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## Preface

From Jacob Hacker, *The Great Risk Shift*

*THE GREAT RISK SHIFT* tells a story that more and more of us are coming to know and yet few of us still fully comprehend—the story of growing economic insecurity in the United States. The story is elusive for many reasons: It is so starkly at odds with our nation’s evident prosperity. It reaches across so many different areas of our lives—our jobs, our families, our retirement, our health care. And it’s a story we have heard only in terms of single issues: how we are more at risk of job layoffs than we once were, or how we are increasingly responsible for our own retirement, or how Health Savings Accounts might make us sole providers for our own health care. But while we know something larger is going on, we have no common language and few reliable indicators for linking these fragmented pieces together and understanding why they make us feel so insecure.

I wrote this book to change that. Using new evidence that unlocks the puzzle of growing insecurity, I show how more and more economic risk has been offloaded by government and corporations onto the increasingly fragile balance sheets of workers and their families. This fundamental transformation, which I call the “Great Risk Shift,” has affected Americans of every walk of life, class standing, and political persuasion. It connects the insecurities of

the new workplace, the strains facing modern families, the rising uncertainties of retirement, and the growing gaps in American health insurance. It is at the root of Americans' rising anxiety about their economic standing and future. And it is at the heart of the biggest debates over domestic policy that now dominate our polarized politics.

The Great Risk Shift is not just an economic change; it is also an ideological change. For decades, Americans and their government were committed to a powerful set of ideals—never wholly achieved, never without internal tension—that combined a commitment to economic security with a faith in economic opportunity. Animating this vision was a conviction that a strong economy and society hinged on basic financial security, on the guarantee that those who worked hard and did right by their families had a true safety net when disaster struck. Social Security, Medicare, private health insurance, traditional guaranteed pensions—all sent the same reassuring message: someone is watching out for you, *all of us are watching out for you*, when things go bad.

Today, the message is starkly different: *You are on your own*. Private employment-based health plans and pensions have eroded, or been radically transformed, to shift more and more risk onto workers' shoulders. Government programs of economic security have been cut, restructured, or simply allowed to grow ever more threadbare. Millions of Americans lack health insurance. Millions more lack guaranteed retirement benefits. Our jobs and our families are less and less financially secure.

And yet what do our political leaders tell us? They tell us we need to take "ownership" of our economic future, giving up the security of insurance in favor of individualized private accounts that leave us at the mercy of market instabilities precisely when we most need stability. They tell us that millions of middle-class Americans who are declaring bankruptcy or losing their houses are failing to take "personal responsibility" for their lives. They tell us the economy is "strong and getting stronger," when for most of us it has only grown more uncertain and insecure. Or they tell us, with a fatalism that scarcely befits a nation built on optimism

and hope, that there is nothing that can be done. Our economy is insecure. Deal with it.

It is indeed time to deal with it. But the solution is not to shift more and more risk onto Americans' already burdened shoulders. I wrote this book because there is a real alternative to the Great Risk Shift, a vision that I call an "insurance and opportunity society." An insurance and opportunity society is based on a simple but powerful notion: We are most capable of fully participating in our economy and our society, most capable of taking risks and looking toward our future, when we have a basic foundation of financial security. Economic security is not opposed to economic opportunity; it is its cornerstone. And restoring a measure of economic security in the United States today is the key to transforming the nation's great wealth and productivity into an engine for broad-based prosperity and opportunity in an ever more uncertain economic world.

To see the future, however, we must first understand the past. For more than a decade, I have been studying the history and structure of America's distinctive framework of economic security: how it came into being, why it differs from what is found in other nations, what its strengths and weaknesses are, and how it can be made stronger. I have surveyed the experience of other nations and delved into our own conflicted history. I have amassed statistics and stories that show how our system of economic protection works, and why it sometimes works so poorly. I have talked with experts and everyday people about where we have come from and where we might yet go. And I have been shocked by how swiftly our framework of economic security is crumbling in the face of changing realities and fierce but largely misdirected criticism. If we do not make the investments necessary to build an insurance and opportunity society today, we will face far higher costs and far greater social dislocation in the years to come.

An insurance and opportunity society does not mean clinging stubbornly to institutions of the past when they no longer work. It does not mean insuring Americans against every contingency or ignoring the need for responsibility and thrift. What it calls on us

to do—all of us—is to reconstruct our framework of economic security on a new and stronger foundation for the twenty-first century, so that every person stirred by the promise of this great nation can have the confidence to reach for and achieve the American Dream.

## THE GREAT RISK SHIFT

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# Introduction

## On the Edge

ANDREA CASE PAUSES on the other end of the line to compliment her nine-year-old son, Jack, who is proudly displaying a handful of fish that he has dredged from the river that runs behind their suburban New Jersey home. Besides overseeing Jack's impromptu fishing expedition, Andrea is pushing her preschool-aged daughter on the swing, the phone against her ear. It's a now-common scene of modern middle-class motherhood: the multitasking mom managing two kids and an animated conversation at the same time. Yet Andrea's life isn't as tranquil as it seems, and the person on the other line isn't her husband or babysitter or friend. It's a researcher asking her about her recent experience with economic insecurity. And that researcher, competing with clamoring kids and gasping fish for Andrea Case's divided attention, is me.

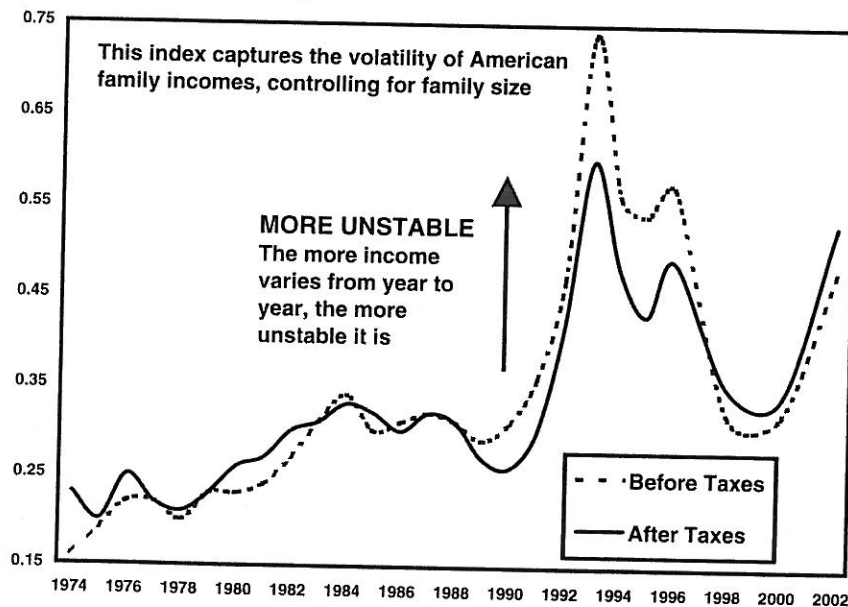
I have called Andrea in response to an e-mail that she wrote me in January 2004, just after I published an op-ed for the *New York Times* arguing that American families were becoming more economically insecure. The op-ed was titled "Call It the Family Risk Factor," and what was perhaps most notable about the piece was the large line chart that appeared alongside the text (reprinted on the next page, in updated form, as figure 1). The chart, taking up a good chunk of the *Times* op-ed page, showed the post-1970s



trajectory of an abstruse economic statistic: the volatility of American family incomes.<sup>1</sup>

Volatility is an accepted measure of the riskiness of stocks. Rather than showing the level of a stock's return, it shows how uncertain, or risky, those returns are likely to be. And what the skyrocketing line on the chart made clear, even to those unversed in statistics, is that the volatility of family incomes has gone up—way, way up. Americans have gotten richer in the last thirty years (though neither as quickly nor as evenly as commonly believed), but they have also faced rapidly growing economic insecurity. Family incomes now rise and fall ever more sharply. In fact, over the past generation the economic *instability* of American families has actually risen much faster than economic *inequality*—the growing gap between rich and poor that is often taken as a defining feature of the contemporary U.S. economy.

Figure 1: The Rising Volatility of American Family Incomes, 1974–2002



Source: Panel Study of Income Dynamics, University of Michigan; Cross-National Equivalent File, Cornell University.

I had hoped for some response to my op-ed. But writing about complex economic trends (with a graph, no less), I didn't have high hopes. I was wrong: The letters and e-mails poured in. Experts on pension plans wrote to tell me about the risks and challenges that retirement savings accounts like 401(k)s presented. Health policy specialists shared horror stories about the medically uninsured. Economists, including a Nobel laureate, inquired about my evidence.

But most gratifying—and troubling—were the responses from nonexperts who just wanted to share their experiences and views. There was Robert, who had tried to set up a health clinic for the working poor but then succumbed to an unexpected sickness and ended up living “four and a half years of sheer hell” trying to gain assistance from America’s “safety net.” There was Elizabeth, a well-educated consultant who said she “felt responsible for herself” but feared what would happen if either she or her husband were laid off, because, with two kids and unstable incomes, they hadn’t been able to “save to the extent that we have a good safety net.” There was the Yale undergraduate whose middle-class but chronically ill parents couldn’t find a company that would even sell them a health care policy. There were tales of lost jobs and lost income, unexpected setbacks and unwelcome hardships. And then there was the graceful yet angry e-mail of Andrea Case.

“I am in one of the families of which you speak,” Andrea’s note began. Then she proceeded to explain how her husband, a computer engineer, and she had been slammed by the exploding tech bubble. They had watched for months as her husband’s firm sank, both fearing his job would go down with it at any time. The family’s earnings plummeted, but the bills just kept coming: the mortgage payments for their new house, the tuition for the Montessori school they’d enrolled their son in because he had learning problems, statements for the gas, electric, telephone, car, and on and on. In the space of a few months they had gone from taking their lives—and smooth upward path—for granted to worrying about paying the utilities. Their income dropped by more than a third. Andrea went from sleeping soundly to lying awake asking herself tough questions. Should they pull their son from the school? Sell the house?

Should Andrea go back to work—and if so, full time? What about health care? Her husband had eventually jumped to a lower-paying job, but under its stingy health plan, the family had to pay nearly \$10,000 in health premiums and out-of-pocket medical costs.

Their freefall stopped when her husband found another position with better benefits, though even lower pay. Yet Andrea still did not feel secure, and she didn't know where to turn. "Who is the candidate for people like me?" her e-mail closed.

Where is the AARP for families? I feel like we need the equivalent of the Million Mom March to let candidates know that parents with young children are hurting. How can busy, overwhelmed parents be educated and motivated? How can we have our voice heard above those of huge PACs and corporations? I know this is nearly a rant, but I am angry and frustrated and don't know where to turn to be effective in getting the leadership this country needs.

WHEN I FINALLY CATCH UP WITH ANDREA on the phone almost two years later, she is still angry but mostly resigned. She has gone back to work, doing two part-time jobs for extra money—a stint at Barnes and Noble for "incredibly low pay" and no benefits, and a Saturday job at her son's Montessori school. But despite having a master's degree from Harvard, she knows she's off the "career track for a while." Her husband's hours and income have improved, but the family is still stretched thin. Their lives changed in an instant, but the road back has been slow. The recovery still isn't complete.

To Andrea, the shift now stands as a painful marker in her life, a branching point in her hopes and outlook. "Up until then," she explains, speaking of the plummet in her husband's earnings, "everything exceeded our expectations." Out of college, they were riding the upward tide of the tech economy. Their combined income was high enough to allow them to move out of a Manhattan apartment near Battery Park, just a few blocks from the World Trade Center, into a three-bedroom, two-bath home on a cul-de-sac in suburban New Jersey—nothing as spectacular as the big homes with granite kitchens nearby, but grand compared with their old apartment. It also allowed Andrea to leave work to have kids. Then, the stock-market bubble burst, the 9/11 attacks occurred,

her husband's firm started shedding workers, his pay dropped sharply. Everything seemed to come undone at once, and the low seemed all the lower because the high had been so high.

The low seemed lower, too, because their situation was at odds with everything they'd been told: Here they were, college-educated, frugal, responsible—and suddenly facing a very different life than they'd had or thought they'd have. In an instant everything had changed. It was as if their old life had been swept away by a hurricane.

ECONOMIC RISK is a lot like a hurricane. Hurricanes strike powerfully and suddenly. They rip apart what they touch: property, landscape, and lives. They are common enough to affect many, yet rare enough still to shock. And although they can be prepared for, they cannot be prevented. Some people will inevitably suffer and require help; others will be spared. Recovery is inevitably traumatic and slow. And so it is with families whose lives have been touched by economic risk. What happens in an instant may change a life forever.

The comparison is not just metaphorical: For more than half a century, Americans responded to economic risk as if it were a natural disaster largely beyond the control or responsibility of those it struck.<sup>2</sup> In the wake of the Great Depression in the 1930s, which left a "third of the nation," in FDR's famous telling, "ill-housed, ill-clad, ill-nourished," political and business leaders put in place new institutions designed to spread broadly the burden of key economic risks, including the risk of poverty in retirement, the risk of unemployment and disability, and the risk of widowhood due to the premature death of a breadwinner.<sup>3</sup> These public and private institutions did not let the individual off the hook; they required contributions and work and proof of eligibility. But they were based on an ideal known as "social insurance"—the notion that certain risks can be effectively dealt with only through institutions that spread their costs across rich and poor, healthy and sick, able-bodied and disabled, young and old.

Today, however, the social fabric that bound us together in good times and bad is unraveling. Over the last generation, we have

witnessed a massive transfer of economic risk from broad structures of insurance, including those sponsored by the corporate sector as well as by government, onto the fragile balance sheets of American families. This transformation, which I call the "Great Risk Shift," is the defining feature of the contemporary American economy—as important as the shift from agriculture to industry a century ago. It has fundamentally reshaped Americans' relationships to their government, their employers, and each other. Andrea Case's parents never enjoyed the same economic highs that she did, but they had higher expectations of security: a stable middle-class income, a guaranteed pension, good health insurance coverage, greater economic security for their kids. One by one, the Great Risk Shift has dashed these expectations, transforming the economic circumstances of American families from the bottom of the economic ladder to its highest rungs.

One crucial point must be understood from the start: This dramatic transformation isn't a natural occurrence—a financial hurricane beyond human control. Sweeping changes in the global and domestic economy have helped propel it, but America's corporate and political leaders could have responded to these powerful forces by reinforcing the floodwalls that protect families from economic risk. Instead, in the name of personal responsibility, many of these leaders are busy tearing the floodwalls down. Proponents of these changes speak of a nirvana of individual economic management—a society of empowered "owners," in which Americans are free to choose. What these advocates are helping to create, however, is very different: a harsh new world of economic insecurity, in which far too many Americans are free to lose.

ECONOMIC INSECURITY isn't just a problem of the poor and uneducated, as most of us assume. Increasingly, it affects people like Andrea Case: educated, upper-middle-class Americans—men and women who thought that by staying in school, by buying a home, by investing in their 401(k)s, they had bought the ticket to upward mobility and economic stability. Insecurity today reaches across the income spectrum, across the racial divide, across lines of geography and gender. It speaks to the common "us" rather than to the insular, marginalized "them."

To understand the change, we must first understand what is changing. America's distinctive framework of economic protection grew out of specific political struggles and a unique set of values and beliefs. Less expansive than some hoped, more expansive than others desired, it was a curious and sometimes contradictory amalgam of goals and institutions. By the early 1970s, it worked tolerably well in insulating most middle-class Americans from the major financial risks of a dynamic capitalist economy. Today, however, it is falling apart under the weight of political attack and economic change, its conflicting elements falling in on each other, its gaps and traps growing by the day.

It is common to say that the United States does little to provide economic security compared with other rich capitalist democracies. Whether because of a deeply embedded mistrust of government, a constitutional structure that makes big policy reforms hard to achieve, the weakness of the American labor movement, or the depth of American ethnic divisions, the United States has provided infertile soil for the comprehensive welfare states that now dominate the economic landscape of most affluent countries. This is true, but it is only half the story. The United States does spend less on government benefits as a share of its economy, but it also relies more—far more—on private workplace benefits, such as health care and retirement pensions. Indeed, when these private benefits are factored into the mix, the U.S. framework of economic security is *not* smaller than the average system in other rich democracies; it is actually slightly larger.<sup>4</sup> With the help of hundreds of billions in tax breaks, American employers serve as the United States' unique mini-welfare states—the first line of defense for millions of workers buffeted by the winds of economic change.

The problem is that these mini-welfare states are coming undone, and in the process, risk is shifting back onto workers and their families. Employers want out of the social contract forged in the more stable economy of the past. And because they do not need to answer to the broader public that depends on the jerry-rigged systems of security they provide, employers are getting what they want. Meanwhile, America's framework of government support is also strained. Patently inadequate to deal with families' growing

risks, it is nonetheless attacked for costing and doing too much—by critics who claim that the ideal of insurance is both outmoded and harmful to economic growth and advancement.

As private and public support erodes, workers and their families must bear a greater burden. This is the essence of the Great Risk Shift. Through the cutback and restructuring of workplace benefits, employers are seeking to offload more and more of the risk once pooled under their auspices. Facing fiscal constraints and political opposition, public social programs have eroded even as the demands on them have risen. And if critics have their way, these programs will erode even further. The next frontier in the Great Risk Shift is the transformation of existing programs—Medicare and Social Security chief among them—from guaranteed benefits defined by law to individualized private accounts that leave workers and families shouldering more and more of the risks that these programs once covered.

The Great Risk Shift might be less worrisome if work and family were stable sources of security themselves. Unfortunately, they are not. Beneath the rosy economic talk, the job market has grown markedly more uncertain and unstable, especially for those who were once best protected from its vagaries. The family, once a refuge from economic risk, is creating new risks of its own. With families needing two earners to maintain a middle-class standard of living, families' economic calculus has changed in ways that accentuate many of the risks they face. At the same time, families are making greater, and more risky, investments in their futures—in buying a home, in gaining new skills, in raising well-educated children—and they are paying the price when those investments fail.

THE GOAL OF THIS BOOK is to explain why the Great Risk Shift has played out, and how it can be countered. I start by demonstrating how dramatic the rise in insecurity is and dissecting one of its overarching causes, what I call "The Personal Responsibility Crusade"—a political drive to shift a growing amount of economic risk from government and the corporate sector onto ordinary Americans in the name of enhanced individual responsibility and control. Thanks in part to this crusade, even middle-class families are facing greater

insecurity in the workplace, in the balancing of work and family, in planning for retirement, and in obtaining and paying for health care.

The shift of risk within these areas—how it has happened, who and what is behind it, and where it leaves us today—is the heart of my story. Work, family, and public and private benefits have all grown more risky at roughly the same time, which is one reason why the weakening of these traditional sources of security has proved so sweeping and so difficult to address. To take in the full scope of the Great Risk Shift, however, requires considering these transformations one by one: the new world of work, the increasingly risk-bound family, and America's enfeebled public-private framework of health insurance and retirement pensions, in which Americans have invested so much money, faith, and hope. The failures here are not small or fleeting. They are enormous and endemic—and the solutions proposed by the Personal Responsibility Crusade will only make them immeasurably worse.

These deep and worsening problems call for bold solutions. What we need are new ways of allowing families to save and insure against some of the most potent risks to their income, coupled with new ideas for revitalizing American social insurance and providing economic opportunity to all. An "insurance and opportunity society" would emphasize work and responsibility. But it would also provide real protection when families fall from the ladder of economic advancement, encouraging families to look to the future rather than fear the present. The old canard that ensuring security always hurts the economy turns out to be cruelly false. Economic security is vital to economic opportunity, and economic insecurity is one of the greatest barriers between American families and the American Dream.



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## The New Economic Insecurity

I WAS BORN in a small college town in Oregon in the early 1970s—just before the oil shocks, stagflation, and upheaval of the decade. I remember gas lines snaking around the block near my family's rented home, and my mother's dismay as prices in the supermarket, like unemployment, just kept rising. Underlying the surface calm was a growing unease—a sense that the nation was unsettled. My first real political memory was the Iranian hostage crisis; the first election I remember was Reagan's rout of Carter in 1980. What I didn't realize as I rode my red Raleigh bike through the quiet streets of my neighborhood was that a larger shift was also occurring in the wider world. An era was ending. A thirty-year period of shared prosperity in the United States was giving way to a new age of insecurity.

Today, the Internet, newspapers, and the airwaves are filled with debates over American national security. Yet a different kind of security threat, the kind many of us got our first taste of in the seventies, is looming larger and larger in the American consciousness. It's a threat that strikes middle-class families like Andrea Case's, workers recently laid off from well-paying jobs in high-tech, parents struggling under the costs of a child's unexpected health problems—in short, our next-door neighbors, our friends, the people we cross paths with everyday. The threat level started rising around

the time of my youth, slowly eroding the confidence of middle-class Americans that they'd have stable jobs, generous benefits, and smooth upward mobility, and that their children would enjoy greater economic security than they'd enjoyed. But who killed economic security and why remains a mystery that we have only just begun to plumb.

We all know something about rising *inequality* in the United States, the growing space between the rungs of America's economic ladder. We hear about the soaring incomes of princely executives who garner hundreds of millions in compensation even as workers at the middle and bottom fall farther and farther behind. Yet we have heard much less about rising *insecurity*, the growing risk of slipping from the economic ladder itself. Perhaps that's because the stories here seem more random—blue-collar workers laid off after long years of service, college-educated middle managers whose upward trajectories have been abruptly halted, working families thrown off balance by catastrophic expenses, middle-class parents who find that health and retirement plans are shifting more costs and uncertainties onto them. It's easy to find the common thread when the subject is hardening divisions between two Americas—one marked by deprivation, the other by excess. It's harder to find it in stories of loss and anxiety whose common element is not constancy or stability, but sudden and often unexpected change.

Inequality and insecurity are deeply interwoven, but they are not the same. Inequality has indeed risen sharply. Between 1979 and 2003 the average income of the richest Americans more than doubled after adjusting for inflation, while that of middle-class Americans increased by only around 15 percent.<sup>1</sup> Nonetheless, it is possible to look at rising inequality and still paint a positive picture. After all, Americans at all points on the income ladder have gotten richer—just not at equal rates—and during this same period, our economy has expanded handsomely. A rising tide may not be lifting all boats as well as it did in the 1950s and 1960s, but it is lifting them nonetheless.

But another tide has been rising in the United States since my youth—the rising tide of economic risk. Americans may be richer than they were in the 1970s, but they are also facing much greater

economic insecurity. And this insecurity is increasingly plunging ordinary middle-class families into a sea of economic turmoil.

Consider some of the alarming facts. Personal bankruptcy has gone from a rare occurrence to a routine one, with the number of households filing for bankruptcy rising from fewer than 290,000 in 1980 to more than two million in 2005.<sup>2</sup> The bankrupt are pretty much like other Americans before they file: slightly better educated, more likely to be married and have children, roughly as likely to have had a good job, and modestly less likely to own a home.<sup>3</sup> They are not the persistently poor, the downtrodden looking for relief. They are refugees of the middle class, frequently wondering how they fell so far so fast.

Americans are also losing their homes at record rates. Since the early 1970s, the mortgage foreclosure rate has increased fivefold.<sup>4</sup> From 2001 to 2005 an average of one in every sixty households with a mortgage fell into foreclosure a year—a legal process that begins when homeowners default on their mortgages and can end with homes being auctioned to the highest bidder in local court-houses.<sup>5</sup> David Lamberger, a Michigan resident who has worked in the auto industry most of his life, can testify to just how shattering the process can be. David and his wife, Mary, purchased their two-story home in the metro Detroit area as an investment in the future for themselves and their four children. When David lost his job at an auto parts maker, he declared bankruptcy to delay foreclosure on the house. But the money he made working at a used-car lot hasn't been sufficient to keep them afloat, and now he's on the verge of losing his family's modest home.<sup>6</sup> For David and scores of other ordinary homeowners, the American Dream has mutated into what former U.S. Comptroller of the Currency Julie L. Williams calls "the American nightmare."<sup>7</sup>

Meanwhile, the number of Americans who lack health insurance has increased with little interruption over the last twenty-five years as corporations have cut back on workplace coverage for employees and their dependents. Over a two-year period, more than 80 million adults and children—one out of three nonelderly Americans, 85 percent of them working or the kids of working parents—spend some time without the protection against ruinous health

costs that insurance offers.<sup>8</sup> They are people like Mark Herrera, a union carpenter who went out on his own to become an independent contractor. Health insurance wasn't a priority when Herrera was using all his resources to get his business off the ground. Or at least it wasn't until he woke up one morning with a massive headache. Reluctant to go to the hospital for fear of the costs, he finally relented only to discover that he had suffered two strokes and his brain was bleeding. Ineligible for Medicaid, his bills now outstrip his pay several times over. "I've got a \$225,000 debt and yeah, if I come into any money, well, the first people I got to pay back is for this medical coverage," says Herrera.<sup>9</sup>

At the same time that the financial threats associated with our jobs, our homes, and our health care have all increased, corporations have raced away from the promise of guaranteed benefits in retirement. Twenty-five years ago, 83 percent of medium and large firms offered traditional "defined-benefit" pensions that provided a predetermined monthly benefit for the remainder of a worker's life. Today, the share is below a third.<sup>10</sup> Instead, companies that offer pensions provide "defined-contribution" plans, such as the 401(k), in which returns are neither predictable nor assured. Defined-contribution pensions can earn big returns, but they also can mean big risks: the risk of stock market downturns, the risk of inadequate savings, the risk of outliving one's account balances. Between 1989 and 1998—a decade in which 401(k) coverage exploded and the stock market boomed—the share of families whose pension savings allowed them to replace at least half of their prior income in retirement actually declined, as old-style guaranteed pensions rapidly became a thing of the past.<sup>11</sup>

Perhaps most alarming of all, American family incomes are now on a frightening roller coaster, rising and falling much more sharply from year to year than they did thirty years ago. Indeed, the *instability* of American families' incomes has risen substantially faster than the *inequality* of families' incomes. In other words, while the gaps between the rungs on the ladder of the American economy have increased, what has increased even more quickly is how far people slip down the ladder when they lose their financial footing.

And this rising insecurity does not come with any obvious silver linings. The chance that families will see their income plummet has risen. The chance that they will experience long-term movement up the income ladder has not. For average families, the economic roller coaster takes them up and down. It doesn't leave them any higher than when they started. As David Lamberger, the Michigan man who is in the process of losing his house, puts it, "There have been years I made \$80,000, and there have been years I made \$28,000. . . . Sometimes we're able to pay bills and get by, but then stuff from the slow times never goes away. You can't catch up, and it comes back to haunt you."<sup>12</sup>

What's more, while these up-and-down swings are more severe for workers like David Lamberger who lack a college education, the pace by which instability has increased since the 1970s has been almost exactly the same for workers who've received a college degree as it has been for those who never earned a high school diploma. Educated professionals may comfort themselves with the thought that they are more financially stable than the check-out clerk who never finished high school. But compared with educated professionals in the past, they are experiencing much greater income swings—swings in fact comparable to those experienced by less-educated workers in the 1970s.

And while national income and wealth have indeed grown handsomely during the era in which insecurity has risen, the economic standing of the American middle class has increased only modestly. The incomes of middle-class families aren't much higher today than they were in the 1970s—and they are much more at risk.

Americans may be willing to turn a blind eye to growing inequality, confident in the belief that their own standard of living is still rising. But economic insecurity strikes at the very heart of the American Dream. It is a fixed American belief that people who work hard, make good choices, and do right by their families can buy themselves permanent membership in the middle class. The rising tide of economic risk swamps these expectations, leaving individuals who have worked hard to reach their present heights facing uncertainty about whether they can keep from falling. Economic inequality may stir up our envy as we ogle the BMWs and

McMansions of our richer neighbors, but the prospect of economic insecurity—of being laid off, or losing health coverage, or having a serious illness befall a family member—stirs up our anxiety. And anxiety, as we shall see, is just what millions of middle-class Americans increasingly feel.

## America's Hidden Insecurity

All this is likely to come as a surprise to those who follow current economic debate. Yes, stories of economic hardship appear in the news. Yes, complaints about particular economic problems, from low savings to high gas prices, are ubiquitous. But the general tone of economic discussion today is decidedly sunny. Americans, we are told, are richer than they have ever been—and not just at the top of the economic ladder. Most working Americans, analysts claim with certainty, are far surpassing their parents' incomes. Back in the fifties and sixties, the optimists point out, owning a new kitchen appliance or installing one's children in a thin-walled bedroom in a Levittown Cape Cod was the height of middle-class luxury. Now, those same middle-income families have DVD players, air conditioners, a cell phone, a bedroom for each family member, and a second car—amenities that only the very rich in the mid-twentieth century could afford.<sup>13</sup>

Not only are middle-income Americans enjoying riches beyond the imagination of citizens of any nation or time, according to this familiar account, they are also living in an age of virtually unparalleled growth. Productivity is rising handily. The economy is humming along. And even as growth rises, inflation and unemployment remain low.<sup>14</sup> In late 2005, the *Wall Street Journal* headlined an online news story about the economy: "The Miracle Continues."<sup>15</sup>

There's just one problem: Americans don't believe the miracle exists. In poll after poll in recent years, Americans have heaped scorn on the happy talk and the sunny statistics. They have said that the country is on the wrong economic track. They have said that they expect the economy to get worse, not better. They have

said that their own financial situation is weakening. And they have said that leaders on both sides of the partisan aisle are failing to address their most fundamental economic concerns.

In exit polls taken as Americans left the voting booth in 2004, for instance, less than a quarter of middle-class voters said that the job situation in their community had improved in the previous four years, and less than a third said their own family's financial situation had improved.<sup>16</sup> Forecasts of the election that crunched just the economic numbers predicted the incumbent president, George W. Bush, would win in a landslide.<sup>17</sup> But on Election Day he squeaked through with the smallest popular vote margin for a winning incumbent president since 1828. Since then, public ratings of the economy have dropped even farther, as have Bush's approval numbers. Today, for all the happy talk, a majority of Americans say that the economy is worsening, that it's a bad time to find a good job, and that economic conditions are "fair" or "poor," rather than "excellent" or even "good." As a Gallup Poll report noted in March 2006, "Americans continue to resist giving the nation's economy positive ratings, regardless of what so-called 'hard' economic indicators may show."<sup>18</sup>

Commentators have offered plenty of reasons to explain—or, more accurately, explain away—Americans' continuing grumpiness. According to the curmudgeonly columnist Robert Samuelson, the United States has become a land of whiners: "Americans have developed perfectionist standards. We expect total prosperity and are disappointed by anything less. There should be no doubts or deficiencies."<sup>19</sup> Others have pointed to the negativity of the news media as the culprit, or Americans' growing unease about the war in Iraq.<sup>20</sup> But perhaps the most popular explanation is that voters have simply not woken up and smelled the economic coffee. Fully four years since the recession of 2001, Americans, we are told, are still gripped by an outdated and irrational pessimism that blinds them to the bountiful riches of the Miracle Economy.

It is high time to embrace a simpler thesis: Americans don't think the economy is all that good because, as far as they're concerned, it's not. And the main reason why it's not that good is that Americans' economic lives are becoming more insecure even though the



basic statistics are strong. In March 2004, for example, unemployment and inflation were both low. Yet roughly half of Americans agreed that "America no longer has the same economic security it has had in the past," while another fifth thought the statement could be true down the road. By contrast, just 27 percent believed that their economic complaints merely reflected the normal downside of the business cycle.<sup>21</sup>

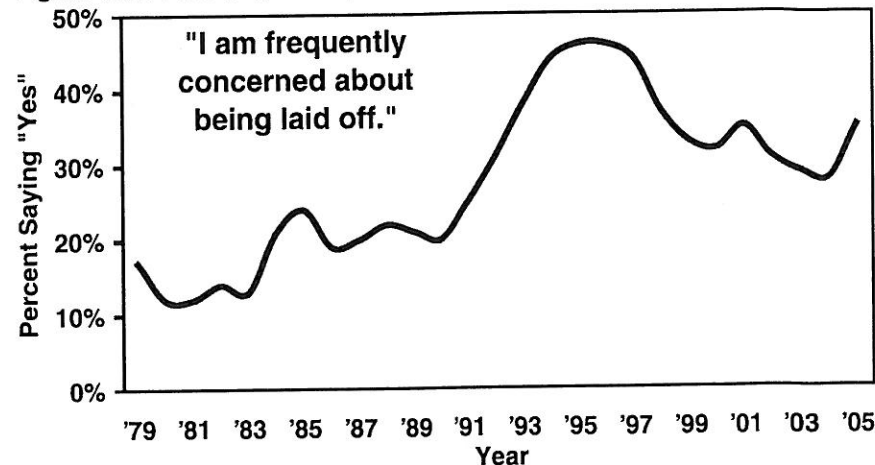
This is not the first time that there has been a disconnect between basic economic statistics and what Americans say they are experiencing. Back in the mid-1990s, a similar—and similarly puzzling—process played out: Voters were far more negative about the economy than most statistics suggested they should be. In 1982, amid a severe recession that had pushed the unemployment rate up to nearly 10 percent, a poll by the private business research firm ISR found that only 12 percent of workers were "frequently concerned about being laid off." Yet in 1996, with the unemployment rate hovering around 5 percent—half what it was when the 1982 poll was done—the percentage of workers who said they were frequently concerned was 46 percent. Even in 2005, with the unemployment rate again at only 5 percent, the number of Americans worried that they would lose their jobs was still about three times as high as it was during the steep economic downturn of 1982 (see figure 1.1).<sup>22</sup>

Americans, it seems, just don't get what the pundits are crowing about. And that's because the statistics that pundits love to cite don't capture what most Americans feel: a sense of ever-increasing financial risk.

## The Risk Factor

Pundits fixate on the current state of the economy: Is GDP growth accelerating or slowing? Is the job market expanding or contracting? Is the stock market rising or falling? These are important questions, but they are about the short-term waves of our economy—the movement on the surface, rather than the fundamental changes

Figure 1.1: A Growing Perception of Job Insecurity



Source: Proprietary data courtesy of ISR; for general information, see [www.isrinsight.com](http://www.isrinsight.com).

below. The Great Risk Shift isn't a wave—it's a rising tide that has increased the level of economic insecurity for nearly all Americans, in good times as well as bad.

Everyone knows what risk is when they experience it. When we first get behind the wheel of a car, or traverse the edge of a perilous cliff, we feel the butterflies in our stomach, the lightheadness of fear. But conceptually, risk is not so easy to grasp. It turns all our conventional frames of reference on their head. We are used to thinking about averages, rather than about ranges; about what happens, rather than what could happen; about events at one point, rather than evolution over time—in sum, about levels, rather than dynamics.

Yet risk—the possibility of multiple outcomes, whether good or bad—is all about dynamics. Sophisticated investors in the stock market (the fearless surfers on the waves of risk) recognize this when they talk about the *volatility* of a stock as well as its return. If a stock has higher volatility, its price undergoes more substantial up and down shifts over time. These fluctuations in its price, or return, mean that the stock embodies greater risk for the investor,

which is why savvy traders only snap up high-volatility stocks when they have high returns as well. Much of our increasingly sophisticated appreciation of risk comes from the efforts of economic players who deal with risk day in and day out to come up with new measures and new models for judging its magnitude and effects.

Risk is at the heart of some of capitalism's greatest successes. The entrepreneurs who financed the nation's first railroad tracks, prospected for oil, and bet on the success of microchips reaped outsized profits. Risk has also been the source of untold misery. For every story of a successful financial or business risk taken, there is one in which individuals lose their shirts. Risk is the reason companies go bankrupt, workers end up on the streets, and, at the extreme, financial markets crash. Seeing risk and understanding it, finding ways to quantify and share and manage it, gaining from its upsides while minimizing its downsides—these constitute some of the greatest achievements of the last two centuries. But while societies have the ability to master risk—to pool it across many people or address its root causes—societies also create risks: the risks of a dynamic investment market, the risks of interruption of earnings that arise in a division-of-labor economy in which people trade their work for pay, and, of course, the risks to health and the environment that modern production and consumption can pose.<sup>23</sup>

Economic insecurity lies on the dark side of risk. Although the term is rarely defined, *economic insecurity* can be understood as a psychological response to the possibility of hardship-causing economic loss. The psychology of insecurity is crucial, for it motivates many of our personal and social responses to risk—responses that can be either positive (buying insurance, building up private savings, forming a family) or negative (suffering anxiety, withdrawing from social life, postponing investments in the future because of fear of loss). Yet a feeling of insecurity is not enough to say someone is insecure. Insecurity requires real risk that threatens real hardship. We know that Americans think they are insecure. What I will show is that they have good reason to think so—that, like the investor who buys a highly volatile stock, Americans are facing much greater risk of substantial economic loss. The Great Risk

Shift is the story of how a myriad of risks that were once managed and pooled by government and private corporations have been shifted onto workers and their families—and how this has created both real hardship for millions and growing anxiety for millions more.

Risk turns out to be a lot harder to capture precisely with people than with stocks. To know what the volatility of a stock is, we need only follow the ticker for a while (with the familiar caveat that past performance is no guarantee of future performance). To know what the volatility of families' economic standing is, however, we need to trace a representative set of families over time, preferably long periods of time. We need to follow these families through all the normal and abnormal events of life: births, deaths, relocations, the formation and destruction of families, and so on. We need, in short, to look at the economy the way people actually live it—as a moving picture, rather than an isolated snapshot.

That's not, however, what economic statistics typically do. Consider the growing body of research on inequality in the United States. We know the gap between the rich and the rest has grown dramatically over the last thirty years, reaching levels not seen since before the late 1930s. The spoils of our system are now so unevenly divided that we must reach back to the Robber Barons of the 1890s and Gatsbys of the 1920s for a similar comparison to today's gap between middle-income Americans and the super-rich. In 2003, the richest 1 percent of U.S. households averaged over \$800,000 in annual income, or more than eighteen times the average for middle-income households. A quarter century ago, the richest 1 percent raked in less than twelve times as much as the middle class.<sup>24</sup>

Yet as arresting as this fact is, it's based on annual surveys that reach different people every year. These surveys can tell us how many people are rich and how many are poor, and how big the gap between the two is. But they cannot tell us whether the same people are rich or poor from year to year, or whether movement up (or down) the income ladder is greater or smaller than it used to be. We all know we'll never be as rich as Bill Gates. But can we depend, as our parents once did, on maintaining—or, even better, steadily augmenting—our income and standard of living? And how

many people are experiencing the wild fluctuations in income (fluctuations that resemble some of our most volatile stocks) that David Lamberger's family has seen?

To answer these sorts of questions, we need to do more than take annual snapshots of income. We need to survey the same people over many years, following them even as they experience death, birth, marriage, pay raises, pay cuts, new jobs, lost jobs, relocations, and all the other events, good and bad, that mark the passage from childhood into old age. We need to see Mark Herrera ensconced in his union job as a carpenter as well as Mark Herrera, independent contractor, as he returns from the hospital, hundreds of thousands of dollars in debt. These kinds of surveys are called "panel surveys," and compared with the usual approach—contacting a different random group of people for each survey—they are exceedingly difficult to carry out. Surveyors must stay in contact with respondents (and their descendants) over long periods of time while periodically adding new respondents to keep the survey representative of a changing population.

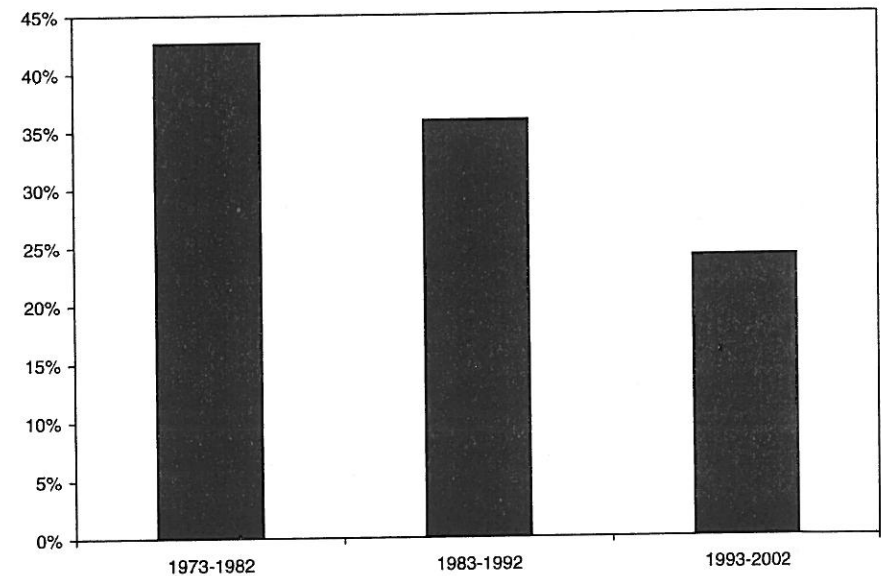
Given the difficulties, it's perhaps understandable that no official economic statistic tries to assess directly the dynamics of family income. Curious citizens who spend a few hours on the websites of the Commerce Department or Census Bureau will come away with a wealth of snapshots of the financial health of American families—from annual wages and income to the gap between rich and poor. But they will search fruitlessly for even the most basic information about how the economic status of American families changes over time, much less about what causes these shifts. If they extend their search beyond official statistics, they will do better, but not much better. Many studies of income dynamics have been done. Yet when I began my research, nobody had looked at the simple question of whether the up-and-down swing of family incomes—the volatility of the American family stock, if you will—had risen or fallen over the last generation.

The answer can be found in the Panel Study of Income Dynamics (PSID)—a nationally representative survey that has been tracking thousands of families from year to year since the late 1960s. Nearly forty years into its operation, the survey has included more

than 65,000 people, some of whom have been answering questions for their entire adult lives, others of whom have been in the survey since their birth. As a result, the PSID is uniquely well suited to examining how and why incomes rise and fall over time.

And what becomes immediately clear is that family incomes rise and fall a lot—far more than one would suspect just looking at static income-distribution figures. To take just one simple measure, during a ten-year period, Americans aged twenty-five to sixty-one have less than a fourth the income in the year they're poorest, on average, as they do in the year they're richest.<sup>25</sup> Over ten years, in other words, an average Betty who had \$60,000 in her best year would have less than \$15,000 in her worst. This striking disparity, it turns out, is a dramatic increase from even the relatively recent past: In the 1970s, as figure 1.2 shows, the low was just shy of 50

Figure 1.2: The Rising Ratio of Low-to-High Family Incomes over 10-Year Periods



Source: Panel Study of Income Dynamics; Cross National Equivalent File. These are the average ratios of low-to-high family income over 10 years; the analysis follows household heads, with top and bottom 1 percent of observations trimmed.

percent below the high—meaning our average Betty would have around \$30,000 in her worst year, rather than less than \$15,000.

These up-and-down swings are what get missed when we use annual snapshots to look at the distribution of American family income. There are not just the well off and the poor. There are Americans who are doing well one year and poorly the next—and vice versa. In fact, a surprisingly big chunk of the income inequality that we see across families at any point in time is due to transitory shifts of family income, rather than to permanent differences across families.

This is a point that the Miracle Economy crowd loves: Sure, inequality is growing, they say, but mobility is alive and well, making any comparison of income groups misleading. The fact that Betty could make \$20,000 one year and more than \$60,000 in another just shows that the American Dream remains strong for those willing to pull themselves up by their own bootstraps.

But this conclusion is as wrongheaded as the image of a frozen class structure that is sometimes taken from income-distribution statistics. Upward mobility is real. Men like Mark Herrera do start their own businesses; David Lamberger does get his dream house. But upward mobility is usually not dramatic, and there is no evidence that it has increased substantially in the contemporary era of rising inequality.<sup>26</sup> Recently, the *Economist* magazine, no foe of American-style capitalism, reported that “a growing body of evidence suggests that the meritocratic ideal is in trouble in America. Income inequality is growing to levels not seen since the Gilded Age, around the 1880s. But social mobility is not increasing at anything like the same pace: would-be Horatio Algiers are finding it no easier to climb from rags to riches, while the children of the privileged have a greater chance of staying at the top of the social heap.”<sup>27</sup>

The evidence shows, moreover, that income mobility across generations is actually lower in the United States than in other affluent nations. According to recent studies, there is more social mobility in European nations such as Sweden than in the United States, and in fact only South Africa and Britain have as little mobility across generations.<sup>28</sup>

Plus, there's an even more glaring oversight of paeans to social mobility: What goes up also goes down. As we saw with David Lamberger, volatility of income can mean making \$80,000 one year and freefalling to \$28,000 the next—and the year of the freefall could be the year one loses not only one's job but also the family home.

The difference between these two scenarios is profound, because both research and common sense suggest that downward mobility is far more painful than upward mobility is pleasurable. In fact, in the 1970s, the psychologists Amos Tversky and Daniel Kahneman gave a name to this bias: “loss aversion.”<sup>29</sup> Most people, it turns out, aren't just highly risk-averse—they prefer a bird in the hand to even a very good chance of two in the bush. They are also far more cautious when it comes to bad outcomes than when it comes to good outcomes of exactly the same magnitude. *The search for economic security is, in large part, a reflection of a basic human desire for protection against losing what one already has.*

Anybody who has watched the differing responses of a toddler to the pleasure of receiving a new toy and the pain of having one taken away knows about loss aversion. Yet it is something of a puzzle why adults behave like toddlers when it comes to things they own. After all, in classic economic theory, goods are simply tickets to enhanced welfare, and we should have no special attachment to things we already possess if other items could deliver welfare just as effectively. Aside from the “diminishing marginal utility” of income (the fact that every dollar buys slightly less happiness or well-being, making us value a \$100 gain modestly less than we lament a \$100 loss), people should, according to standard theory, value losses and gains in roughly equal terms.

Experiments show that few actual people think this way. Even when given a trivial item, we suddenly become willing to pay a much higher price to retain it than we were willing to shell out to buy it. (One clever study involved giving college students mugs and pencils—seemingly trivial items—and finding that they insisted on selling their gift for much more than they'd earlier said they would pay for it.) Researchers call this the “endowment effect,” and it helps explain myriad features of the economic world



that are otherwise inexplicable: why, for example, wages don't generally fall during recessions; why stocks have historically had to pay much higher returns than bonds to entice people to take on the increased risk of loss—and why insurance against economic injury remains the most popular and extensive of all the activities that modern governments engage in. (In 2001, for example, spending by public and private social programs like Medicare, Social Security, workplace retirement pensions, and unemployment insurance represented a quarter of our economy.)<sup>30</sup>

The endowment effect is surprisingly strong. Americans are famously opportunity-loving. But when asked in 2005 whether they were “more concerned with the opportunity to make money in the future, or the stability of knowing that your present sources of income are protected,” 62 percent favored stability and just 29 percent favored opportunity.<sup>31</sup> In 1996 the Panel Study of Income Dynamics asked participants a similar question. Which would you choose: your present job with your current income for life, or a new job that offered a fifty-fifty chance of doubling your income and a fifty-fifty chance of cutting your income by a third?

On paper, the deal was pretty good. If John was making \$30,000 and won the gamble, he'd have \$60,000—a comparative fortune. If he lost the gamble, he'd make \$20,000—not great, but not terrible compared with what he had. If John didn't worry at all about risk, the choice would be easy: Since he has a fifty-fifty chance of ending up with \$60,000 and a fifty-fifty chance of ending up with \$20,000, the rational position would be to treat the gamble as offering \$40,000 (the average of the two salaries)—an amount a third higher than his present income.

Few people who were asked whether they'd take the gamble were rational in this fashion: Only 35 percent said they would roll the dice. Lowering the potential income loss budged some of the cautious, but surprisingly few. More than a third of respondents said they wouldn't accept even the most generous deal that the survey presented (which promised, on average, an almost 50 percent income increase). People like to gamble, but not, it seems, when they think that their long-term economic security is on the line.

Loss aversion is a well-known phenomenon in behavioral economics—the study of how people actually reason about economic choices. But the implications of loss aversion for our understanding of the ups and downs of economic life are often missed. What loss aversion means is that drops in income, even when later compensated for by equal or even larger gains, are intensely psychologically difficult. (Perhaps that's why a recent cross-national study finds that the best predictor of the self-reported happiness of a nation's citizenry isn't national income, but the extent of economic security.)<sup>32</sup> Upward mobility is nice; downward mobility is devastating, especially since it's on the downward trips that jobs, houses, savings, and the other things gained on the way up often get lost. ✕

## The Economic Roller Coaster

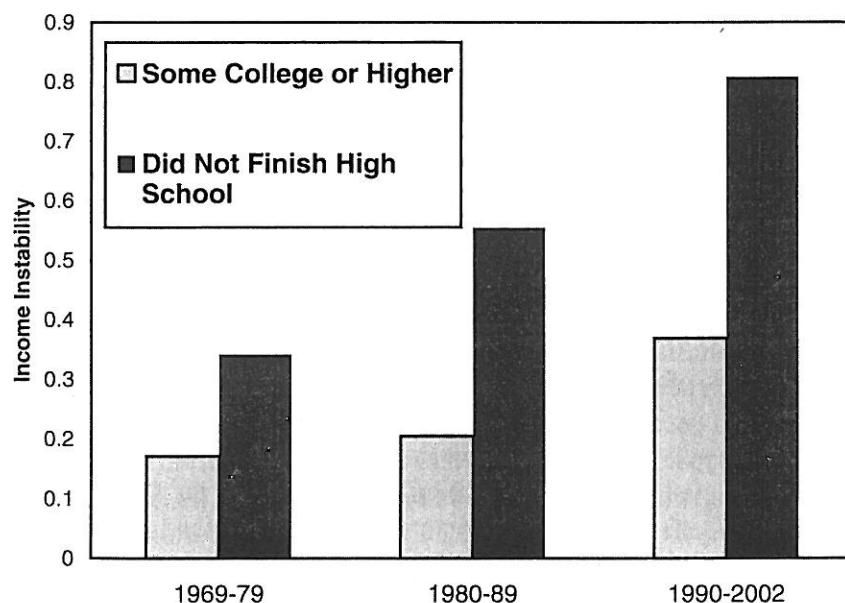
Judged on these terms, what my evidence shows is troubling, to say the least. When I started out, I expected to see a modest rise in instability. But I was positively thunderstruck by what I found: Instability of before-tax family incomes had skyrocketed. *At its peak in the mid-1990s, income instability was almost five times as great as it was in the early 1970s.* And while it dropped during the boom of the late 1990s, it never fell below twice its starting level, and it shot up again in recent years (my data end in 2002) to three times what it was in the early 1970s. The rise is less pronounced when taxes are taken into account, but it's still dramatic.<sup>33</sup> Moreover, while instability and inequality have both risen substantially, instability has actually risen faster and farther than inequality. The gap between Bill Gates and Joe Citizen is a lot larger than it used to be, but it's actually grown less quickly than the gap between Joe Citizen in a good year and Joe Citizen in a bad year.

Isn't this just a problem of the less educated, the workers who've fallen farthest behind in our skills-based economy? The answer is no. Volatility is indeed higher for less educated Americans than for more educated Americans—slightly more than twice as high.<sup>34</sup> (It is also higher for blacks and Hispanics than for whites, and for women than for men.) Yet, surprisingly, volatility has risen by

roughly the same amount across all these groups over the last generation. During the 1980s, people with less formal education experienced a large rise in volatility, while those with more formal education saw a modest rise. During the 1990s, however, the situation was reversed: Educated workers saw the instability of their income rise more, and by the end of the decade, as figure 1.3 shows, the overall instability of their income had increased by almost as much from the 1970s baseline. The story of the 1990s is the generalization of the income instability that once afflicted mostly the less educated and disadvantaged. Increasingly, more educated workers are riding the economic roller coaster once reserved for the working poor.

This suggests that growing economic instability cannot easily be chalked up to poor personal choices. It might be argued that workers without a college degree could have gotten additional education (although this would leave open the question of who exactly

Figure 1.3: Instability Rise at Both High and Low Education Levels



Source: Panel Study of Income Dynamics.

would fill the millions of jobs that require little advanced training or skills). But how can we say that about workers who did stay in school and yet still experience high levels of volatility? The forces that have created the new economic roller coaster—growing workplace insecurity, the new risks of the contemporary family, and the erosion of stable social benefits—have swept through the lives of almost every American. Prudent choices can reduce but not eliminate exposure to the growing level of economic risk. Indeed, many of the choices that expose Americans to risk—from going to school to seeking a better job to building a family—are precisely the ones that most greatly benefit families and society as a whole. Families can give up many of these risks only by giving up on the American Dream.

A major clue on this point is found in the Panel Study of Income Dynamic's questions about risk mentioned earlier, questions that measure the extent to which people are risk-seeking or risk-avoiding. If much of the volatility in income that we see in the PSID was caused by voluntary choices, then we would expect that people who are more worried about risk would be less likely to experience large income swings. After all, if you want to avoid risk and you have the power to do so, you are unlikely to put yourself in a position where your income is highly unstable. If you are risk-averse, you won't choose to go back to graduate school when you can continue working at the local bank, and you won't leave your cushy corporate job for that one-in-a-million opportunity to get your own business off the ground.

Yet the PSID data reveal few consistent relationships between how risk tolerant someone is and how unstable their income is.<sup>35</sup> The risk tolerance of someone in the PSID turns out to be a terrible predictor of their income experience. People who are highly risk-seeking experience wild income swings, but so too do people who are highly risk-averse—which is not at all what one would expect if income volatility were mostly voluntary. It's as if a cautious grandmother and reckless teenager were each equally likely to take up bungee jumping, a sure sign that something other than unfettered free choice is at work.

Maybe so, but couldn't family breakup be driving the results? If a family divorces, for example, does one family become two, each with a lower income? The answer is yes, divorce does cause some instability in my measure, but that's because divorce is a real risk to family incomes. The analysis looks at how unstable people's incomes are, and family changes (birth, death, marriage, divorce, separation, and the like) are an important cause of income instability. Lest it be thought that rising divorce rates are the main reason for the rise in income instability, however, it's worth pointing out that the U.S. divorce rate actually peaked in the early 1980s and fell in the 1990s—precisely when economic instability climbed.<sup>36</sup>

How can we make sure that we aren't confusing instability with income growth? If Americans are getting richer and richer, wouldn't that show up as greater income variance? The answer is no. (The premise of the question is also wrong—most Americans are not flying into the income stratosphere.) Just as with the volatility of a stock, the volatility of family incomes is meant to capture how much income bounces around its overall growth path. If the income of a family rises smoothly, then it's not counted as unstable. It has to swing, not just climb.<sup>37</sup>

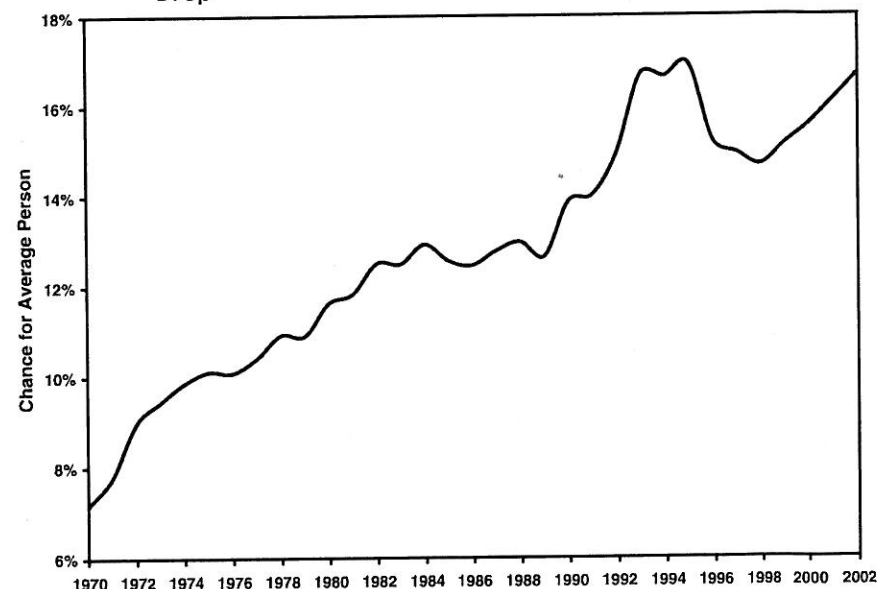
## Drop Zone

Still, it's hard to think about income instability in the same way we think about stock volatility. When most of us contemplate the financial risks in our lives, we don't worry about the up-and-down movement of our finances around some long-term path, even though that's technically what financial risk is. We think about downside risks, about drops in our income—and understandably so: We are loss averse, in major part, because losing what we have can require wrenching adjustments. We have to cut back, to go without, to adjust our expectations, to rethink our lives. When losses are catastrophic, people have to confront what the anthropologist Katherine Newman calls "falling from grace"—to contend "not only with financial hardship, but also with the psychological, social, and practical consequences" of losing our proper place.<sup>38</sup>

We can get a better sense of these "falls from grace" by looking specifically at *drops* in family income. About half of all families in the PSID experience a drop in real income over a two-year period, and the number has remained fairly steady. Yet families that experience an income drop fall much farther than they used to. In the early 1970s the typical income loss was a bit more than 25 percent of prior income; by the late 1990s it was around 40 percent.<sup>39</sup> For a family earning \$42,000 (the median income for U.S. households in 1999), a 40 percent loss would mean an income drop of almost \$17,000. And remember, this is the *median* drop: Half of families whose incomes dropped experienced even larger declines.

Figure 1.4 uses somewhat fancier statistics to show what the chance of experiencing a 50 percent or greater family income drop is for an average person each year. The probability of a 50 percent or greater drop for an average person was just 7 percent in the

Figure 1.4: Americans' Chance of a 50 Percent or Greater Income Drop



Source: *Panel Study of Income Dynamics*. Results are from a logistic regression predicting drops in household-size-adjusted family income among individuals aged 25–61.

1970s. It's risen dramatically since, and while (like income volatility) it fell in the strong economy of the 1990s, it has recently spiked to record levels.<sup>40</sup> There is nothing extraordinary about "falling from grace." You can be perfectly average—with an average income, an average-sized family, an average likelihood of losing your job or becoming disabled—and you're still two-and-a-half times as likely to see your income plummet as an average person was thirty years ago.

The most dramatic consequence of "falling from grace" is poverty—subsistence at a level below the federal poverty line (for 2006, an annual income of slightly less than \$10,000 for an individual and about twice that for a family of four).<sup>41</sup> Our conventional view of poverty envisions a distinct group—"the poor," "the truly disadvantaged," "the underclass"—whose experience of deprivation lasts for years, and perhaps even extends across generations. Yet long-term poverty, though real and worrisome, is rarer than we think. Most of the poor at any moment are not poor for long. Less than a tenth of Americans experience five consecutive years of poverty during their adult life.<sup>42</sup>

The flipside of this picture, however, is that poverty afflicts many more Americans at some point in their lives than is commonly believed. Take the U.S. child poverty rate of 20 percent—a rate three times higher than the norm in northern Europe. Most people look at this number and think that "only" one in five kids experience poverty in the United States. That's true in any given year, but the kids who are poor change from year to year. If we want to know how many kids experience poverty at some point in their childhood, we need to count up the total number who spend at least a year beneath the poverty line by the age of eighteen. The answer, it turns out, is shocking: More than *half* of American kids spend at least a year in poverty by the time they're eighteen—compared with less than a quarter of German children.<sup>43</sup>

The picture is similar for adults. Using the PSID, the sociologist Mark Rank has calculated that a stunning 58.5 percent of Americans will spend at least a year in poverty between the ages of twenty and seventy-five.<sup>44</sup> I have asked Rank whether this striking result somehow hinges on including cash-poor college students in the

calculations, and he has assured me it does not. Indeed, even if *everyone* younger than twenty-five is excluded from the calculations, the chance of experiencing poverty by the age of seventy-five is still almost 50 percent.

Worse, the chance of spending at least a year in poverty has increased substantially since the late 1960s, even for workers in their peak earning years. People who were in their forties in the 1970s had around a 13 percent chance of experiencing at least a year in poverty during their forties. By the 1990s, people in their forties had more than a 36 percent chance of ending up in poverty—an almost threefold rise.<sup>45</sup>

These numbers illuminate the hidden side of the Miracle Economy: the growing economic insecurity faced by ordinary workers and their families. And unlike other possible measures, these statistics are as direct and comprehensive as they come. They tell us by exactly how much the roller coaster goes up and down, looking at every source of a family's income, from friends to employers to government. Rates of bankruptcy or home foreclosure (which have both increased dramatically in the last generation) might go up because financial meltdowns have lost their stigma or because people are making foolish choices about spending and debt. But nobody files for a major income drop or spends their way into a highly unstable income. Income instability is the DNA of economic insecurity, its basic building block.

Income instability is the building block of insecurity, but it is not the whole. Indeed, as dramatic and troubling as the trends we have examined are, they vastly *understate* the true depth of the problem. The up-and-down movement of income among working-age Americans is a powerful indicator of the economic risks faced by families today. Yet economic insecurity is also driven by the rising threat to families' financial well-being posed by budget-busting expenses like catastrophic medical costs, as well as by the massively increased risk that retirement has come to represent, as more and more of the responsibility of planning for the post-work years has shifted onto Americans and their families. When we take in this larger picture, we see an economy not merely changed but fundamentally transformed.



## What's Going On?

Over the years as I've revisited the old neighborhood where I once rode my bike, it looks essentially unchanged—a city in amber. The supermarket is still there. Close by, other neighborhoods have sprouted large new homes amid long stretches of green. The surface is tranquil, even improved. The old gas station where I remember gas-crisis lines is gone; a microbrewery has moved in nearby. But beneath the calm facade is a growing canker. Families whose lawns remain manicured fear not being able to meet their next mortgage payment. Having seen their salaries drop once, if not more than once, they question their ability to hang on.

The Great Risk Shift is a classic murder mystery: Who killed economic security in the United States? The potential culprits are many, the motives murky, the evidence often circumstantial. Yet much of this book is devoted to pinning the suspects and explaining their role in the crime. The answer is not as neat or simple as some murder mysteries, but then again we are talking about momentous shifts in our economy, our society, and our nation's social policies. A change as big as the Great Risk Shift does not usually stem from a single grand cause.

The mystery, it turns out, is not just *why* Americans have come to face greater economic risk. There are straightforward reasons why workers and their families experience heightened financial instability in today's economy and society. The big puzzle is why political and corporate leaders have been so slow to respond. In fact, the puzzle is even deeper than that. Political and corporate leaders haven't simply failed to respond; they've actually piled on new risks even as Americans have become increasingly less secure.

To answer this puzzle requires not further statistical inquiries but a historical journey into the rise and decline of an ideal—the ideal of insurance. This is our next subject: America's sweeping ideological transformation away from an all-in-the-same-boat philosophy of shared risk toward a go-it-alone vision of personal responsibility.

## 2

# Risking It All

"WHO'S AFRAID OF PERSONAL RESPONSIBILITY?" That was the rhetorical title of a recent law-review article by Richard Kaplan, a law professor at the University of Illinois.<sup>1</sup> The article concerned Health Savings Accounts (HSAs), tax-free individual accounts that are now being hotly promoted by financial institutions, medical insurers, and free-market policy advocates to allow people to save money so that they can pay their routine health care expenses directly, rather than through traditional group insurance.

The idea behind HSAs is that you should save for most of your health care expenses on your own, paying them out of pocket just as patients did in the days before group health insurance. Insurance would be only for the truly catastrophic costs—the costs that exceed \$5,000 or \$10,000 a year. In return for taking on this hefty risk, you get a tax-free investment account that is under your control. You can use it however you wish for medical care; you can even pass it on to your heirs or surviving spouse when you die. As the Treasury Department brochure for HSAs reads: "You own and you control the money in your HSA. Decisions on how to spend the money are made by you without relying on a third party or a health insurer. You will also decide what types of investments to make with the money in the account in order to make it grow."<sup>2</sup>

(known to grateful authors simply as "Purdy") has managed publicity for the book with true indefatigability. My agent, Sydelle Kramer, deserves a special thanks. She didn't just help me figure out what I wanted to do with this book and guide me as I went; she also taught me almost everything I know about the world of publishing. I could not wish for a better guide.

My greatest debt, as always, goes to my family. My wife, Oona Hathaway, has been my best friend and my most trusted guide for more than seventeen years now—nearly half my life. So it is understandable why I can't fathom a world in which she isn't there helping me and teaching me and lifting me up. She has shaped who I am in the deepest sense, and she and my two children, Ava and Owen, make my life whole.

Finally, I dedicate this book to my parents, who taught me the value of both love and learning—and who shared with me their own simple conviction that injustice faced by any of us is injustice faced by all of us.

## Notes

### INTRODUCTION

1. Jacob S. Hacker, "Call It the Family Risk Factor," *New York Times*, January 11, 2004, sec. 4, 15. These estimates, like the other calculations based on the Panel Study of Income Dynamics (PSID) that appear in chapter 1, were carried out in cooperation with Dr. Nigar Nargis, assistant professor at the University of Dhaka in Bangladesh, currently a postdoctoral fellow of the Strategic Training Program of Tobacco Research at the Canadian Institute of Health Research at the University of Waterloo in Canada. The estimates in figure 1 use family income, adjusted for family size, for families with heads twenty-five to sixty-one years of age. Further description of the PSID analyses are contained in chapter 1. More information on the PSID is available on the study's excellent website: <http://psidonline.isr.umich.edu>.
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## CHAPTER 1

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22. Other polls showed even higher concern: In response to a 1995 *New York Times* survey, 53 percent of Americans said their own job was insecure, nearly 83 percent said it was hard to find a good job in their community, and 48 percent feared that they would lose their own job and that it would be hard to find a good job in their area. The survey, "Economic Insecurity," is available via the Roper public opinion database (<http://roperweb.ropercenter.uconn.edu/iPoll>) as USNYT95-012. The same basic pattern appears in public responses to the Gallup Poll, which has been asking a standard question about economic conditions since 1992. The share of Americans describing the economy as "only fair" or "poor" was extremely high in the early 1990s (peaking at 90 percent in 1992) and did not fall below a majority until late 1997. It remained low in 1998, 1999, and 2000, bottoming out at 25 percent in 2000, before shooting back up to its current high levels of 60–80 percent in 2001. This pattern matches up almost perfectly with the trends in pre-tax income volatility discussed later in this chapter. Indeed, between the beginning of 1992 (when Gallup Poll data begin) and the end of 2002 (when the income volatility data end), the correlation between negative public appraisals of the economy and income volatility is greater than 70 percent. Gallup Poll data available online at <http://poll.gallup.com>. The question wording is as follows: "How would you rate economic conditions in this country today—as excellent, good, only fair, or poor?"
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34. Not surprisingly, volatility is also higher for lower-income Americans. See Lily Batchelder, “Taxing the Poor: Income Averaging Reconsidered,” *Harvard Journal on Legislation* 40 (2003): 395–452.
35. This is not to say that there are no relationships; people with higher incomes do seem less worried about the risk of economic loss than people with lower incomes, and people who have experienced substantial upward mobility are less worried about risk than those who have experienced flat or falling incomes.
36. Elmer and Seelig, “The Rising Long-Term Trend of Single-Family Mortgage Foreclosure Rates,” 31.
37. What’s more, all these results are based on analyses that transform income so that it is what statisticians call “mean-independent.” This is just a fancy way of saying that the level of a family’s income doesn’t directly affect the measure of volatility. Take two families—each of whose income drops by 20 percent between two years. If family one has twice the income as family two, that 20 percent drop is going to be twice as large in dollar terms, even though the two families are experiencing exactly the same size change relative to their prior income. Using mean-independent measures fixes that, making it possible to compare volatility across people with different income levels and across years with different average income levels. All these analyses also use inflation-adjusted dollars, so year-to-year changes in the inflation rate don’t show up as instability either.
38. Katherine S. Newman, *Falling from Grace: The Experience of Downward Mobility in the American Middle Class* (New York: Free Press, 1988).
39. Median drops in family income are estimated by looking at changes in post-tax family income over a two-year period among families experiencing income drops. As in the other PSID analyses, the sample is restricted to families with heads aged twenty-five to sixty-one with positive income. The table shows the median drops from 1969 to 2002.

Years	Median Drop in Family Income
1969–1971	27%
1970–1972	29%
1971–1973	29%
1972–1974	29%
1973–1975	27%
1974–1976	29%
1975–1977	29%
1976–1978	27%
1977–1979	26%
1978–1980	26%
1979–1981	26%
1980–1982	28%
1981–1983	30%
1982–1984	30%
1983–1985	28%
1984–1986	28%
1985–1987	31%
1986–1988	28%
1987–1989	25%



1988–1990	25%
1989–1991	27%
1990–1992	30%
1991–1993	39%
1992–1994	37%
1993–1995	35%
1994–1996	38%
1996–1998	44%
1998–2000	37%
2000–2002	38%

40. A logistic regression was used to estimate the average probability that an individual experiences at least a 50 percent drop in family-size-adjusted income over a two-year interval. The analysis controls for the demographic and social characteristics of individuals, as well as individuals' permanent family income levels (measured as the five-year moving average of family income). It also includes variables that account for different types of risks that may contribute to income drops, including unemployment, retirement, disability, illness, divorce, marriage, and the birth or adoption of children. A time-trend variable in the model captures any consistent change in the probability of income loss over time that cannot be accounted for by the other variables in the model. To predict the probability of income loss for each year for an "average" individual simply requires using the coefficients of the model to calculate the probability of an income drop of 50 percent or greater for an individual possessing the mean values on each of the variables. The rising trend shown in figure 1.4 is robust to the inclusion of individual fixed effects—that is, controlling for individual-specific attributes that are invariant over time but that may be correlated with the likelihood of an income drop.
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44. Rank, *One Nation, Underprivileged*, 94.
45. Daniel Sandoval, Thomas A. Hirschl, and Mark R. Rank, "The Increase of Poverty Risk and Income Insecurity in the U.S. Since the 1970's" (paper presented at the American Sociological Association Annual Meeting, San Francisco, CA, August 14–17, 2004).

## CHAPTER 2

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