



Middle Class in Turmoil

Description of Methodology and Discussion of Findings

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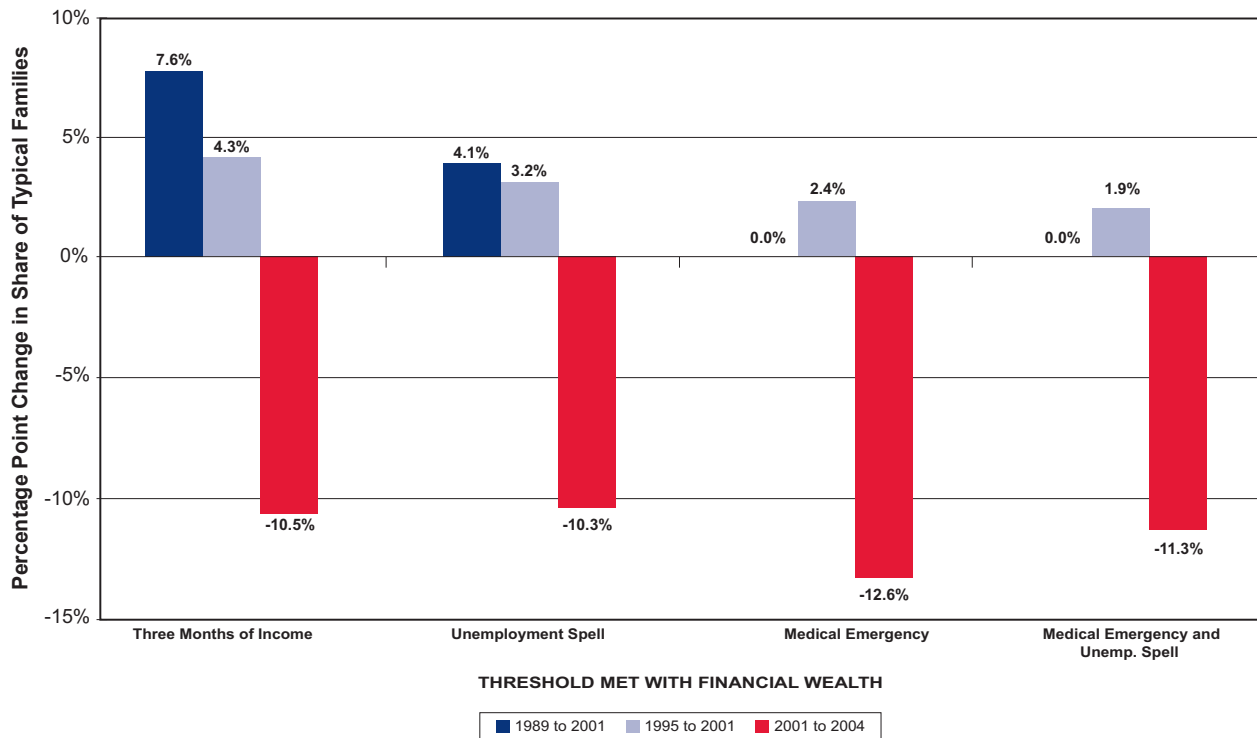


INTRODUCTION

In our main paper we detail the reasons why middle class American families are justifiably worried about their financial well-being amid a five-year economic boom. In our analysis we rely on a wealth of government statistics to make some key analytical assumptions about the economic structure of middle class families, their spending requirements and debt service capacities, and the kinds of financial emergencies they might face over time.

In this paper we detail the methodology employed in our study and discuss some of the key findings further in light of our methodological approach. At times we will revisit some of the conclusions made in the main paper in order to more fully detail the veracity of our findings.

Figure 1
Changes in Middle-Class Security Indicators



Notes: Changes are in percentage points. The typical family is a two-earner couples between the ages of 35 and 54 with incomes in the middle three income quintiles. Financial wealth is the difference of all financial assets, including retirement savings accounts, such as IRAs and 401(k)s, minus all outstanding debt. See appendix for additional details.



Defining costs of unemployment spells and medical emergencies

The economic security of America's families depends not only on the chance of encountering an economic emergency, but also on what happens if they do. For instance, will they be able to keep their home if they become unemployed or experience a medical emergency? That is, do they have sufficient wealth to withstand one or both of these emergencies?¹

First, we need to operationalize these two emergencies. The costs of an unemployment spell are equal to the median length of unemployment times the share of income dedicated to basics times income minus the median length of unemployment times the average weekly unemployment benefit:

$$COSTUE_t = \frac{LUE_t}{52} ConsShare_t Y_t - LUE_t UI_t \quad (1)$$

Where $COSTUE$ is the cost of an unemployment spell, LUE is the median length of unemployment, $ConsShare$ is the average share of basic consumption items out of before tax income for the middle quintile, Y is annual before tax income, and UI is the average weekly unemployment benefit. In case of a dual-earner couple, the first part of the equation is divided by two. Data for median length of unemployment are taken from BLS (2006a), consumption data from BLS (2006c), income from BOG (2006a), and unemployment insurance data from DOL (2006).

The summary data for the unemployment cost measures are presented in table 1. The figures show a clear upward trend in terms of long-term unemployment starting in 2000. By 2004, the median length of unemployment was still a comparatively high 9.8 weeks. At the same time, though, the average share of basic consumption from before-tax income declined to a relatively low 61.1 percent in 2004, i.e., unemployed workers had to replace less income than in prior years. Average weekly unemployment benefits rose after the recession, but gradually declined again, in inflation-adjusted terms, after 2003.



Table 1
Summary statistics for costs of unemployment, 1989 to 2004

Year	Median length of unemployment	Basic share of consumption out of before tax income	Average weekly unemployment benefit (in 2004 dollars)
1989	4.8	68.7%	225
1990	5.3	67.8%	227
1991	6.8	68.3%	231
1992	8.7	73.0%	231
1993	8.3	69.6%	231
1994	9.2	71.8%	231
1995	8.3	70.8%	229
1996	8.3	73.4%	227
1997	8	71.5%	225
1998	6.7	68.0%	228
1999	6.4	70.5%	235
2000	5.9	72.4%	238
2001	6.8	70.4%	245
2002	9.1	68.7%	262
2003	10.1	67.3%	267
2004	9.8	61.1%	262

Notes: See appendix for detailed notes on tables and figures

Besides the costs of an unemployment spell, we also consider the costs of a medical emergency. A medical emergency is defined as the costs that an individual is asked to bear in case of a medical emergency, here comprised of exactly one emergency room visit and one hospital visit.

Our goal in defining a medical emergency is to determine the actual consumer costs of medical emergencies. One obvious starting point is that a medical emergency is an event that requires immediate medical attention, which is usually provided by a hospital emergency room. However, emergency room visits can include events that are not necessarily a serious threat to one's health and financial state.

For instance, in rural areas and for uninsured people, emergency rooms can be used to provide services that most people receive from doctors' offices (CFEC, 2006). That is, we wanted to ways to isolate emergencies that cause severe disruptions to the patient's daily routine and finances. To do this, we narrowed the group of people who visit emergency rooms and who were admitted to a hospital following an emergency room visit. About 13 percent of all emergency room visits result in hospital admission (McCaig and Nawar, 2006).



We use the Medical Expenditure Panel Survey (MEPS) as primary data source to calculate the costs of a medical emergency. As the U.S. government's official survey of household level healthcare spending, it is considered the authoritative source for this kind of data (Bartkowiak and Finnegan, 2004).

In calculating the costs that patients see on their bill we addressed three issues: population selection, determining the amount of expenses paid out of pocket, and determining the amount of unpaid charges billed as out of pocket. Specifically, we considered only the amounts for patients who had exactly one emergency room visit and exactly one hospital stay, since we are interested in determining the costs of one medical emergency. The costs, then, are the actual out-of-pocket expenditures plus any bad debt that providers could not collect. To approximate the bad debt, we used the difference between reported charges (what providers bill for) and expenses (what providers actually receive). Part of this gap is explained by discounts negotiated by private insurance companies and Medicare. The remainder is considered uncompensated care, which consists of bad debt and free or charity care.² The amount that the hospital expects to collect and a patient is actually billed is the "bad debt." We assumed that 50 percent of the difference between charges and expenses was bad debt.³

Middle class security has eroded since 2001, wiping out gains of 1990s

The economic security of America's families not only depends on the chance of encountering an economic emergency, but also on what happens if they do. For instance, will they be able to keep their home if they become unemployed or experience a medical emergency? That is, do they have sufficient wealth outside of their homes to withstand one or both of these emergencies?⁴

Among typical two-earner couples between the ages of 35 and 44 with incomes in the middle 60 percent of the income distribution, i.e., between \$18,500 and \$88,030 in 2004, a substantially smaller share was prepared for an emergency in 2004 than in 2001 (figure 1).⁵ One middle class security indicator is how much wealth they have relative to their income. For instance, middle class families who had at least three months of their income in savings declined by 10.5 percentage points over this three year period, from 28.8 percent in 2001 to 18.3 percent in 2004 (table 2).

An additional indicator of middle class security is whether a family has sufficient savings to survive a spell of unemployment. From 2001 to 2004, families who had enough financial wealth to cover a spell of unemployment dropped by 10.3 percentage points, from 39.2 percent to 28.8 percent.⁶ In each case, these declines more than eliminated all gains made from 1989 to 2001 (figure 1).

Another indicator of middle class security is the preparedness of typical middle class families for a medical emergency.⁷ Despite rapidly rising health care costs, the share of these families that could cover a medical emergency with their financial wealth grew by 2.4 percentage points from 1995 to 2001, climbing from 32.4 percent in 1995 to 34.8 percent in 2001. However, the comparable share dropped by 12.6 percentage points to 22.3 percent in 2004 (table 2). And the share of families who could cover both a medical emergency and a spell of unemployment fell by 10.3 percentage points between 2001 and 2004, after rising by 3.2 percentage points from 1995 to 2001 (figure 1).



Table 2

Changes in Middle Class Security Indicators for Typical Family, 1989 to 2004

Year	Have three months of income worth in financial wealth	Can cover unemployment spell	Can cover medical emergency	Can cover medical emergency and unemployment spell
1989	21.2%	35.0%	n.a.	n.a.
1992	16.7%	25.3%	n.a.	n.a.
1995	24.5%	36.0%	32.4%	31.8%
1998	22.6%	33.1%	29.2%	28.6%
2001	28.8%	39.2%	34.8%	33.7%
2004	18.3%	28.8%	22.3%	22.3%
1989 to 2004	-2.9%	-6.2%	n.a.	n.a.
1989 to 2001	7.6%	4.1%	n.a.	n.a.
1995 to 2001	4.3%	3.2%	2.4%	1.9%
2001 to 2004	-10.5%	-10.3%	-12.6%	-11.3%

Notes: See appendix for details on tables and figures.

When considering the plight of America's middle class, the use of a hypothetical middle class couple is very instructive. Specifically, labor force participation and age can influence the chance of a family to withstand an economic emergency, thus potentially affecting trends in national averages.

For instance, a dual income couple will presumably have another source of income if one earner experiences a medical emergency or a spell of unemployment. Also, older families have had more time to build up savings that would allow them to cover an economic emergency. Therefore, holding labor force participation and age roughly constant, we can gain a sense of the financial security of similarly situated families over time.

All demographic groups see erosion of financial security after 2001

The data can be further analyzed by demographic characteristics (tables 3 through 7). In 2004, the shares of households who were prepared for an emergency generally increase with income, union membership, and age. They are also typically higher for whites than for minorities, higher for single men than married couples, and higher for married couples than single women.

The pattern differs a little for spells of unemployment due to the offsetting effect of average unemployment benefits, which are held constant for all households. That is, lower income households tend to be somewhat better prepared to withstand an unemployment spell than middle income families.

Importantly, in all instances large shares, more often than not, even the majority of families do not have sufficient financial wealth to withstand an emergency.



Table 3

Changes in Middle Class Security Indicators, by Income 1989 to 2004

Threshold	1989	1992	1995	1998	2001	2004	1989 to 2004	1989 to 2001	1995 to 2001	2001 to 2004
Bottom quintile										
Three months of income	24.26%	25.68%	29.10%	28.95%	28.05%	20.27%	-4.0%	3.8%	-1.0%	-7.8%
One unemp. spell	59.2%	60.5%	62.7%	61.6%	62.9%	59.1%	-0.1%	3.6%	0.2%	-3.8%
One medical emergency	n.a.	n.a.	29.3%	27.1%	27.5%	17.7%	n.a.	n.a.	-1.8%	-9.9%
One med. emerg. and one unemp. spell	n.a.	n.a.	34.8%	29.5%	29.1%	20.7%	n.a.	n.a.	-5.7%	-8.4%
Second quintile										
Three months of income	32.2%	33.8%	34.5%	37.5%	36.3%	27.4%	-4.8%	4.0%	1.7%	-8.9%
One unemp. spell	49.4%	49.6%	47.1%	51.4%	50.4%	46.1%	-3.3%	1.0%	3.3%	-4.3%
One medical emergency	n.a.	n.a.	40.5%	42.1%	40.9%	31.0%	n.a.	n.a.	0.4%	-9.9%
One med. emerg. and one unemp. spell	n.a.	n.a.	39.9%	41.2%	39.9%	31.5%	n.a.	n.a.	0.1%	-8.5%
Middle quintile										
Three months of income	36.0%	35.5%	31.6%	35.0%	35.1%	29.2%	-6.8%	-0.9%	3.5%	-5.9%
One unemp. spell	48.5%	43.6%	42.2%	43.8%	44.7%	39.0%	-9.5%	-3.8%	2.5%	-5.7%
One medical emergency	n.a.	n.a.	41.8%	41.6%	42.2%	35.3%	n.a.	n.a.	0.4%	-6.9%
One med. emerg. and one unemp. spell	n.a.	n.a.	39.7%	40.3%	40.4%	33.7%	n.a.	n.a.	0.7%	-6.8%
Fourth quintile										
Three months of income	28.6%	31.8%	34.6%	38.0%	40.3%	36.5%	7.9%	11.7%	5.7%	-3.8%
One unemp. spell	39.1%	38.7%	40.5%	43.6%	47.3%	41.2%	2.1%	8.2%	6.8%	-6.1%
One medical emergency	n.a.	n.a.	41.4%	43.7%	47.4%	40.7%	n.a.	n.a.	6.1%	-6.8%
One med. emerg. and one unemp. spell	n.a.	n.a.	39.7%	42.4%	45.2%	40.1%	n.a.	n.a.	5.5%	-5.0%
Top quintile										
Three months of income	45.2%	45.2%	46.8%	54.9%	55.9%	49.4%	4.1%	10.7%	9.2%	-6.6%
One unemp. spell	52.9%	52.4%	53.2%	59.3%	62.1%	54.9%	2.1%	9.2%	8.9%	-7.2%
One medical emergency	n.a.	n.a.	55.1%	60.6%	63.1%	55.4%	n.a.	n.a.	8.0%	-7.7%
One med. emerg. and one unemp. spell	n.a.	n.a.	52.7%	58.6%	61.4%	53.9%	n.a.	n.a.	8.6%	-7.4%

Notes: See the appendix for details on all tables and figures.



Table 4

Changes in Middle Class Security Indicators, by Union Membership 1989 to 2004

Threshold	1989	1992	1995	1998	2001	2004	1989 to 2004	1989 to 2001	1995 to 2001	2001 to 2004
Union members										
Three months of income	23.7%	26.4%	29.6%	31.5%	35.1%	29.4%	5.8%	11.4%	5.5%	-5.7%
One unemp. spell	38.1%	37.5%	40.0%	39.4%	46.2%	38.1%	0.1%	8.1%	6.2%	-8.1%
One medical emergency	n.a.	n.a.	37.7%	35.3%	41.8%	34.6%	n.a.	n.a.	4.0%	-7.1%
One med. emerg. and one unemp. spell	n.a.	n.a.	36.2%	34.5%	39.9%	34.0%	n.a.	n.a.	3.7%	-5.9%
Non-union members										
Three months of income	26.7%	28.8%	29.4%	32.7%	34.1%	27.6%	0.9%	7.4%	4.6%	-6.5%
One unemp. spell	44.4%	42.3%	42.5%	45.4%	47.6%	41.7%	-2.7%	3.1%	5.1%	-5.9%
One medical emergency	n.a.	n.a.	35.9%	37.8%	39.7%	31.5%	n.a.	n.a.	3.8%	-8.2%
One med. emerg. and one unemp. spell	n.a.	n.a.	35.9%	36.9%	38.5%	31.3%	n.a.	n.a.	2.6%	-7.1%

Notes: See the appendix for details on all tables and figures.

Table 5

Changes in Middle Class Security Indicators, by Race/Ethnicity, 1989 to 2004

Threshold	1989	1992	1995	1998	2001	2004	1989 to 2004	1989 to 2001	1995 to 2001	2001 to 2004
White										
Three months of income	39.7%	39.3%	38.6%	42.2%	44.3%	38.3%	-1.5%	4.6%	5.7%	-6.1%
One unemp. spell	54.0%	51.9%	50.9%	53.7%	55.9%	50.0%	-4.0%	1.9%	4.9%	-5.8%
One medical emergency	n.a.	n.a.	44.8%	46.1%	49.1%	41.7%	n.a.	n.a.	4.3%	-7.4%
One med. emerg. and one unemp. spell	n.a.	n.a.	44.4%	45.6%	48.2%	41.8%	n.a.	n.a.	3.8%	-6.4%
African-American										
Three months of income	10.0%	16.6%	20.6%	24.8%	23.7%	17.4%	7.4%	13.7%	3.1%	-6.3%
One unemp. spell	39.0%	44.5%	46.9%	48.4%	46.8%	43.1%	4.1%	7.8%	-0.1%	-3.7%
One medical emergency	n.a.	n.a.	24.9%	27.4%	28.3%	20.2%	n.a.	n.a.	3.4%	-8.1%
One med. emerg. and one unemp. spell	n.a.	n.a.	27.2%	27.5%	27.3%	19.9%	n.a.	n.a.	0.1%	-7.4%
Hispanic										
Three months of income	7.2%	12.0%	16.4%	14.4%	10.9%	9.4%	2.3%	3.7%	-5.5%	-1.4%
One unemp. spell	34.8%	36.7%	39.9%	40.2%	43.3%	41.8%	7.0%	8.5%	3.5%	-1.6%
One medical emergency	n.a.	n.a.	21.5%	19.4%	19.0%	13.6%	n.a.	n.a.	-2.5%	-5.4%
One med. emerg. and one unemp. spell	n.a.	n.a.	23.4%	19.3%	17.0%	13.0%	n.a.	n.a.	-6.5%	-3.9%

Notes: See the appendix for details on all tables and figures.



Table 6

Changes in Middle Class Security Indicators, by Age, 1989 to 2004

Threshold	1989	1992	1995	1998	2001	2004	1989 to 2004	1989 to 2001	1995 to 2001	2001 to 2004
25 to 34										
Three months of income	11.7%	14.2%	18.3%	15.1%	16.4%	10.9%	-0.8%	4.7%	-1.9%	-5.5%
One unemp. spell	31.5%	30.2%	32.9%	31.4%	31.5%	29.4%	-2.1%	0.0%	-1.4%	-2.1%
One medical emergency	n.a.	n.a.	24.4%	19.3%	21.9%	15.0%	n.a.	n.a.	-2.5%	-6.9%
One med. emerg. and one unemp. spell	n.a.	n.a.	24.4%	19.1%	21.3%	14.4%	n.a.	n.a.	-3.1%	-6.9%
45 to 54										
Three months of income	31.2%	34.7%	34.8%	36.2%	41.1%	32.2%	0.9%	9.9%	6.3%	-8.9%
One unemp. spell	47.2%	45.9%	46.1%	46.4%	51.5%	44.1%	-3.1%	4.3%	5.4%	-7.4%
One medical emergency	n.a.	n.a.	42.2%	41.2%	45.9%	36.3%	n.a.	n.a.	3.8%	-9.7%
One med. emerg. and one unemp. spell	n.a.	n.a.	40.9%	39.6%	45.2%	36.1%	n.a.	n.a.	4.3%	-9.1%
65 and older										
Three months of income	64.4%	62.8%	61.8%	66.5%	65.1%	55.4%	-9.0%	0.7%	3.3%	-9.7%
One unemp. spell	82.2%	82.5%	81.9%	83.4%	82.2%	74.8%	-7.4%	-0.1%	0.3%	-7.4%
One medical emergency	n.a.	n.a.	66.8%	68.9%	67.8%	57.9%	n.a.	n.a.	0.9%	-9.9%
One med. emerg. and one unemp. spell	n.a.	n.a.	68.5%	69.5%	67.8%	59.0%	n.a.	n.a.	-0.7%	-8.8%

Notes: See the appendix for details on all tables and figures.

Table 7

Changes in Middle Class Security Indicators, by Family Status, 1989 to 2004

Threshold	1989	1992	1995	1998	2001	2004	1989 to 2004	1989 to 2001	1995 to 2001	2001 to 2004
Married couples										
Three months of income	34.0%	33.8%	34.3%	37.4%	40.2%	33.3%	-0.7%	6.3%	6.0%	-6.9%
One unemp. spell	47.1%	44.8%	46.2%	48.2%	52.1%	46.0%	-1.1%	4.9%	5.8%	-6.1%
One medical emergency	n.a.	n.a.	40.9%	42.2%	46.2%	38.4%	n.a.	n.a.	5.3%	-7.8%
One med. emerg. and one unemp. spell	n.a.	n.a.	40.6%	41.7%	45.3%	38.0%	n.a.	n.a.	4.7%	-7.3%
Single women										
Three months of income	29.9%	34.1%	36.3%	40.0%	36.5%	29.1%	-0.8%	6.6%	0.3%	-7.5%
One unemp. spell	54.7%	56.6%	57.0%	60.3%	57.2%	50.0%	-4.7%	2.4%	0.2%	-7.2%
One medical emergency	n.a.	n.a.	40.7%	43.1%	39.4%	29.9%	n.a.	n.a.	-1.3%	-9.5%
One med. emerg. and one unemp. spell	n.a.	n.a.	42.0%	42.4%	38.9%	30.3%	n.a.	n.a.	-3.0%	-8.7%
Single men										
Three months of income	34.1%	33.9%	33.2%	36.2%	36.5%	36.0%	1.9%	2.4%	3.3%	-0.5%
One unemp. spell	55.8%	54.7%	50.3%	52.7%	53.5%	53.3%	-2.5%	-2.3%	3.3%	-0.2%
One medical emergency	n.a.	n.a.	40.1%	37.5%	41.1%	38.0%	n.a.	n.a.	1.0%	-3.2%
One med. emerg. and one unemp. spell	n.a.	n.a.	39.1%	38.4%	39.0%	38.6%	n.a.	n.a.	-0.1%	-0.4%

Notes: See the appendix for details on all tables and figures.



Further, for all demographic groups, financial security eroded after 2001. For the vast majority of families, the erosion of financial security after 2000 was either a reversal of the improvements in the late 1990s or an acceleration of a slow deterioration. Sharper turnarounds in financial security from the late 1990s to the years after 2001 came for families in the middle quintile, non-union households, whites, families between 45 and 54 years of age, and married couples than for their counterparts. The general trend is that many middle class families saw a sharp deterioration in their financial security after 2001 while they saw a substantial improvement in the preceding years.

America's families do not share equitably in economic and financial boom

As one would expect, the changes are less pronounced for all families as compared to the typical family. However, the majority of families still cannot even go through one such emergency without dipping into the equity in their homes, that is, if they are lucky to have some. For instance, in 2004, the last year for which data is available, only 32.5 percent of families had enough financial wealth, including the money in their IRAs and 401(k)s, to cover three months of their income in case of a unexpected emergency or expense. More specifically, only 36.0 percent of families had enough financial wealth to cover a medical emergency (table 8). And only 36.1 percent of families had enough financial wealth to survive an unemployment spell even after taking unemployment insurance benefits into account.⁸

Again, the deterioration in the financial security of American families from 2001 to 2004 eliminated all gains made in the 1990s. For example, the share of families who had at least three months of their income in savings declined by 6.2 percentage points, from 38.8 percent in 2001 to 32.5 percent in 2004, after rising by 5.9 percentage points from 32.8 percent in 1989 (table 8). This is a clear reflection of the inability of a growing number of American families to save as the value of their assets declined due to the stock market crash.

Table 8
Changes in Middle Class Security Indicators for Entire Population, 1989 to 2004

Year	Three months of income	Unemployment spell	Medical emergency (one emergency room visit and one hospital stay)	Unemployment spell and medical emergency (one emergency room visit and one hospital stay)
1989	32.8%	50.5%	n.a.	n.a.
1992	33.9%	49.5%	n.a.	n.a.
1995	34.7%	49.8%	41.2%	40.7%
1998	37.9%	52.1%	42.9%	41.8%
2001	38.8%	53.6%	43.8%	43.7%
2004	32.5%	48.2%	36.0%	36.1%
1989 to 2004	-0.3%	-2.3%	n.a.	n.a.
1989 to 2001	5.9%	3.1%	n.a.	n.a.
1995 to 2001	4.1%	3.8%	2.6%	3.0%
2001 to 2004	-6.2%	-5.4%	-7.8%	-7.7%

Note: See appendix for details on tables and figures.



As far as specific economic emergencies, medical crises can pose a much bigger threat than unemployment spells to the financial security of American families. In 2004, only 36 percent of families had sufficient financial resources to cover such an emergency, a decline of 7.8 percentage points from 2001 and a much lower share than in 1995, the first year for which data is available (table 8).⁹

The changes reported here reflect consistent trends after 2000 (figure 2).¹⁰ Importantly, America's families did not receive a respite after the effects of the recession in 2001 and the stock market crashes of 2001 and 2002. Specifically, the share of families who had at least three months of their income in financial wealth declined after 2000 as did the share of families who had enough financial wealth to cover a medical emergency, or a medical emergency coupled with a spell of unemployment. Importantly, the declines continued after the recession ended in 2001 and after the stock market declined ended in 2002. That is, an economic and stock market recovery did not translate into more financial security for America's families.

The trends shown here are calculated using an interpolation technique that requires several steps. First, the distribution of financial wealth is approximated by calculating the 5-percentile cut-offs for each year from the Survey of Consumer Finances (BOG, 2006a). Then, average financial wealth is calculated based on the Flow of Funds Accounts and population data (BOG, 2006b; Census, 2005). Third, it is assumed that the ratio between the respective percentiles and average wealth is the same for the Flow of Funds Accounts and the Survey of Consumer Finances in the survey years and that it remains constant in the years following a SCF survey year. This generates wealth cut-offs for 20 percentiles for each year. Fourth, based on the wealth cut-offs, the relevant shares are calculated based on the following process. The probability of having wealth that is greater than X is:

$$P(X > x) = \left(\frac{x}{x_m}\right)^{-k} \quad (2)$$

Where x_m is the smallest value in the percentile, into which the share falls, and k is the Pareto index. The smallest share is defined by:

$$x_m = \left(\frac{P_b - P_a}{1/a^k - 1/b^k}\right)^{1/k} \quad (3)$$

Where P_a is the share of the sample that lies below a and P_b is the share of the sample that lies below b . In addition, the Pareto index k is defined by:

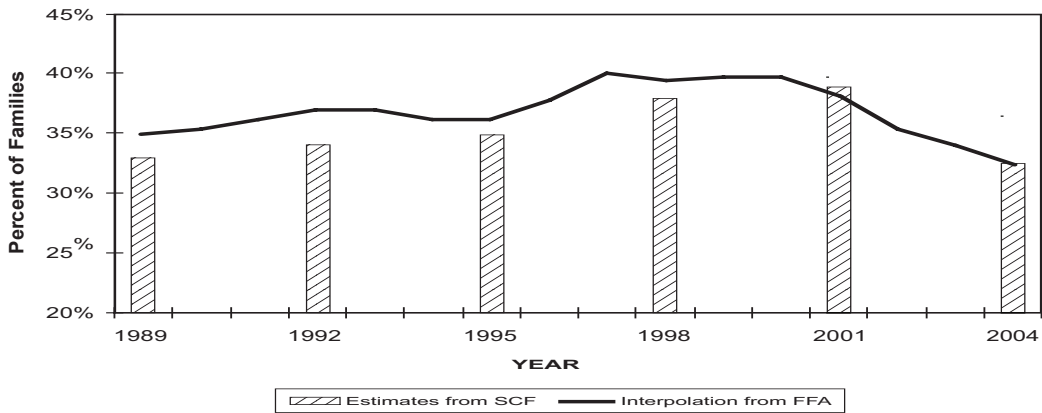
$$k = \frac{\log(1 - P_a) - \log(1 - P_b)}{\log(b) - \log(a)}$$

All calculations for the trend lines are conducted on the basis of one survey, in this case the Flow of Funds Accounts, instead of a combination of both surveys. The reason for this is that the wealth categories do not perfectly match between the two surveys, in fact average and total wealth figures diverge between the two (Antoniewicz, 2000). By using only one survey, the trends should be as consistent over time as possible. To see how comparable the estimated shares from both surveys are, they are combined for each of the four thresholds in figures 2 through 4.



Figure 2

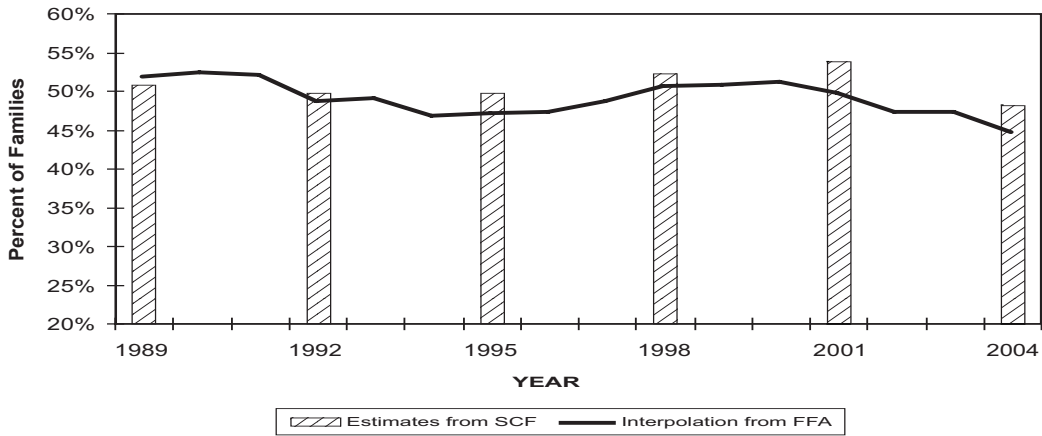
Shares of Families Who Have the Equivalent of 25% of Their Income in Financial Wealth



Notes: See the appendix for details on all tables and figures.

Figure 3

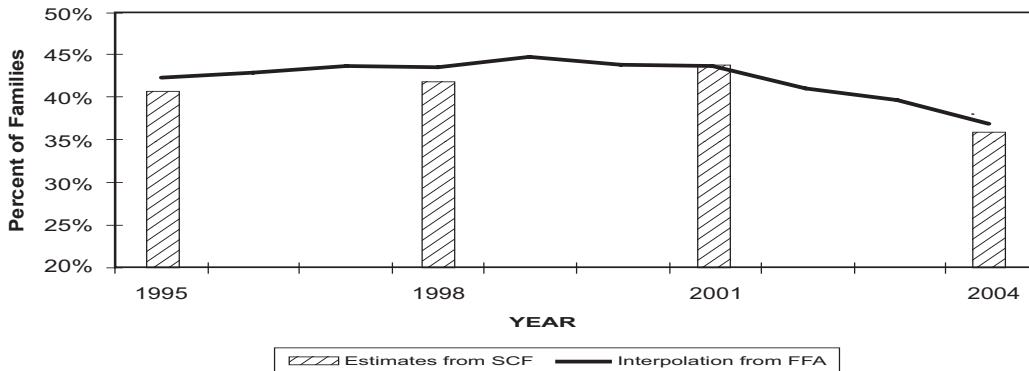
Share of Families Who Can Cover One Unemployment Spell with Financial Wealth



Notes: See the appendix for details on all tables and figures.

Figure 4

Share of Families Who Can Cover a Medical Emergency with Financial Wealth

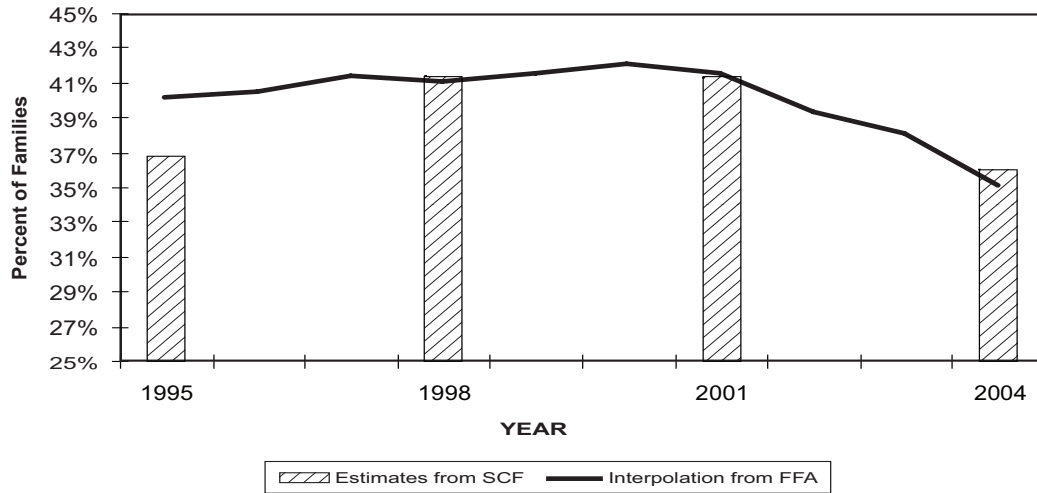


Notes: See the appendix for details on all tables and figures.



Figure 5

Shares of Families Who Have the Equivalent of 25% of Their Income in Financial Wealth



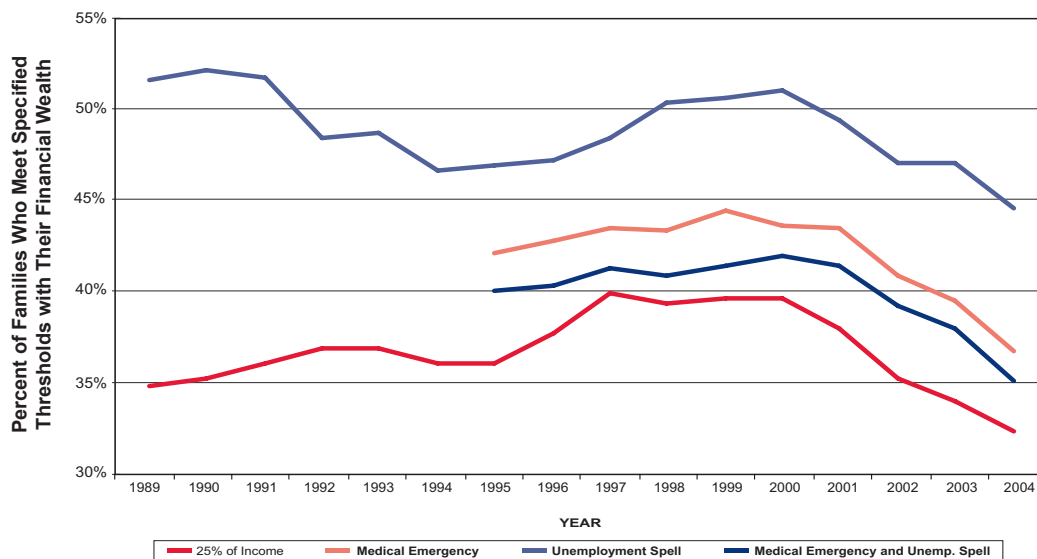
Notes: See the appendix for details on all tables and figures.

The comparison between the two estimates shows that both estimates generate similar trends, and that our interpolation technique does not introduce a consistent bias towards underestimating or overestimating the shares of families.

How can we explain the fact that at a time of a growing economy and expanding financial markets, the financial security of America’s families decreased? The answer is simple. Most families did not share equitably in the economic gains of the last few years. A very weak labor market recovery went hand-in-hand with sharply higher costs for many typical middle class items, such as housing, health care, college education, and transportation. To maintain their consumption, families accelerated their borrowing and ended up with more consumer debt relative to their income than ever before.

Figure 6

Trends in Middle Class Security Indicators



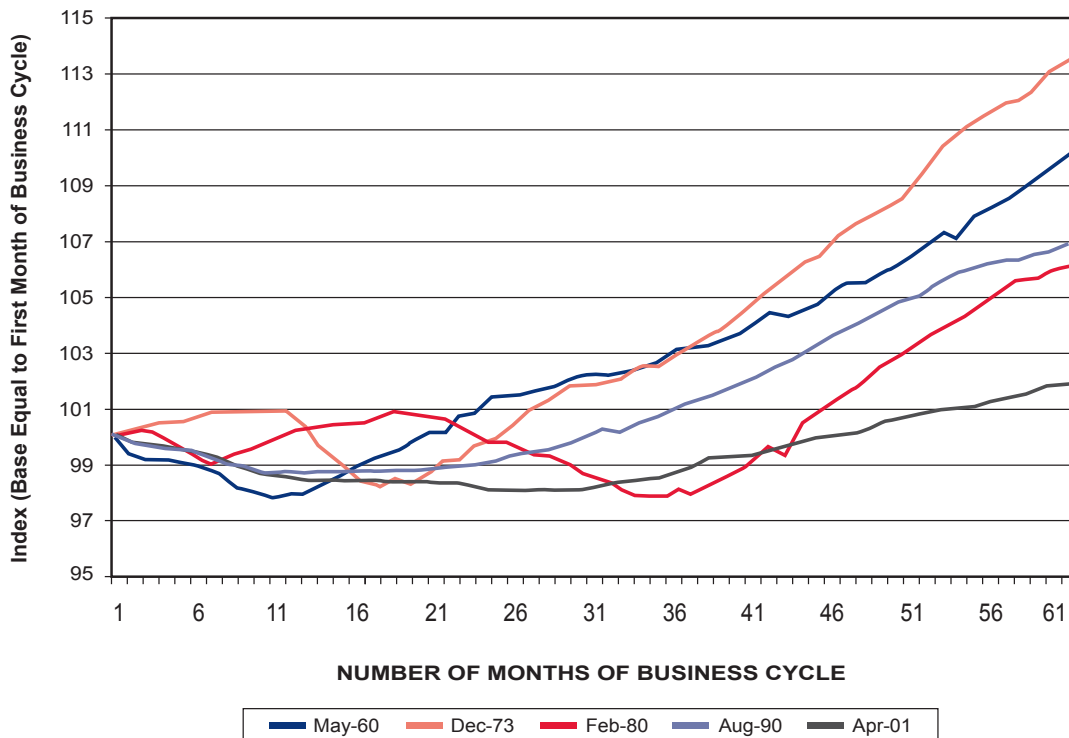
Notes: See the appendix for details on all tables and figures.



Slowest job growth since World War II and flat wages translated into declining incomes

One of the foremost reasons for the erosion in middle class economic security is the fact that families faced a comparatively weak labor market in the middle of a growing economy. For instance, job growth in the business cycle that started in March 2001 was the weakest of any business cycle since World War II (figure 3).¹¹ In fact, in the initial stages of the economic recovery, which started officially in November 2001, the economy shed jobs for a sustained period of time, a first for any economic recovery.

Figure 7
Employment Growth in Business Cycles of Comparable Length

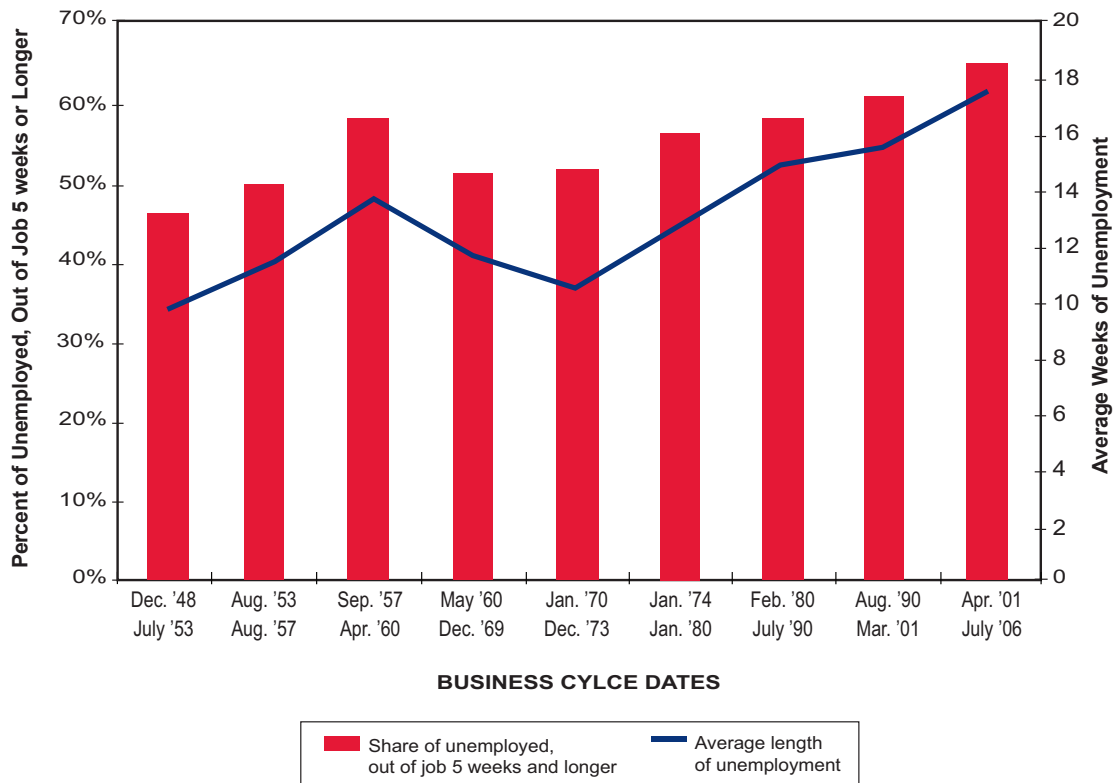


Notes: See the appendix for details on all tables and figures.

A direct result of the slow job growth of this business cycle has been disproportionately high long-term unemployment. The average length of unemployment for this business cycle was 17.6 weeks, longer than for any other business cycle (figure 4). Also, the median length of unemployment—not shown here—averaged 9.0 weeks in the most recent business cycle, which is also longer than in any previous business cycle. Similarly, the share of people unemployed for 5 weeks or more was on average 65.0 percent—again, the largest share of any business cycle (figure 4). In fact, it is the people unemployed for 15 weeks or longer who keep this share high. For the entire business cycle, they constituted on average 34.6 percent of the unemployed – higher than any other business cycle (BLS, 2006a).



Figure 8
Measures of Long-Term Unemployment



Notes: See the appendix for details on all tables and figures.

The comparatively low job growth of this business cycle went along with flat wage growth in inflation-adjusted terms. By the end of 2004, inflation-adjusted hourly earnings were 0.2 percent higher than in November 2001 and only 1.6 percent higher than in March 2001. Subsequently, inflation-adjusted wages actually declined in 2005 and the first half of 2006. By June 2006, inflation-adjusted hourly wages were below those of November 2001 and only 1.0 percent higher than in March 2001. Inflation adjusted weekly earnings were only 0.5 percent larger in June 2006 than in March 2001 (BLS, 2006d).

Weak job growth and flat wages claimed much of families' incomes. In inflation-adjusted terms, family incomes did not rise in any single year between 2000 and 2004 (table 3). Almost all groups witnessed either declines or flat incomes during this period, with two small exceptions. High-income and Hispanic families saw small income increases from 2003 to 2004. However, there is an important difference. The overall declines have been larger for minority families and lower income earners than their higher-earning counterparts. For instance, from 2000 (the last full year of the last business cycle), to 2004, the inflation-adjusted incomes of black families declined by 7.3 percent and those of Hispanic families dropped by 5.9 percent, while those of white families dropped by 2.1 percent during the same period. Also, the incomes for low income families declined by 7.9 percent as compared to a decrease of 4.0 percent for middle income families. In fact, the decline after 2000 for low income families was large enough to erase all income gains made by low income families from 1989-2000 (table 3).



Table 9
Family Income Trends, 2000 to 2004

Year	Total	White only	Black only	Hispanic	Bottom quintile	Middle quintile	Top quintile
1989	42,524	45,693	26,602	32,248	10,289	42,553	125,823
1990	41,963	44,769	26,173	31,294	10,043	41,736	122,116
1991	40,746	43,717	25,437	30,690	9,774	40,775	119,193
1992	40,422	43,924	24,746	29,815	9,574	40,415	120,213
1993	40,217	43,992	25,145	29,462	9,474	40,257	130,345
1994	40,677	44,286	26,510	29,528	9,725	40,830	133,572
1995	41,943	45,761	27,563	28,138	10,272	41,980	134,671
1996	42,544	46,494	28,148	29,855	10,303	42,537	138,466
1997	43,430	47,623	29,400	31,252	10,374	43,632	144,080
1998	45,003	49,116	29,340	32,787	10,674	45,098	147,595
1999	46,129	50,052	31,636	34,851	11,238	46,190	153,305
2000	46,058	50,043	32,541	36,382	11,141	46,325	156,054
2001	45,062	49,412	31,448	35,817	10,816	45,490	155,766
2002	44,546	49,264	30,489	34,771	10,494	44,959	150,988
2003	44,482	49,061	30,442	33,884	10,265	44,759	151,031
2004	44,389	48,977	30,134	34,241	10,264	44,455	151,593
1989 to 2004	4.4%	7.2%	13.3%	6.2%	-0.2%	4.5%	20.5%
1989 to 2000	8.3%	9.5%	22.3%	12.8%	8.3%	8.9%	24.0%
1995 to 2000	9.8%	9.4%	18.1%	29.3%	8.5%	10.4%	15.9%
Change 2000 to 2004 (in percent)	-3.6%	-2.1%	-7.4%	-5.9%	-7.9%	-4.0%	-2.9%

Notes: See the appendix for details on all tables and figures.

Health care inflation and lack of health insurance expose families to higher medical care costs

The other ingredients for rising financial insecurity for many middle class families are rapidly rising costs. An important aspect here is the combination of accelerated price increases for medical care and of declining health insurance coverage, since it leaves more and more families exposed to the chance of ever higher spending from their own pockets. For instance, the share of people without health insurance rose from 14.2 percent in 2000 to 15.7 percent in 2004 (table 4) and the share of people with employer-provided health insurance dropped from 63.6 percent to 59.8 percent during the same period (Census, 2005). The share of the uninsured was thus the highest since 1998 after rising for four years in a row.

Over the same period, from 2000 to 2004, prices for medical care grew by a total of 18.9 percent, while prices in general grew at about half that rate with 9.7 percent (BLS, 2006b). Underlying the overall growth rate in medical care prices was a price increase in hospital services of 32.5 percent and of prescription drugs of 18.1 percent (BLS, 2006b).



Not surprisingly then, health insurance premiums have also increased (table 4). Importantly, the average growth rates of health insurance premiums were in the double digits from 2001 through 2004 and were only modestly lower with 9.2 percent in 2005.

As a result of declining health insurance coverage and rising health care costs, the potential financial threat to a family from a medical emergency has also increased. While the costs of a medical emergency were an estimated \$1,871 for the median family in 1995, the estimated costs had risen to \$3,313 in 2004—a 77.1 percent increase in inflation-adjusted terms (table 4).

Table 10
Selected Data on Health Care Costs and Coverage, 1989 to 2005

Year	Share of people without health insurance	Annual growth rate of medical care consumer price index	Annual growth rate of prescription drug prices	Annual growth rate of hospital services	Annual growth rate of health insurance premiums	Costs of medical emergency (in 2004 dollars)
1989	13.6	7.7	8.7	n.a.	18.0	n.a.
1990	13.9	9.0	10.0	n.a.	n.a.	n.a.
1991	14.1	8.7	9.9	n.a.	n.a.	n.a.
1992	15.0	7.4	7.5	n.a.	n.a.	n.a.
1993	15.3	5.9	3.9	n.a.	8.5	n.a.
1994	15.2	4.8	3.4	n.a.	n.a.	n.a.
1995	15.4	4.5	1.9	n.a.	n.a.	1,871
1996	15.6	3.5	3.4	n.a.	0.8	1,905
1997	16.1	2.8	2.6	n.a.	n.a.	2,024
1998	16.3	3.2	3.7	3.2	n.a.	2,701
1999	14.5	3.5	5.7	4.1	5.3	2,268
2000	14.2	4.1	4.4	6.0	8.2	3,149
2001	14.6	4.6	5.4	6.6	10.9	2,832
2002	15.2	4.7	5.2	9.0	12.9	3,307
2003	15.7	4.0	3.1	7.4	13.9	3,238
2004	15.6	4.4	3.3	6.0	11.2	3,313
2005	15.9	4.2	3.5	5.3	9.2	n.a.

Notes: See the appendix for details on all tables and figures.



Debt Burden Reaches Record Highs as Families Struggle to Make Ends Meet

It was not just health care costs that skyrocketed in recent years, although health care stands out as the largest and fastest-growing consumption item. Importantly, health care inflation accelerated again after 2000. Quarterly price increases averaged 3.2 percent on an annualized basis between March 2001 and June 2006, up from 2.7 percent from December 1995 to March 2001 (table 5).

This meant a sharp increase in the share of disposable income dedicated to health care. From March 2001 to June 2006, the share of disposable income used for medical care grew by 2.1 percentage points, faster than for any other consumption items. This increase after 2000 continued a longer-standing trend of growth of both prices and relative consumption levels of medical care.

As a result, medical care moved from being the third-largest consumption item in 1989 to being the largest in 1995 and thereafter. The combination of being a large consumption item with steep price increases and sharply higher consumption levels not only makes medical care unique, it also shows that families can often not escape the grip of higher medical care costs.

This is not to say that other consumption items did not see sharp price increases. In fact, especially big ticket items did see prices rise. Food, housing, and household operations all saw average quarterly price increases of 2-3 percent between 1990 and 2006 (table 5). In comparison, smaller consumption items observed occasional or persistent price declines, such as cars, furniture, and clothes. Importantly, prices for the top five consumption items grew 2-12 times faster than prices for the smallest five consumption items, such as gasoline, which increased an average quarterly price of 11.4 percent from March 2001 through June 2006 (table 5).

With the exception of the late 1990s, families expanded their consumption relative to their disposable income for small and large items. However, while families managed to slow the growth of big ticket items below the growth of their disposable income in the late 1990s, largely because of strong income gains, the opposite was the case after 2000.

Specifically, price increases for the five largest consumption items were almost identical from the end of 1995 through March 2001. But because income grew strongly due to respectable employment and wage growth in the late 1990s, the share of these big ticket consumption items relative to disposable income declined by 0.7 percentage points from 1995 to 2001 and rose by 2.0 percentage points after March 2001 (table 5).

Caught between rising prices and stagnant and declining income, families borrowed more money. This is also reflected in a sharp decline of the personal saving rate. From June 1990 through June 2006, personal saving relative to disposable income dropped by 8.7 percentage points (table 5). While personal savings was the fourth most important allocation of disposable income in 1989 and the sixth most important in 1995, it had fallen to last place by 2000.

Table 11
Changes in Prices and Consumption Shares of Ten Large Consumption Categories and Personal Saving, 1990 to 2006

Category	Cars	Furniture	Food	Clothes	Gasoline	Housing	Household Operation	Transp.	Medical Care	Recreation	Saving	Top 5	Bottom 5
Rank													
1989	6	8	1	7	11	2	5	9	3	10	4	n.a.	n.a.
1995	5	8	3	7	11	2	4	9	1	10	6	n.a.	n.a.
2000	5	6	3	7	10	2	4	8	1	9	11	n.a.	n.a.
2006	5	6	3	8	9	2	4	10	1	7	11	n.a.	n.a.
Price Change													
1990 to 2006	1.1%	-4.1%	2.2%	-1.1%	5.9%	3.0%	2.2%	2.7%	3.5%	3.0%	n.a.	2.6%	0.6
1990 to 2001	1.8%	-3.7%	2.2%	-0.8%	3.2%	3.0%	2.0%	2.8%	3.7%	3.1%	n.a.	2.7%	0.4
1995 to 2001	0.4%	-5.6%	2.3%	-1.2%	5.4%	3.0%	1.8%	2.2%	2.7%	3.1%	n.a.	2.4%	0.2
2000 to 2006	-0.2%	-5.1%	2.3%	-1.6%	11.4%	3.0%	2.7%	2.7%	3.2%	2.9%	n.a.	2.5%	1.2
Change in Consumption Share													
1990 to 2006	-0.4%	0.2%	-1.4%	-1.0%	1.1%	0.6%	-0.1%	0.1%	3.9%	1.1%	-8.7%	2.7%	1.5%
1990 to 2001	0.3%	0.2%	-2.0%	-0.7%	0.0%	0.3%	0.3%	0.6%	1.8%	0.9%	-5.3%	0.7%	0.9%
1995 to 2001	0.3%	-0.1%	-0.7%	-0.4%	0.3%	0.0%	0.1%	0.1%	-0.2%	0.2%	-2.1%	-0.6%	0.2%
2000 to 2006	-0.7%	0.0%	0.6%	-0.3%	1.1%	0.4%	-0.4%	-0.5%	2.1%	0.2%	-3.4%	2.0%	0.6%

Notes: See the appendix for details on all tables and figures.

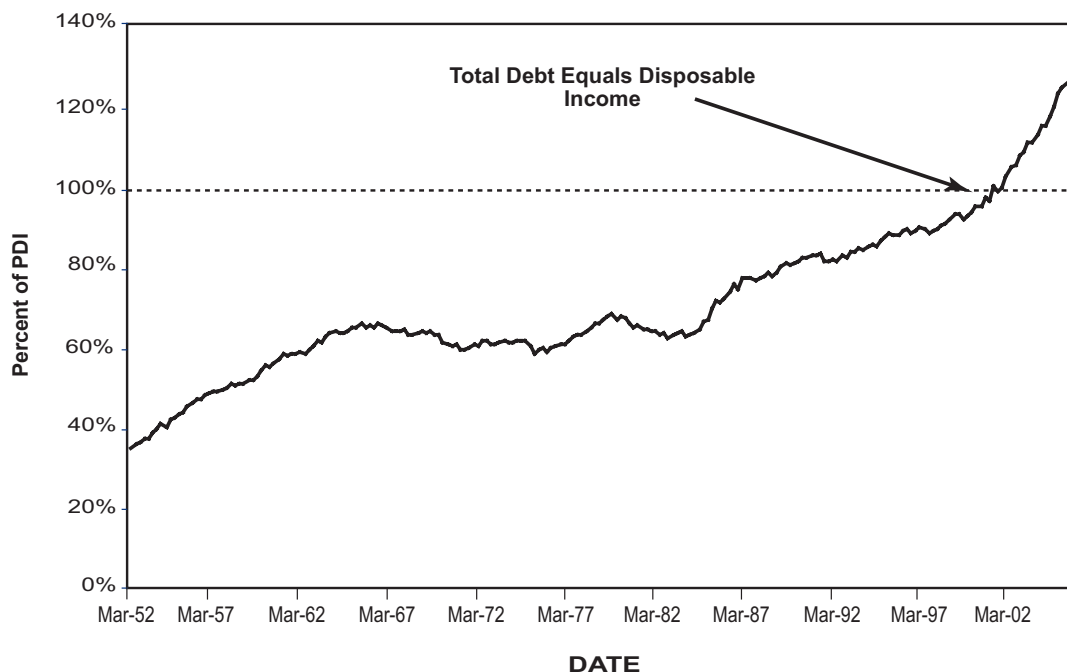


Going hand-in-hand with the decline in personal saving is a sharp increase in household debt relative to disposable income after 2001 (figure 5). By early 2006, families had amassed a record high amount of debt equivalent to 126.4 percent of disposable income. At the end of 2001, family debt equaled disposable income for the first time on record. Moreover, the increase of debt relative to income averaged 1.3 percentage points per quarter from March 2001 through March 2006, compared to an average increase of 0.4 percentage points from December 1995 through March 2001 (figure 5).¹²

Not only did the levels of debt increase, but also the share of disposable income used to pay it off. It reached a record high of 13.9 percent in March 2006 (BOG, 2006c).

Figure 9

Household Debt Relative to Personal Disposable Income (PDI), 1952 to 2006



Notes: See the appendix for details on all tables and figures.

With personal savings declining and even becoming negative, and with household debt mounting, families have fewer resources to fall back on if anything should go wrong. In fact, financial wealth declined in inflation-adjusted dollars by 9.2 percent from 2001 to 2004 and the share of households with positive financial wealth declined by 6.1 percentage points from 52.0 percent in 2001 to 45.9 percent in 2004, the smallest share ever recorded (table 6). Even total accessible wealth, which includes the late 1990s real estate boom, only increased by 6.1 percent in inflation-adjusted terms from 2001 to 2004. In comparison, total accessible wealth grew by 37.8 percent and financial wealth by 57.7 percent from 1995 to 2001 (table 6).



Table 12
Select Family Wealth Data, 1989 to 2004 (in 2004 Dollars)

Year	Share of families with positive accessible wealth	Share of families with positive financial wealth	Median accessible wealth for families with accessible wealth	Median financial wealth for families with financial wealth
1989	80.6%	48.3%	94,268	26,829
1992	80.9%	48.4%	86,008	27,874
1995	80.9%	48.0%	84,772	31,011
1998	81.4%	50.6%	104,292	44,402
2001	81.9%	52.0%	116,842	48,909
2004	82.3%	45.9%	124,020	44,400
1989 to 2004	1.7%	-2.5%	31.6%	65.5%
1989 to 2001	1.3%	3.7%	23.9%	82.3%
1995 to 2001	1.0%	3.9%	37.8%	57.7%
2001 to 2004	0.4%	-6.1%	6.1%	-9.2%

Notes: See appendix for details on tables and figures.

CONCLUSION

America's middle class families are caught in an unprecedented crunch. Despite a growing economy, their incomes have been stagnant or flat. And because prices for big ticket items such as housing and health care have gone through the roof, families were not able to put away a rainy day fund. On the contrary, middle class families had to take on more debt at an accelerating pace to maintain their consumption, indicating that they were increasingly vulnerable to an economic emergency if anything went wrong.



APPENDIX

Notes on Figures:

Figure 1: Changes are in percentage points. The typical family is defined as two-earner couples between the ages of 35 and 54 with incomes in the middle three income quintiles. Median costs for medical emergencies are for individuals undergoing exactly one emergency room visit and exactly one hospital visit in a given year. Medical expenditure data are extrapolated for 1995 and 2004. Extrapolation is done by adjusting the closest known expenditure data, i.e. 1996 and 2003, respectively, by the share of people without health insurance and the consumer price index for medical care. Unemployment costs are the difference between basic consumption – as share of income – multiplied by the median length of unemployment and the average unemployment benefit multiplied by the median length of unemployment. Basic consumption items are food consumed at home, housing, utilities, apparel, transportation, health care, personal care, education, and insurance. The median share of basic consumption relative to before tax income for the entire population is set equal to the average share of the middle quintile. Financial wealth is the difference of all financial assets, including retirement savings accounts, such as IRAs and 401(k)s, minus all outstanding debt. Authors' calculations based on AHRQ (2006), BLS (2006a, 2006b, 2006c), and BOG (2006a).

Figure 2: All figures are in percent. See text for explanation of interpolation technique.

Figure 3: Same as figure 2.

Figure 4: Same as figure 2.

Figure 5: Same as figure 2.

Figure 6: All figures in percent. Shares are calculated based on BOG (2006b) using Pareto interpolations to approximate annual distributions. All interpolations are done on the basis of 20 equal sized groupings. Distributions are calculated based on BOG (2006a) for the survey years and held constant for the subsequent two years.

Figure 7: Authors' calculations are based on BLS (2006d). Only business cycles that lasted at least as long as the current one are considered. In each case, employment is indexed to the first month of the business cycle.

Figure 8: Median weeks are available only after June 1967. The average median length of unemployment for the five business cycles, for which complete data are available are: 5.7 weeks, 6.7 weeks, 7.1 weeks, 7.5 weeks, and 9.0 weeks in chronological order. That is, the most recent business cycle also has the longest median length of unemployment. Source is BLS (2006a).

Figure 9: All figures in percent. Total debt is all credit market instruments. Authors' calculations based on BOG (2006b).



Notes on Tables:

Table 1: Units are given in table. Authors' calculations based on BLS (2006a, 2006c) and DOL (2006).

Table 2: All figures are in percent. Changes are in percentage points. The typical family is defined as two-earner couples between the ages of 35 and 54 with incomes in the middle three income quintiles. Median costs for medical emergencies are for individuals undergoing exactly one emergency room visit and exactly one hospital visit in a given year. Medical expenditure data are extrapolated for 1995 and 2004. Extrapolation is done by adjusting the closest known expenditure data, i.e. 1996 and 2003, respectively, by the share of people without health insurance and the consumer price index for medical care. Unemployment costs are the difference between basic consumption – as share of income – multiplied by the median length of unemployment and the average unemployment benefit multiplied by the median length of unemployment. Basic consumption items are food consumed at home, housing, utilities, apparel, transportation, health care, personal care, education, and insurance. The median share of basic consumption relative to before tax income for the entire population is set equal to the average share of the middle quintile. Financial wealth is the difference of all financial assets, including retirement savings accounts, such as IRAs and 401(k)s, minus all outstanding debt. Authors' calculations based on AHRQ (2006), BLS (2006a, 2006b, 2006c), and BOG (2006a).

Table 3: Same as table 1.

Table 4: Same as table 1.

Table 5: Same as table 1.

Table 6: Same as table 1.

Table 7: Same as table 1.

Table 8: All figures are in percent. Changes are in percentage points. Median costs for medical emergencies are for individuals undergoing a) exactly one hospital visit, b) exactly one hospital visit if they also had exactly one emergency room visit, and c) at least one hospital visit if they had at least one emergency room visit in a given year. The conditionalities of the different calculations result to the counterintuitive result that costs for exactly one hospital stay are slightly higher than costs for exactly one emergency room visit and exactly one hospital stay in 2004. Medical expenditure data are extrapolated for 1995 and 2004. Extrapolation is done by adjusting the closest known expenditure data, i.e. 1996 and 2003, respectively, by the share of people without health insurance and the consumer price index for medical care. Unemployment costs are the difference between basic consumption – as share of income – multiplied by the median length of unemployment and the average unemployment benefit multiplied by the median length of unemployment. Basic consumption items are food consumed at home, housing, utilities, apparel, transportation, health care,



personal care, education, and insurance. The median share of basic consumption relative to before tax income for the entire population is set equal to the average share of the middle quintile. Financial wealth is the difference of all financial assets, including retirement savings accounts, such as IRAs and 401(k)s, minus all outstanding debt. Authors' calculations based on AHRQ (2006), BLS (2006a, 2006b, 2006c), and BOG (2006a).

Table 9: All dollar values are in 2004 dollars. Percentages are percent changes. Figures for total, Whites, Blacks, and Hispanics are median family incomes. Figures by quintile are averages for the respective quintile. Data for whites and blacks refer to whites only and blacks only. Prior to 2001, people could only select one race/ethnicity, while they have been able to choose one or more since then. Authors' percent change calculations based on Census (2005).

Table 10: All figures are in percent, unless otherwise noted. Sources are Census (2005), BLS (2006b), Kaiser (2005), and AHRQ (2006). Data on health insurance premium reflect total health insurance premium for family of four. A medical emergency is defined as exactly one emergency room visit and exactly one hospital visit in a given year. Data for 1995 and 2004 are extrapolated by adjusting for changes in the CPI-U for medical care and the share of people without health insurance.

Table 11: Price changes are in percent. Price changes are annualized quarterly average changes. Average price changes for top and bottom consumption groups are weighted averages, with consumption shares in the four quarter before the respective period used as weights. Changes in consumption relative to disposable income are in percentage points. Changes in consumption relative to disposable income are total changes. Changes for top and bottom consumption item groups are the sums of each group's components. All calculations are based on BEA (2006).

Table 12: Shares are expressed in percent and changes in shares as percentage points. Levels of wealth are in 2004 dollars and changes in levels of wealth are in percent. Authors' calculations based on BOG (2006a). Financial wealth is the difference of all financial assets, including retirement savings accounts, such as IRAs and 401(k)s, minus all outstanding debt. Total accessible wealth is equal to financial wealth plus real estate holdings.



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Endnotes

- ¹ Financial wealth is the difference between financial assets, including retirement savings, such as IRAs and 401(k)s, and all debt.
- ² A brief description of uncompensated care, bad debt and free care is available at American Hospital Association. “Uncompensated Hospital Care Cost Fact Sheet.” November 2005. <http://www.aha.org/ahapolicyforum/resources/content/0511UncompensatedCareFactSheet.pdf>
- ³ Research for Oregon showed bad debt accounting for 40-75% of uncompensated care totals in the state (OAHHS, 2006).
- ⁴ Financial wealth is the difference between financial assets, including retirement savings, such as IRAs and 401(k)s, and all debt.
- ⁵ The dates chosen here for comparison are determined by data availability and by the business cycle. The intent is to compare business cycles with each other. The last full year before the prior business cycle was 1989 and is thus chosen as a comparison point. The last full year of the last business cycle was 2000. However, no data are available for 2000 and thus 2001 is chosen as the closest survey year. WIn case, where annual data are available, comparisons are drawn to 2000 instead of 2001.
- ⁶ The costs of an unemployment spell are equal to the median length of unemployment times the share of income dedicated to basic consumption times the income of one worker minus the average weekly unemployment benefit times the median length of unemployment.
- ⁷ A medical emergency is the median cost of exactly one emergency room visit and exactly one hospital stay.
- ⁸ All unemployment related calculations are net of average weekly unemployment benefits for the median length of unemployment in the respective year.
- ⁹ This result and all others hold, regardless of how a medical emergency is defined – whether just a hospital stay, an emergency room visit and a hospital stay, or at least one emergency room visit and at least one hospital stay. See Weller and Staub (2006) for more details.
- ¹⁰ The shares depicted in figure 2 differ slightly from those calculated in table 1 as they are based on a different data set. Although both surveys – the Flow of Funds Accounts and the Survey of Consumer Finances – are meant to capture the same household wealth, there can be substantial divergence from year to year (Antoniewicz, 2000). However, differences in the levels and changes of the shares of families who meet the various thresholds are small.
- ¹¹ The figure provides additional information, beyond 2004, to illustrate that the exceptionally weak job market performance of the first few years was not followed by an exceptionally strong employment growth.
- ¹² Data are not shown here. Calculations are done for data underlying figure 5.



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