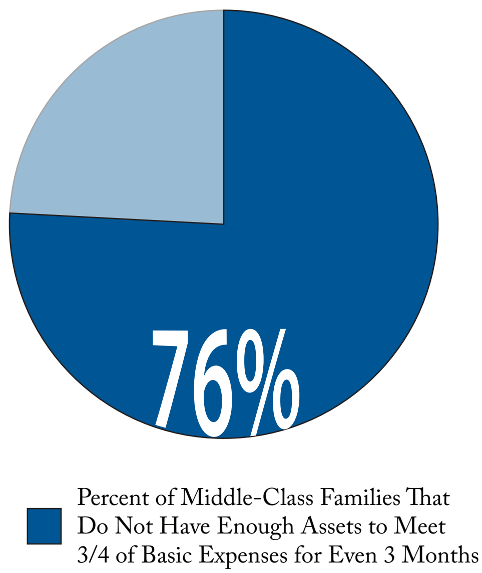
Lack of assets continues to be a security-threatening weakness for the vast majority of middle class families. In fact, this weakness continues to worsen.

Between 2000 and 2006, the median assets held by middle class families declined by 22 percent. This means that every for dollar in median assets middle-class families held in 2000, they held just 78 cents by 2006. These figures do not include home equity and therefore do not reflect additional losses families may have experienced due a decline in their home values. A decline in the amount of assets held was made worse by an 11 percent increase in non-mortgage debt, with increasing debt eating wealth, as families pay for past consumption with their nest eggs.

Graphic 4. Decline in Median Assets of Middle-Class Families, 2000-2006



Graphic 5. Vulnerability in Net Financial Assets

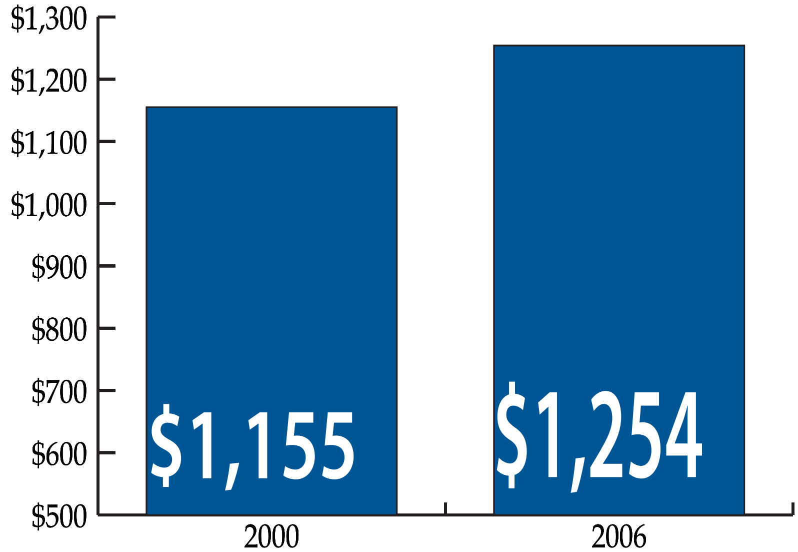


As of 2006, 76 percent of middle class families could not meet even three-quarters of their essential expenses for three months if they needed to live on assets alone. This represents a slight deterioration from 2000, when the figure was 75 percent. The number of families who could not cover their essential expenses for any length of time, one in two, remained constant between 2000 and 2006.

Rising Housing Costs

Between 2000 and 2006 the median amount middle-class families spent on housing expenses increased by 9 percent. These expenses consisted of unavoidable obligations such as mortgage principle and interest, rent, insurance, taxes, maintenance, fuel and utilities on primary residences.

Graphic 6. Rise in Median Monthly Housing Expenses, 2000-2006

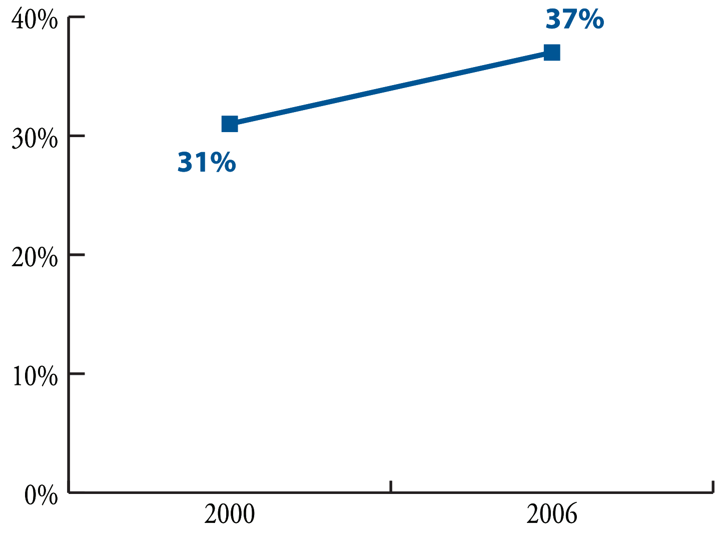


This increase in expenses pushed many families into a condition described by the Department of Housing and Urban Development as housing cost burdened. According to HUD's definition, "Families who pay more than 30 percent of their income for housing are considered cost burdened and may have difficulty affording necessities such as food, clothing, transportation and medical care."[5]

In 2000, 31 percent of middle class families met HUD's definition for housing cost burdened. By 2006 that figure grew to an alarming 37 percent.

This increase foretells the challenges faced by many middle-class families today as housing expenses have grown even less affordable and the housing market has become even less stable than it was in 2006.[6]

Graphic 7. Percent of Middle-Class Families Who Spend 30% or More of Income on Housing, 2000-2006



Homeownership: From Supporting the American Dream to Destabilizing Financial Security

For most middle-class families, home equity forms a substantial part of wealth. The Middle Class Security Index does not measure home equity as part of our asset calculation. This is due to data availability. Instead our assets measurement shows how long a family can survive (or, in the case of most families, cannot survive) before needing to tap into resources of last resort such as home equity.

We know that during the heart of the housing boom, millions of households tapped into home equity in order to make ends meet. They replaced more expensive credit card debt and financed current living expenses with mortgage debt by withdrawing equity from their homes. (*Borrowing to Make Ends Meet*, Dēmos 2007) According the Joint Center for Housing Studies of Harvard University, Americans cashed out more than 1.4 trillion dollars worth of home equity between 2001 and 2007. (*The State of the Nation's Housing*, 2008)

In light of the recent downturns, foreclosure crisis, and subprime mess, using home equity as a band-aid strategy has had disastrous consequences. Many families are now upside-down in their homes, having taking out mortgages they cannot afford, or owning more on a mortgage or home equity loan than they will be able to recoup by selling their home.

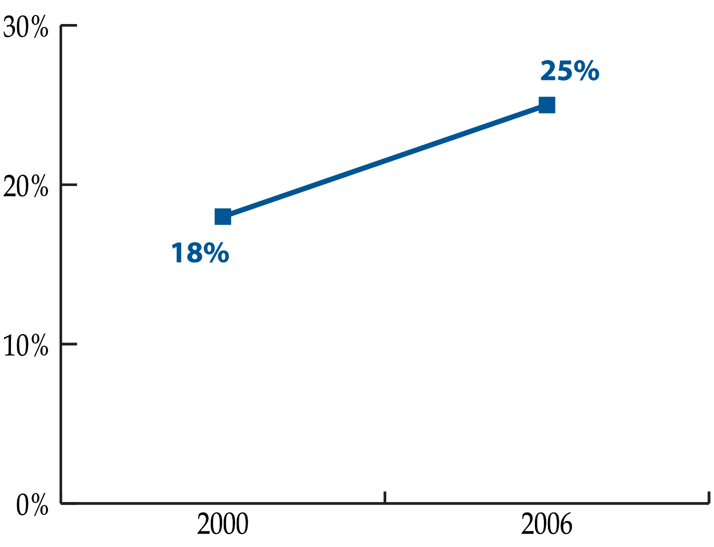
The latest data available from which to calculate our Index shows that in 2006 middle-class families were in great trouble. There is little doubt that the negative consequences of the current housing crisis—and its fallout not just in the real estate market but in other sectors of the economy—have only intensified the challenges faced by middle-class families.

Loss of Health Insurance

Unexpected illness can drive uninsured families into financial ruin. The need to pay medical expenses is a growing reason why middle-class families are taking on unprecedented levels of credit card debt, and a major cause behind bankruptcies.[7]

Having even one family member uninsured is a risk to financial security. The number of middle-class families who experience this risk is growing. In 2006, 25 percent of middle-class families had at least one uninsured member. This figure represents a substantial increase over 2000, when 18 percent of middle-class families had at least one uninsured member.

Graphic 8. Percent of Middle-Class Families in Which At Least 1 Member Lacks Health Insurance Coverage



What Can We Do?

We must put aside party differences and face the necessary challenge of rebuilding and revitalizing a strong middle class. To do this, we must directly address practices that erode middle-class financial security and place roadblocks in front of those looking to move into the middle class.

Building Assets, Reducing Debt, Fixing the Mortgage Crisis

As of 2006, more than 3 out of 4 families earning a middle-class income do not have sufficient assets to survive for just three months should their income source fluctuate or disappear.

The ongoing absence of a safety net combined with shrinking incomes means that many middle-income families are borrowing to make ends meet. As the costs of essentials such as gas, utilities, and food continue to rise, the struggles faced by the average family are intensifying. Many families see no option but to turn to credit cards to meet basic expenses. This creates a dangerous cycle that families find difficult to escape.

Even homeownership—the most common source of wealth for most families—has become precarious. We now know the devastating impact high-priced loans and an out of control mortgage industry can have on families as a booming market goes bust.[8]

The United States currently does not have a comprehensive savings and asset-building policy, but rather a scattershot set of policies that when taken together largely benefit households that need help the least.

The existing patchwork of policies that promote or reward savings and asset-building overwhelmingly benefit households that already have substantial net worth and economic security. According to analyses by the Corporation for Enterprise Development, while the federal government spent $367 billion on asset-building policies in 2005, 45 percent of these subsidies went to households with incomes over $1 million.[9]

The largest asset-building expenditure—the home mortgage deduction—is particularly skewed toward the best-off households in America. The bottom half of earners receive 3 percent of the tax benefits while the richest 10 percent receive 59 percent.

In order to grow and strengthen the middle class, America needs to embrace a set of principled investments that better target those households for whom a modest subsidy would make a significant difference in building emergency savings and saving for future investments such as college and a downpayment on a home. We also need a set of policies that would address abusive and predatory lending practices in both the mortgage and credit card industries.

- **Help Households Save for Emergencies** by enacting policies to promote traditional savings through creating universal savings accounts and targeted tax credits that would provide progressively structured credits per the amount saved.
- **Make Homeownership More Secure** by helping young families save for a downpayment and thereby reduce their mortgage debt. HomeSavers accounts should be created that would provide progressive matches in the form of tax credits.
- **Protect Homebuyers from Deceptive and Abusive Mortgage Lending Practices** by establishing strong federal standards that would protect consumers throughout the entirety of the mortgage process, including licensure at the federal level for mortgage brokers.
- **Require that Consumers be Offered the Best Possible Loan for Which They Qualify**, rather than the largest and most costly loan they can be convinced into taking.

- **Reduce Foreclosures Among Future Sub-Prime Borrowers by** requiring that lenders qualify borrowers based on the fully indexed rate of the loan—not the teaser rate as is the case with "exploding" adjustable rate mortgages. Additional steps include: encouraging agencies to pursue meaningful enforcement against lenders and brokers whose underwriting practices harm homeowners; requiring that subprime lenders evaluate the borrower's ability to repay before making a home loan; and outlawing mortgages with pre-payment penalties.

- **Give Families a Fair Chance to Pay Down Debt by Prohibiting Abusive Credit Card Practices** that allow the lender to change the terms of the account at any time, for any reason, and apply interest rate increases retroactively to existing balances.

- **Develop a Comprehensive Approach to Curbing the Ongoing Impact of the Mortgage Meltdown on Owners and Renters**. For ideas to achieve this, see a previous Dēmos report *Beyond the Mortgage Meltdown: Addressing the Current Crisis, Avoiding a Future Catastrophe*.

Addressing the Healthcare Crisis

In one in four middle-class families, at least one family member lacks health insurance, placing families at both physical and financial risk. The cost burden on middle-class families in the form of higher out-of-pocket expenses has also risen dramatically in the last decade.[10] In the wake of rising premiums and often limited benefits, prior research by Dēmos has revealed that even middle-class families with health insurance have problems paying their medical expenses and are using credit cards to meet their health needs.[11]

Healthcare security among the middle class can no longer be taken for granted. With a renewed public debate over how to fix the broken healthcare system in the United States—one that is characterized by high costs, widely varying degrees of benefits, and a growing uninsured population—the future security of America's middle class hinges on whether we can muster the political and public will to markedly overhaul health-related funding and access policy in this nation.

- **Ensure All Americans Have Affordable and Comprehensive Health Care Coverage** by dramatically reforming our current healthcare system. At this time, the means are less important than our commitment to the end: quality health care coverage for every adult and child in the United States.

Conclusion

Between 2000 and 2006 the number of middle-class families able to survive on assets during emergencies, who can afford their housing, and who have all members covered by health insurance declined significantly.

Since that time, the signs of economic insecurity have only gotten stronger. Costs of essential expenses have risen. The housing market, a significant source of middle-class stability, has grown weaker. The financial industry has grown more unstable and unpredictable. We do have policy solutions at our fingertips to bolster the middle class. What remains to be seen is how effectively our elected officials will pursue a bipartisan course of action that achieves this.

In light of the recent downturns, foreclosure crisis, and subprime mess, using home equity as a band-aid strategy has had disastrous consequences. Many families are now upside-down in their homes, having taking out mortgages they could not afford, or owning more on a mortgage or home equity loan than they will be able to recoup by selling their home.

The latest data available from which to calculate our Index shows that in 2006 middle-class families were in great trouble. There is little doubt that the current economic crisis has only intensified the challenges faced by middle-class families.

Endnotes

1. Figures are in 2006 dollars. We defined net financial assets as financial assets minus debt. Financial assets exclude home equity but includes savings accounts, checking accounts, brokerage accounts, US savings bonds, securities such as stocks, mutual funds and bonds, and money owed to a member of the household. Debt includes money owed on gas, store or major credit cards, to financial institutions, medical practitioners for expenses not covered by insurance, and other credit such as school and personal loans; it excludes housing, vehicle and business loans. We define essential living expenses as food, housing, clothing, transportation, health care, personal care, education, personal insurance and pensions.
2. See "What Makes a Middle-Class Family Financially Secure?" For further detail, see *By A Thread: The New Experience of America's Middle Class* (Dēmos, 2007).
3. Due to missing data, any population estimates given in this report are likely to be low. The actual numbers are likely to be higher.
4. We use the Consumer Expenditure Survey to calculate our Index. The 2000 and 2006 surveys use different techniques for imputing income. For this report we are using the 2000 income calculation.
5. See http://www.hud.gov/offices/cpd/affordablehousing.
6. See "Housing: From Supporting the American Dream to Destabilizing the Middle Class."
7. Elizabeth Warren, "Medical Bankruptcy: Middle Class Families at Risk," Testimony before the House Judiciary Committee," (July 17, 2007).
8. See "Homeownership: From Supporting the American Dream to Destabilizing Financial Security.
9. Lillian Woo and David Buchholz*, Subsidies for Assets: A New Look at the Federal Budget* (Corporation for Enterprise Development, February 2007), http://www.cfed.org/imageManager/assets/subsidiesforassets.pdf.
10. Elizabeth Warren and Amelia Warren Tyagi, "What's Hurting the Middle Class," (*Boston Review*, September/October 2005).
11. Cindy Zeldin and Mark Rukavina, *Borrowing to Stay Healthy: How Credit Card Debt is Related to Medical Expenses* (Dēmos and The Access Project, Winter 2007).
12. Borrowing to Make Ends Meet, Dēmos 2007.

About Dēmos

Dēmos is a non-partisan public policy research and advocacy organization. Headquartered in New York City, Dēmos works with advocates and policymakers around the country in pursuit of four overarching goals: a more equitable economy; a vibrant and inclusive democracy; an empowered public sector that works for the common good; and responsible U.S. engagement in an interdependent world.

The Economic Opportunity Program addresses the economic insecurity and inequality that characterize American society today. The program offers fresh analysis and bold policy ideas to provide new opportunities for low-income individuals, young adults and financially-strapped families to achieve economic security.

Dēmos was founded in 2000.

Miles S. Rapoport, President
Tamara Draut, Vice President of Policy and Programs

About The Institute on Assets and Social Policy at Brandeis University

The Institute on Assets and Social Policy is dedicated to the economic and social mobility of individuals and families, particularly those traditionally left out of the economic mainstream, and to the expansion of the middle class. The Institute is part of The Heller School for Social Policy and Management at Brandeis University. Working in close partnership with state and federal policymakers, constituency organizations, grassroots advocates, private philanthropies, and the media, the Institute bridges the worlds of academic research, government policy-making, and the interests of organizations and constituencies. The Institute works to strengthen the leadership of policy makers, practitioners and others by linking the intellectual and program components of asset-building policies.

Thomas M. Shapiro, Director
Tatjana Meschede, Senior Research Associate, Project Manager

The Future Middle Class Series and The Middle Class Security Index

From Middle to Shaky Ground: The Economic Decline of America's Middle Class, 2000–2006 is the third report from Dēmos measuring the economic stability, size and accessibility of the middle class in the United States. This report is based on the new *Middle Class Security Index* developed through collaborative research by Dēmos and The Institute on Assets and Social Policy at Brandeis University. The first report based on the Index was *By a Thread: The New Experience of America's Middle Class*, published at the end of 2007. The second was *Economic (In)Security*, which examines the financial experience of the Latino and African-American middle class. *From Middle to Shaky Ground* is the sixth report in Dēmos' *Future Middle Class Series*, which examines ways to strengthen and grow the middle class in the United States. Other titles in this series include *African Americans, Latinos and Economic Opportunity in the 21st Century, Millions to the Middle,* and *Measuring the Middle.*

Forthcoming reports in the Future Middle Class series will examine America's opportunity infrastructure related to trends in demographics, access to higher education, healthcare, debt, assets, housing and economic inequality.

Upcoming *By a Thread* reports in this series will examine the security of the middle class by age and income.

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