Jennifer WHEARY
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BY A THREAD

THE NEW EXPERIENCE OF AMERICA'S MIDDLE CLASS

Future Middle Class Series

Dēmos

IASP

About Dēmos

Dēmos: A Network for Ideas & Action is a nonpartisan public policy research and advocacy organization committed to building an America that achieves its highest democratic ideals. We believe this requires a democracy that is robust and inclusive, with high levels of electoral participation and civic engagement; an economy where prosperity and opportunity are broadly shared and disparity is reduced; and a strong and effective public sector with the capacity to plan for the future and provide for the common good. Founded in 2000, Dēmos' work combines research with advocacy—melding the commitment to ideas of a think tank with the organizing strategies of an advocacy group.

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

Miles S. Rapoport, President
Tamara Draut, Director, Economic Opportunity Program

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

The Future Middle Class Series and the Middle Class Security Index

By a Thread: The New Experience of America's Middle Class is the first biennial 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. *By a Thread* is the fourth 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 series will examine America's opportunity infrastructure related to trends in demographics, access to higher education, healthcare, debt, assets and housing, and economic inequality.

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

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EXECUTIVE SUMMARY

The middle class is a social and economic cornerstone of the United States and a symbol of the "American way of life." It is also seen as a key part of the engine that drives American prosperity. The middle class provides the skilled workers and consumer purchasing power essential to a strong economy. The quality of life associated with being middle class also fuels aspirations of social mobility.

When we think of the middle class, we think of having financial security, raising a family with a reasonable standard of living, building a solid future for the next generation, receiving quality healthcare, and retiring in comfort. This type of security does not just happen. Rather, it is supported by a range of factors. Middle-class families need to have:

- Financial assets sufficient to develop a safety net in case of job loss or serious illness, build a solid nest egg for a secure future and comfortable retirement, and help children get off to a good start toward economic security;
- The education necessary to find a good job in today's competitive global economy;
- Incomes that make it possible to afford quality housing and other essential living expenses; and
- Comprehensive, high quality, affordable healthcare for all family members to ensure that care is available when needed and that financial stability is not eroded in case of serious illness.

We have created a Middle Class Security Index that provides a comprehensive portrait of how well middle-class families are faring in each of these areas. This report, *By a Thread: The New Experience of America's Middle Class,* is the first report in a series to present findings using this new Index.

Our Middle Class Security Index can be likened to a common cholesterol test. Such tests measure a variety of factors and determine whether an individual's overall profile supports cardiovascular health, puts that individual at high risk for a heart attack or stroke, or leaves him or her somewhere in between.

For each area measured by our Index—education, assets, housing, budget and healthcare—we set a threshold that would be optimal to support overall financial health (or financial security) and a threshold that would threaten it. We then determined what percentage of families considered middle class by income met each of these thresholds.

If three or more of the factors in a family's profile supported financial health, we considered that family to be securely middle class. If three or more of the factors in a family's profile threatened that family's financial security, we considered them to be at high risk for slipping out of the middle class.

Our Index results spotlight the strengths and vulnerabilities of the middle class. In this report, we use these results to identify barriers to financial security and to begin formulating policy solutions that would enable the broad majority of American families to enjoy a stable middle-class life.

Highlighting the strengths and weaknesses of America's middle class not only clarifies what is needed to bolster it, but also elucidates how we can further assist families in achieving upward mobility and higher levels of stability and security. Our Middle Class Security Index shows troublesome trends.

OVERALL ECONOMIC SECURITY

- Only 31 percent of middle-income families match our profile for being securely middle class. That is, despite falling into the broad range that defines middle-class "income," fewer than one in three families has the necessary combination of other factors to ensure middle-class security.
- Our Index results vary by race. Thirty-four percent of white middle-income families are securely in the middle class, as compared to 26 percent of African-American middle-income families and only 18 percent of Latino middle-income families.
- One in four middle-class families matches our profile for being at high risk of slipping out of the middle class altogether.
- One in five (21 percent) white families is at high risk for slipping out of the middle class, as compared to one in three (33 percent) African-American headed households and an alarming two in five (41 percent) Latino families.

LACK OF ASSETS

- More than half of middle-class families have no net financial assets whatsoever—that is, no financial assets or debt levels that exceed their assets.[1]
- Only 13 percent of middle-class families have sufficient assets to meet three-quarters of their essential living expenses for nine months, should their source of income disappear.
- About four out of five middle-class families do not have sufficient assets to cover three-quarters of essential living expenses for even three months should their source of income disappear. We defined essential living expenses as food, housing, clothing, transportation, health care, personal care, education, personal insurance and pensions.[2]
- Middle-class families have a median debt of $3,500 and median net assets of $0.

INSUFFICIENT INCOME TO MEET LIVING EXPENSES, COVER HOUSING COSTS, AND BUY HEALTHCARE

- Twenty-one percent of middle-class families have less than $100 per week ($5,000 per year) remaining after meeting essential living expenses. These families are living from paycheck to paycheck with very little margin of security.
- In nearly one out of four middle-class families (23 percent), at least one family member lacks health insurance of any kind.
- Twenty-eight percent of middle-class families spend 30 percent or more of their income on housing expenses, putting them above federal guidelines for housing affordability.

EDUCATION

- Twenty-seven percent of middle-class families do not have any education beyond high school, placing them increasingly at risk in a rapidly developing global economy where higher education skills have become fundamental to achieving middle-class status.

By a Thread also recommends a set of policies that will help open access to, and strengthen, America's middle class. Legislative proposals in this report cover a range of important issues affecting American households, including asset building and debt reduction, making higher education more accessible and affordable, and addressing the healthcare crisis. Additional briefing papers in this series will examine middle class security by race, age and income demographics. The Middle Class Security Index will be updated biennially, with accompanying reports, as new statistical data is made available.

INTRODUCTION

The middle class is a celebrated example of the nation's belief in success won from hard work. It defines the American way of life and its existence inspires millions to achieve what those who came before them could not. It is also an integral part of the American economy, providing the skilled workers and purchasing power that position the country as a strong force in the global economy. Yet, the middle class did not just emerge. Rather, it was created through deliberate policy measures and investments as well as a strong demand for U.S. products in the years following World War II.

After World War II, educational attainment rose as the GI Bill and Higher Education Act of 1965 increased college access and affordability. Homeownership increased as government programs enabled more people to obtain home loans, made mortgage interest tax deductible, promoted suburban housing development, and enacted reforms targeting discriminatory lending practices. Income and wealth grew as legislation raised the minimum wage to a historic high in 1968 and public policy fueled the economy by ensuring a tight labor market, promoting full employment, and facilitating union organizing.

These postwar policy efforts and investments, combined with the commitment of employers to provide health and pension benefits, created a system through which millions of Americans could enter the middle class. Under the postwar social contract, companies provided job stability, regular increases in pay, and social insurance protection. Workers reciprocated this loyalty through long job tenure and an investment in the quality of the goods and services they produced. While benefiting labor and business, the positive effects of this system were felt across sectors of American society and throughout the economy.

THE MIDDLE CLASS DID NOT JUST EMERGE...IT WAS CREATED THROUGH DELIBERATE POLICY MEASURES AND INVESTMENTS. (BUT) THE STRUCTURES THAT PROVIDE OPPORTUNITY HAVE WEAKENED.

Over the last three decades, the structures that provide opportunity have weakened. For many hard-working Americans, they have disappeared altogether. The activist policies of the postwar era that built the middle class have given way to a laissez-faire approach to the economy. Consequently, dramatic, growing gaps between the rich and poor have emerged. Global competition has grown fiercer and the clout of an organized workforce has been diminished.

Many of the good jobs that ensured widespread prosperity in the past are migrating overseas. The cost of a standard middle-class life—a home, healthcare, a college education—has soared in recent years, outpacing growth in incomes. As a result of these changes, it is becoming increasingly difficult for Americans to enter and remain in the middle class. The costs of essentials like housing, healthcare, transportation and college continue to rise much faster than inflation and, most importantly, much faster than the incomes of 80 percent of American families. The recent mortgage crisis and overall instability in the housing market have turned the dream of homeownership into a nightmare for many.

We have created a new measurement, a Middle Class Security Index, to examine how the middle class is faring under the erosion of programs and initiatives that provide social mobility. In order to ensure long-term financial stability for middle-class Americans while also guaranteeing economic opportunity for those who aspire to social mobility, our Index looks beyond income and considers several major factors that contribute to building a middle-class life. As a result, the Index shows how secure the middle class really is, the nature of its weaknesses, and what factors strengthen or destabilize it.

The Index identifies and examines five factors that play a role in ensuring financial stability.

1. Families need to have the **education** level necessary to find a good job.
2. Families must be able to afford their **housing costs**.
3. They must also be able to cover their **essential living expenses**.
4. Families must hold enough **financial assets** to provide a safety net for troubled times and a nest egg for the future.
5. All family members must have adequate **health insurance** to ensure that financial stability is not eroded in the event of an unforeseen illness.

Measuring Middle Class Security

We used data from the Department of Labor's 2004 Consumer Expenditure Survey (CEX) to examine the level of financial security enjoyed by families whose income level can be considered middle class. There are multiple ways to define what constitutes a middle-class income. For the purposes of our Index, families were considered to have middle-class incomes if their household earnings fell within a range that was at least two but no more than six times the Federal Poverty Guideline for their family size. Federal Poverty Guidelines allowed us to adjust for family size. We eliminated families with substantial personal wealth— those whose net financial assets placed them in the top 1 percent of asset holders.

Our income qualifier captured families in roughly the 26th to 80th income percentiles. Under 2006 guidelines, more than two but less than six times the Federal Poverty Level translates to a family of four earning at least $40,000 but no more than $120,000. Eliminating the top 1 percent of asset holders meant that no one in our middle-class sample had more than $500,000 in net financial assets. We also restricted our sample to individuals between ages 25 and 64 to capture the working-age population.

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.)

In our final middle-class sample, the majority of respondents were married (65 percent) and lived in urban areas (85 percent). The average age was 44 and the average family size was 2.8. Seventy-six percent of the sample was white (non-Hispanic), followed by African American (10.5 percent), Latino (8.8 percent), Asian (2.5 percent), multi-racial (1.2 percent), Native American (0.6 percent), and Pacific Islander (0.5 percent).

Our Middle Class Security Index takes an approach similar to that of common cholesterol tests. Such tests examine a variety of factors and determine whether an individual's overall profile supports cardiovascular health, puts that individual at high risk for a heart attack or stroke, or leaves him or her somewhere in between. Our analysis focused on five factors—assets, education, housing, budget and healthcare. For each factor measured by our Index, we set an optimal threshold for overall financial health (or financial security) and a vulnerability threshold. We

then determined what percentage of families considered middle class by income met each of these thresholds.

If three or more of the factors in a family's profile supported financial security, we considered that family safely middle class. If three or more of the factors in a family's profile threatened financial security, we considered the family 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. However, they still lack the basic components for safeguarding their financial security.

Index Categories

Securely in Middle Class	Optimal in 3 or more factors that support financial security
High Risk for Slipping Out of Middle Class	Threatened/At Risk in 3 or more factors that support financial security
In between these two groups is a middle ground where families are not at immediate and high risk for falling out of the middle class yet still lack the basic components for safeguarding their financial security.	

In setting many of our thresholds for each factor of the Index, we relied on precedents set by previous research or public policy. In determining others, we made reasonable judgments based on the research and policy experience of the authors and their colleagues.

ASSETS

Much research now shows that financial assets are a linchpin of middle class security. A lack of assets not only makes it harder for many families to secure their position in the middle class, but also affects the ability of their children, and their children's children, to secure such a position in the coming decades. This is because assets have what has been called a "transformative power" in transmitting financial stability and security across generations. This transformative power gives current generations an important safety net and future generations a head start. A family with assets is better able to support children through college, to make a down payment on a house, to invest, and to weather unpredictable economic circumstances, such as job loss or illness. In addition, some studies suggest that asset ownership leads people to develop attitudes that are commonly associated with being middle class, such as participating more in civic life and expecting that one's children will go on to college.

We based our asset factor on the number of months a family could meet three-quarters of its essential living expenses—in the absence of employment income—using just net financial assets. We defined net financial assets as financial assets minus debt. Financial assets excluded home equity but included savings accounts, checking accounts, brokerage accounts, U.S. savings bonds, securities such as stocks, mutual funds and bonds, and money owed to a member of the household. Debt included 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 defined essential living expenses as food, housing, clothing, transportation, health care, personal care, education, personal insurance and pensions.[3]

We use three-quarters of essential living expenses as our yardstick because we assumed that families would make sacrifices and adjust their expenditures to weather temporary hardship. Our threshold is designed to measure the personal safety net provided by assets and does not take into account public benefits like unemployment. In our definition, the optimal level of net assets would allow a family to cover three-quarters of its essential living expenses for at least nine months. A family's financial security was considered at risk if it did not have sufficient net assets to cover three-quarters of its essential living expenses for even three months.

EDUCATION

As the difference in earnings between high school and college graduates hits record levels, a college degree is becoming a minimum requirement for the middle class. Over the course of a lifetime, a graduate of a 2-year college earns about $275,000 more than someone with only a high school diploma. Someone with a degree from a 4-year college earns nearly double. A 4-year degree translates to around a $1,000,000 more in lifetime earnings.[4]

Greater earning potential means greater likelihood one will be able to own, save and invest—in short, to pursue middle-class security. The correlation between education level, income and ownership will undoubtedly continue in the future. In the past, a worker with a high school diploma, solid work experience, and stable employment could support a family and attain middle-class security. Because of changes in the labor market, this is rarely the case today.

It is difficult to imagine that workers holding only high school diplomas will be able to support families and achieve security within 20 years. For this reason, our optimal education threshold was set at requiring the head of the household or spouse to have a bachelor's degree. Financial security was considered at risk if neither the head of the household nor spouse had education beyond a high school diploma.

THE COST OF A STANDARD MIDDLE-CLASS LIFE—A HOME, HEALTHCARE, A COLLEGE EDUCATION—HAS SOARED...OUTPACING INCOMES. IT IS BECOMING INCREASINGLY DIFFICULT FOR AMERICANS TO ENTER AND REMAIN IN THE MIDDLE CLASS.

HOUSING

Our housing factor is based on the definition of housing affordability used by the Department of Housing and Urban Development (HUD). According to HUD, "the generally accepted definition of affordability is for a household to pay no more than 30 percent of its annual income on housing. 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] The housing expenses we measured included mortgage principle and interest, rent, insurance, taxes, maintenance, utilities, fuels and public utilities.

To capture those families most able to afford their housing, we set our optimal threshold at spending less than 20 percent of after-tax income on housing. This conservative figure is linked to financial security because it allows families far greater potential to target more of their income for future education, retirement or asset-building needs. We considered spending 30 percent or more of after-tax income on housing as a threat to financial security.

BUDGET

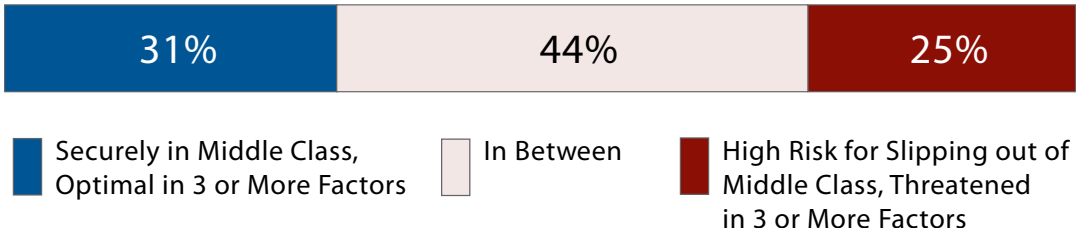
Our budget factor is based on the amount of money a family has left each year after paying taxes and meeting essential living expenses. A family with $25,000 or more left over after meeting its expenses was considered to have an optimal budget. This translates to having about $480 left over per week. Families with less than $5,000 left over, which translates to less than $100 per week, were considered financially at risk in terms of their budgets.

HEALTHCARE

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. Nearly half of the families who filed for bankruptcy in 2001 did so because of health-related expenses.[6] Most of those filing for medical bankruptcy were middle class, as were those suffering from financial hardship due to medical expenses. Mounting evidence of the severe financial consequences for the uninsured convinced us to set our optimal healthcare threshold at insurance coverage for every member of the household. Having even one family member uninsured was considered a risk to financial security.

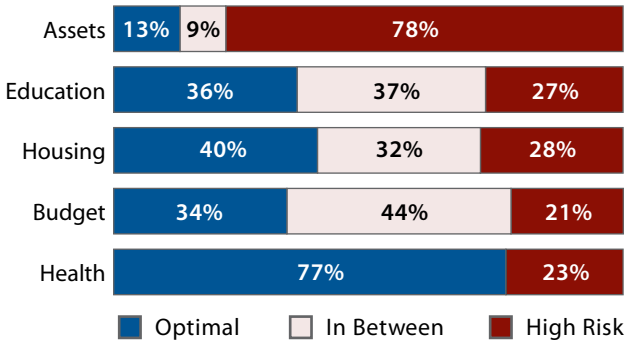
The Index: How Secure Are You?

MIDDLE CLASS SECURITY INDEX



The Middle Class Security Index shows that only 31 percent of middle-class families match our profile for being securely in the middle class. In other words, less than a third have the majority of optimal factors in place with regard to assets, education, housing, budget or healthcare. This means that 69 percent of middle-class families lack the basics they need to ensure financial security. In fact, the typical middle-class family has only two of the five optimal factors it needs to support financial security. Twenty-five percent of families measured by the Index match our profile for being at high risk of slipping out of the middle class altogether and face serious threats to their financial security. Forty-four percent of middle-class families find themselves somewhere on the border between being financially secure and being at risk of losing their middle-class status.

Financial Security Profile of the Middle Class, by Factor



Number of factors in which middle-class families match optimal thresholds

0	7%
1	28%
2	33%
3	22%
4	8%
5	1%

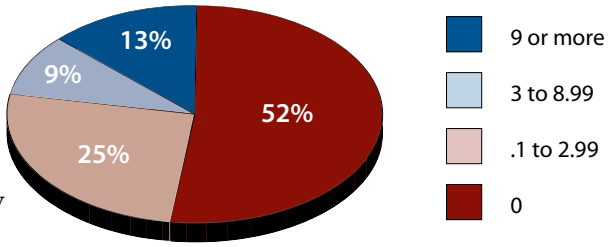
Factors Influencing Middle Class Economic Security

	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

THE ASSET GAP: AS THE HOUSEHOLD SAFETY NET DISAPPEARS, SO DOES OPPORTUNITY

According to the Middle Class Security Index, only 13 percent of middle-class families match our profile for optimal financial assets. These families have sufficient net financial assets to meet three-quarters of their essential living expenses for nine months or more if their source of income disappeared. Nearly four out of five middle-class families (78 percent) match our at-risk profile. They do not have sufficient net assets to meet three-quarters of their essential living expenses for even three months should their source of income disappear. Nine percent of middle-class families have enough net financial assets to cover three-quarters of their essential living expenses for between three and nine months.

Number of Months the Middle Class Can Meet Three-Quarters of Essential Living Expenses Using Net Financial Assets Only



Fifty-two percent of middle-class families have no net financial assets at all and therefore could not meet three-quarters of their essential expenses for any length of time. On average, a middle-class family has a monthly before-tax income of $4,898[7] and spends $3,360 per month on essential living expenses.[9] Housing constitutes $1,158 of those expenses per month.[10] The average middle-class family is $8,328 in debt and holds net financial assets of $9,918. Middle-class families have a median debt of $3,500 and median net assets of $0. This debt includes student, medical and personal loans, and credit card debt. It does not include mortgages or vehicle or business loans.

EDUCATIONAL ACHIEVEMENT: THE (BARELY CRACKED) DOOR TO THE MIDDLE CLASS

As the difference in earnings between high school and college graduates hits record levels, a college degree is becoming a minimum requirement for entry into the middle class. Over the course of a lifetime, a graduate of a 2-year college earns about $275,000 more than someone with only a high school diploma. An individual with a 4-year college degree earns nearly double that amount. A four-year degree translates to about $1,000,000 more in lifetime earnings.

Greater earning potential means greater likelihood that one will be able to pursue middle-class financial security by owning, saving and investing. The correlation between education level, income and ownership will undoubtedly intensify in the future. In the past, a worker with a high school diploma, solid work experience, and stable employment could support a family and achieve middle-class security. Because of changes in the labor market, this is rarely the case today.

Our Index shows that in 36 percent of middle-class households there is at least one individual with a bachelor's degree or higher, our optimal education criterion. More than one out of four (27 percent) middle-class households are at high risk in terms of this factor, meaning that neither the primary earner nor the spouse has education beyond high school. In 36 percent of households, at least one individual has at least some college or has earned an associate's degree.

THE CHALLENGE OF MAKING ENDS MEET: HOUSING AND INCOME TO MEET BASIC FAMILY NEEDS

According to our Index, 28 percent of middle-class households spend 30 percent or more of their before-tax income on housing expenses. This means that more than one in four middle-class families meet the Department of Housing and Urban Development's criteria for fiscal "housing burden" and match our criterion for being high risk in the housing factor. Forty percent of middle-class families spend less than 20 percent of their income on housing, meeting our optimal housing criterion. Thirty-two percent of households spend between 20 and 30 percent of their before-tax income on housing.

While 34 percent of middle-class families have $25,000 or more left over each year (about $480 per week) after paying income tax and meeting their essential living expenses, more than one in five (21 percent) have less than $100 per week ($5,000 per year). Forty-four percent of middle-class households fall in between these two groupings.

ONLY 13 PERCENT OF MIDDLE-CLASS FAMILIES MATCH OUR PROFILE FOR OPTIMAL FINANCIAL ASSETS; 78 PERCENT MATCH OUR AT-RISK PROFILE.

ILLNESS AND THE AMERICAN DREAM: THE RISK OF NOT HAVING HEALTH INSURANCE

It seems almost given that a middle-class worker should be covered by health insurance, but in an alarming trend, this is less the case. The number of middle-class families turning to public health insurance due to a loss of private coverage or the inability to pay high premiums is growing. Eight to 10 million Americans lost their employment-based health insurance coverage in the last three years alone. According to our research, 77 percent of middle-class families meet our optimal healthcare criterion, being fortunate enough to have all family members covered by either private or government health insurance. However, nearly one in four (23 percent) middle-class families are at high risk, having at least one member who lacks health insurance of any kind. Elsewhere in this report we briefly discuss the adequacy of insurance and suggest that many middle-class families are *underinsured*.

Looking Forward

In this report, we have applied the Index to the middle class as a whole. Future reports will look more closely at financial stability and vulnerability by a range of demographic characteristics. We discuss ideas for future work below.

INCOME

This report focuses on sources of strengths and weaknesses within the middle class. However, we could also explore more deeply the significance of family income on each indicator of economic security. For each factor we studied, the percentage of families who are secure increased progressively with income level. Conversely, family vulnerability heightened as income levels decreased. This effect of income on security is present within the middle class as well as among those still struggling to get into it. One in four middle-class families is vulnerable in the majority of areas we measured. This proportion climbs to 42 percent when we look at families at the lower rungs of the middle-class income spectrum, those whose earnings are $40,000 to $60,000 for a family of four. The proportion climbs to more than three out of four families when we look at those earning less than middle-class incomes.

RACE

A forthcoming report will examine the financial security characteristics of Latinos and African Americans more closely. The population of these groups is growing rapidly but individual households have significantly fewer opportunities than whites to enter the middle class. Our Index shows that African Americans and Latinos are less likely to enjoy long-term middle-class financial security than whites. These groups are also significantly more likely to be in danger of slipping out of the middle class.

Only 34 percent of white middle-class families enjoy long-term financial security. This figure is even lower for African American and Latinos. Only 26 percent of African-American families and 18 percent of Latino families enjoy long-term financial security. Twenty-one percent of white middle-class families exhibit severe vulnerabilities in three or more of the areas measured in our Index, putting them at serious risk for falling out of the middle class. Thirty-three percent of African-American families and 41 percent of Latino families are in danger of losing their middle-class status.

OTHER AREAS

Future work could also examine the long-term trends impacting middle-class security and demonstrate the impact of policy changes designed to bolster the components measured by the Index. Such policy changes might include creating laws that cap interest rates charged by credit card companies, reforming health insurance, and enacting living wage laws.

Specialized training and certificate programs offered by community colleges may provide an important credential that employers can consider when making hiring and wage decisions. With these types of credentials on the rise, future Index analyses could incorporate a broader definition of education to include such credential-granting programs.

We also hope to explore health coverage in greater depth by examining households that are underinsured as well as *uninsured*. Additional analysis might include identifying key characteristics—such as age, family size, or education level—associated with security in each Index category along with overall security and vulnerability.

POLICIES TO STRENGTHEN THE MIDDLE CLASS

Middle-class financial security eludes an estimated 70 million American working-age households. These households either have earnings that fall below middle-class incomes (below 200 percent of the poverty line) or have middle-class incomes but are not financially secure.[10] The erosion of financial security did not occur overnight, and it should not persist. Action is needed to stabilize and strengthen the ability of all families to support themselves, build a solid future for the next generation, be cared for when ill, and retire comfortably.

The following policy recommendations are focused on addressing the most dramatic cases of vulnerability among the middle class and are not intended to serve as a comprehensive agenda aimed at reversing decades of stalled mobility and declining economic security. In order to both strengthen and grow America's middle class, other strategies will be critical, particularly reforms that restore fairness to the tax system and strengthen the collective bargaining rights of workers. Future reports on each of the five components that comprise economic security will provide more detailed policy directions.

1. BUILDING ASSETS AND REDUCING DEBT

Nearly four out of five families earning a middle-class income do not have sufficient assets to survive for just three months should their income source fluctuate or disappear. In the absence of such a safety net—due in part to shrinking incomes—many middle-income families are borrowing to make ends meet. They turn to credit cards to meet basic budgetary expenses such as food, housing and healthcare. This creates a dangerous cycle that families find difficult to escape. Fueled by the steady deregulation of the financial services industry, credit card companies increasingly charge excessive interest rates and fees, making it harder for families to get out of debt and back to securing a better future.

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. Even homeownership—the most common source of wealth for most families—has become more precarious. In 2006, the National Association of Realtors estimated that 45 percent of first-time homebuyers put $0 down. Amid declining incomes and inflated home prices, today's young families—the next middle class—are carrying higher mortgage debt than ever or finding it difficult to put aside the funds needed to make the all-important life investment of purchasing a home.

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.[11] 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 2.9 percent of the tax benefits while the richest 10 percent receive 59 percent. Meanwhile, the "bottom" 60 percent receive a meager 3 percent of this investment budget.

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 col-

lege and a downpayment on a home. We also need a set of policies that would address abusive and predatory lending practices.

- ***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. Lastly, 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 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. Finally, Congress needs to establish a rescue fund to directly help households currently facing foreclosure as a result of aggressive and predatory subprime mortgages with no regard for their ability to repay.
- ***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.

2. MAKING HIGHER EDUCATION MORE ACCESSIBLE AND AFFORDABLE

Education is a key to middle-class security in an economy where most of the well-paying jobs require at least some college and where a 4-year degree is steadily becoming the minimum requirement to enter and stay in the middle class. Tomorrow's middle class will need to be more highly educated than today's. Yet, access to higher education has become more elusive and expensive in the last decade. As tuition has soared, rising faster than both inflation and family income, more students have been unable to afford college. At the start of the millennium, over 400,000 college-qualified high school graduates from low- and moderate-income families did not enroll in a 4-year college, and 168,000 did not enroll in any college at all. These statistics translate into frustrated dreams today and a weaker middle class tomorrow. America needs bold new efforts to increase access to higher education. At the same time, those students who do enroll in and complete college are taking on increasing amounts of student loan debt. Today, two-thirds of college graduates borrow to pay for school and graduate with an average of $19,200 in student loan debt. Students from lower-income families are more likely to borrow and at higher amounts—making their entry into the middle class even more precarious.

Expanding and strengthening the middle class today and in the future will demand that our nation redouble its efforts to make college affordable and accessible. The core of this effort must address the weakening of the federal financial aid system, which over the last two decades has shifted away from a grant-based system to a debt-based system.

- ***Strengthen the Federal Financial Aid System*** by enhancing grant aid for low- and middle-income students and providing early and upfront knowledge of the financial aid available to families starting as early as 7th grade. Dēmos has developed a proposal based on these principles—*The Contract for College*—that would dramatically reduce student loan debt and increase college-going rates by providing a guaranteed financial aid package of loans, grants and work-study based on sliding scale system in which grant-aid would cover from 75 percent of the total costs of attendance for the lowest income students to 40 percent of the cost of attendance for middle-income students.

3. ADDRESSING THE HEALTHCARE CRISIS

Today, in nearly one in four middle-class families, at least one family member lacks health insurance, placing families at both physical and financial risk. In addition, other research indicates that the cost burden on middle-class families in the form of higher out-of-pocket expenses has also risen dramatically in the last decade. 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] Health 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

The United States faces major challenges in sustaining a strong middle class in the decades ahead. Rapidly changing, often volatile economic conditions are making it more difficult to enter the middle class—and stay there. However, a bleak future is far from inevitable. With less than one-third of middle class families actually secure in that status, we can and must choose to invest in programs and policies that support the stabilization and expansion of the middle class. These investments will require making difficult choices, but they are worth the effort. A strong, well-educated and prosperous future middle class is essential to ensuring that the American way of life is sustained well into this century.

Our nation has a history of supporting the middle class through public policy that encourages economic opportunity and rewards hard work. We must build on that history as well as improve upon it. We can do this by renewing our focus on supporting a strong middle class and ensuring that our efforts are extended equally to all Americans.

THE NEED FOR FURTHER STUDY OF HEALTHCARE

Data from the Consumer Expenditure Survey show that 77 percent of middle-class households are fully insured while 23 percent have at least one member who is not insured. In this study, we consider the 77 percent of middle-class households where all members are insured as health secure and the 23 percent of households with at least one uninsured person as health vulnerable. But a significant number of middle-class households, including many that are fully insured, do not consider themselves health secure. They feel vulnerable to losing their insurance, having to pay more for insurance premiums, paying out of pocket for costs that are not covered, and being inadequately protected in the event of a serious illness.

Health care costs are continuing to rise much faster than inflation. In response, employers are beginning to look for ways to cut their health insurance costs. These include cutting employer-sponsored health insurance entirely or reducing the number of employees that are covered, changing to lower cost policies with less benefits, requiring employees to pay a higher share of premium costs, or raising co-pays and deductibles.

In addition to the impact of being uninsured, future reports will look at the impact of underinsurance on health security. They will also look at multiple factors that determine health security: health benefits that are covered; premiums that are paid by the household; out of pocket costs for co-pays and deductibles; and health status. A report by the Kaiser Commission on Medicaid and the Uninsured provides insight into these issues and reasons why many middle-class families do not securely feel they can get high quality, affordable health care when they need it.

- The number of uninsured adults under 65 years of age increased by 6.3 million from 2000 to 2004, largely the result of a 5 percentage point drop in the number of adults covered by employer-sponsored insurance. If this trend continues, fewer middle-class families will be health secure.
- In many cases, people who lose insurance will not be covered for "pre-existing conditions" when they get new insurance, putting families where one or more people have a serious illness at great risk.
- The number of uninsured middle-class non-elderly adults with incomes above 200 percent of the poverty level increased by 2.1 million in four years.
- A significant number of middle-class people below 65 years of age are insured but are covered by Medicaid or private non group insurance, an indicator of reduced security. Fifteen percent are between 200 and 299 percent of the poverty level, 11 percent between are between 300 and 399 percent of poverty level, and 8 percent are at 400 percent of the poverty level or above.
- Health status is a major factor in health security or fragility. Even the best insurance leaves families with high out-of-pocket cost in the event of a serious illness. The Kaiser Commission study found that 5 percent of people with employer-sponsored or other private insurance, 9 percent of the uninsured, and 20 percent covered by Medicaid or other state programs only had fair or poor health.

Endnotes

1. 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. Personal insurance and pensions are considered one variable in the dataset we used to create the Index.
3. Personal insurance and pensions are considered one variable in the dataset we used to create the Index.
4. Jennifer Cheeseman Day and Eric C. Newburger, *The Big Payoff: Educational Attainment and Synthetic Estimates of Work-Life Earnings* (U.S. Census Bureau, July 2002), http://www.census.gov/prod/2002pubs/p23-210.pdf.
5. See http://www.hud.gov/offices/cpd/affordablehousing/.
6. Elizabeth Warren, "Medical Bankruptcy: Middle Class Families at Risk," Testimony before the House Judiciary Committee (July 17, 2007), http://judiciary.house.gov/media/pdfs/Warren070717.pdf.
7. Before-tax income: combined income earned by all consumer unit members 14 years old or over during the 12 months preceding the interview, including wage and salary income, business income, farm income, Social Security income and Supplemental Security income, unemployment compensation, workmen's compensation, public assistance, welfare, interest, dividends, pension income, income from roomers or boarders, other rental income, income from regular contributions, other income, and food stamps.
8. Housing expenses: mortgage principle and interest for owned home and/or vacation homes, rent, insurance, taxes, maintenance, utilities, fuels and public services.
9. We calculated this number by adding the population estimates for the number of working age households with incomes below 200% of poverty and the number of middle class households who do not meet our criteria for financial security.
10. 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.
11. Cindy Zeldin and Mark Rukavina, "Borrowing to Stay Healthy: How Credit Card Debt is Related to Medical Expenses" (Demos and the Access Project, Winter 2007).

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