

Center for American Progress



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High Risks Reflect  
Middle-Class Anxieties

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Christian E. Weller, Senior Economist, Center for American Progress.

### **Introduction**

America's middle class is worried about its finances. It is struggling with stagnant wages, slow employment, and rising costs. However, this is only part of the story. The other part is that the economic risks for middle-class families have grown, too. Should anything go wrong – job loss, medical emergency and the like – middle-class families will experience a sharper drop in their finances than in prior business cycles. The sharpest reflection of this trend is the growth of personal bankruptcies to record high levels.

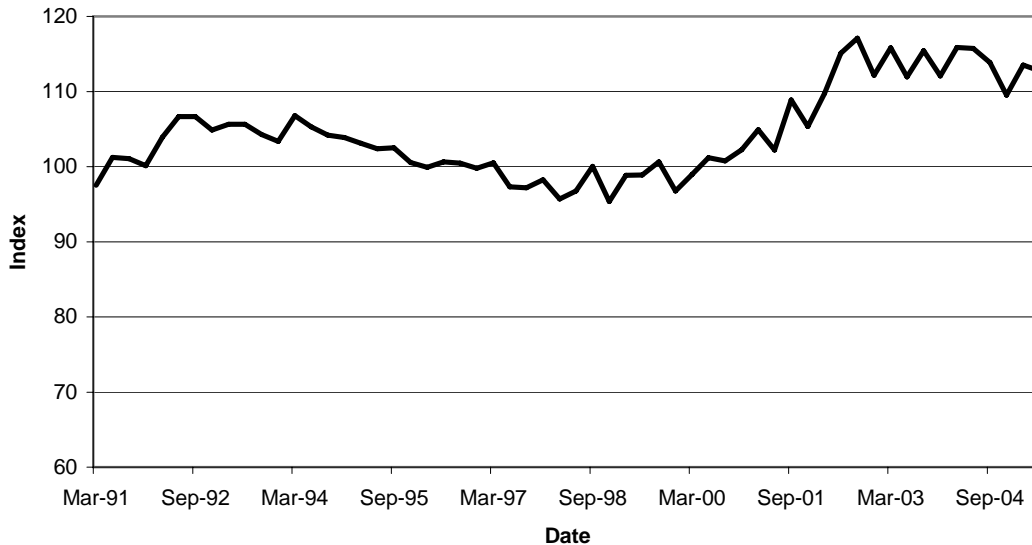
Key findings of this report are:

- **Higher Risk of Long-Term Job Loss:** In February, long-term unemployment rose to its highest level in more than 20 years and stayed high. In the fourth year of the recovery, the average length of unemployment was still at about 18 weeks.
- **Greater Debt:** Despite lower interest rates, homeowners had to dedicate a record 10.8 percent of their disposable incomes to paying their mortgages in the third quarter of 2005. At the current rates, a household with a mortgage has a one-in-60 chance of being foreclosed on over the course of a year.
- **Shrinking Benefits:** Four percent fewer private sector full-time workers had a pension in 2004 than in 2000, and the share of people with employer-provided health insurance declined from 63.6 percent to 59.8 percent at the same time.
- **Rising Oil Prices:** Oil prices rose sharply. Higher energy prices and their unpredictable price increases make it harder for households to plan for their future and to save money.

### **Middle-Class Risks Reflected in High Anxieties and Record Bankruptcies**

Middle-class risks rose sharply in the most recent recession and stayed high throughout the business cycle. Middle-class risks rose sharply in the most recent recession, from March 2001 to the end of 2001 (figure 1). Even when the economy began its recovery, these risks continued to rise. By September 2002, middle-class risks were 11.6 percent higher than in March 2001. Moreover, middle-class risks in this business cycle have been about 10 percent greater than the average risk in the last business cycle and they remained high well into the business cycle as risk exposure in June 2005 was 7.5 percent higher than in March 2001 (figure 1).

Figure 1: Middle Class Risk Index

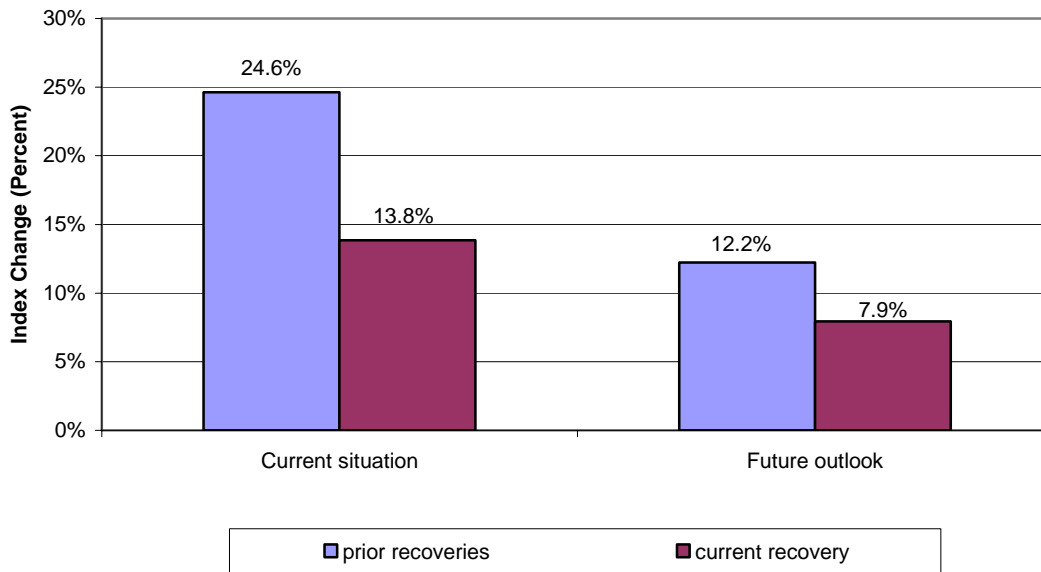


Notes: See technical appendix for explanation of calculation.

Changes in consumer outlook reflect the American middle class' nervousness about its future (figure 2). By March 2005, people's assessment of their current situation and their outlook for the future had improved at much slower rates than over the same period in previous recoveries.<sup>1</sup> While people's assessment of their future improved by 24.6 percent in all previous business cycles since the 1960s, it only rose by 13.8 percent in this one. A similar discrepancy exists in people's assessment of their future. In past business cycle, it rose by 12.2 percent, compared to only 7.9 percent this time.

<sup>1</sup> The first year of the current business cycle was 2001, its first quarter was the second quarter in 2001, and its first month was April 2001. For previous business cycle dates see NBER (2005).

**Figure 2: Changes in Current and Future Consumer Outlook  
13 Quarters into Recovery**



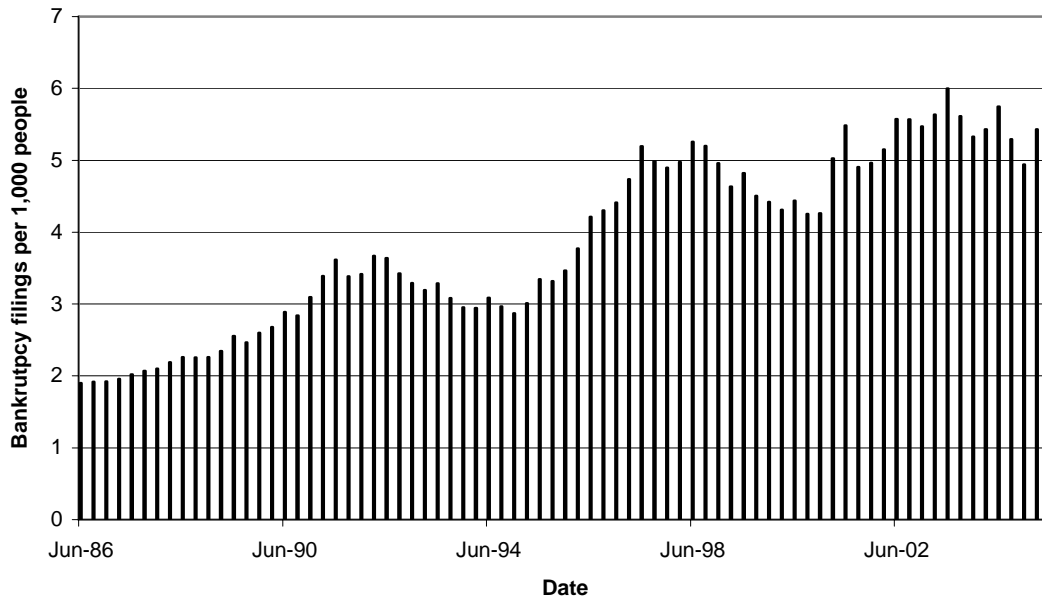
Author's calculations based on data from the UM (2005), NBER (2005).

To some degree, the anxieties of middle-class families mirror their economic struggles. It has become harder for middle-class families to afford middle-class items. In September 2005, the average two-earner family needed to work 32.0 weeks to pay for taxes and a range of middle-class items (health care, housing, college, and transportation). That is an increase from 30.2 weeks in March 2001, and from 28.7 weeks in March 1979 (Weller, 2006). A direct result of the squeeze of higher prices and stagnant incomes is less money left over to pay for a variety of items, including saving for retirement. In 2005, after paying for the items outlined above, the average two-earner family had about \$19,229 left to pay for basics—such as clothing, food, and utilities—to save for retirement, to improve their economic well-being, and to spend on any leisure and recreation. That is \$1,263 less than families had in 2000 and \$2,015 less than in 1980 (Weller, 2006).

Middle-class families have responded by working longer hours and borrowing more. Longer work hours have meant less time to spend with children and higher out-of-pocket expenditures for child care and for food outside the home. In addition, household debt soared to a record 121 percent of disposable income in September 2005 (Weller, 2005) and average debt service burden levels soared to a record high of 13.8 percent in the third quarter of 2005 (BOG, 2005a).

The middle-class squeeze, though, is only part of the story. Adding to these struggles are high economic risks. This is probably best exemplified by the personal bankruptcy rate. The number of bankruptcy filings stayed at or above an annualized rate of 5.0 filings per 1,000 throughout this business cycle (figure 3) – a level barely seen before.

**Figure 3: Personal Bankruptcy Filings Relative to the Population**



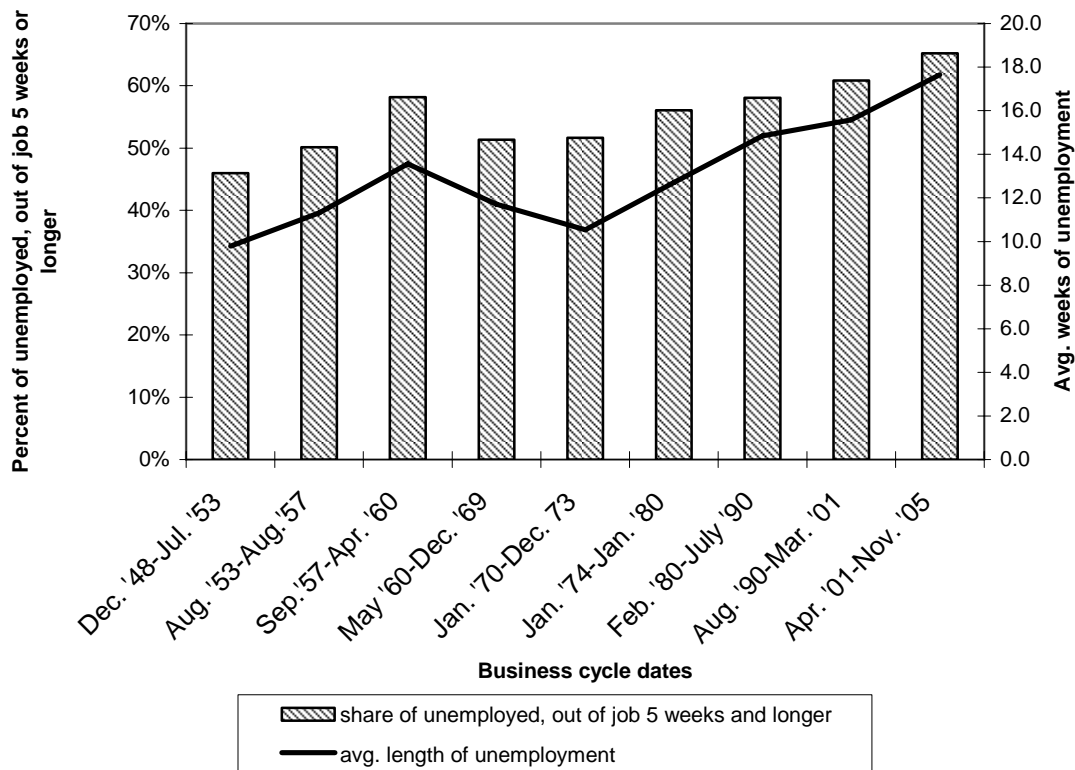
Notes: Figures are annualized. Author's calculations based on ABI (2005) and Census (2005a).

## **Widespread Economic Risk Increases**

### *Income*

The rise in the bankruptcy rate mirrors weak income growth (Weller and Gino, 2005). It also reflects the fact that job loss, among the primary causes of personal bankruptcies, has become associated with much higher costs than in the past. Measures of long-term unemployment have been at or near 20-year highs for the entire business cycle. The current business cycle has the highest average share of people out of a job for five weeks or more and the highest average length of unemployment (figure 4). Throughout the business cycle, the average length of unemployment rose to its highest level in 20 years and stayed at about 18 weeks even in the fourth year of the recovery. That is, once a worker loses a job, reentry into a job is harder than in the past.

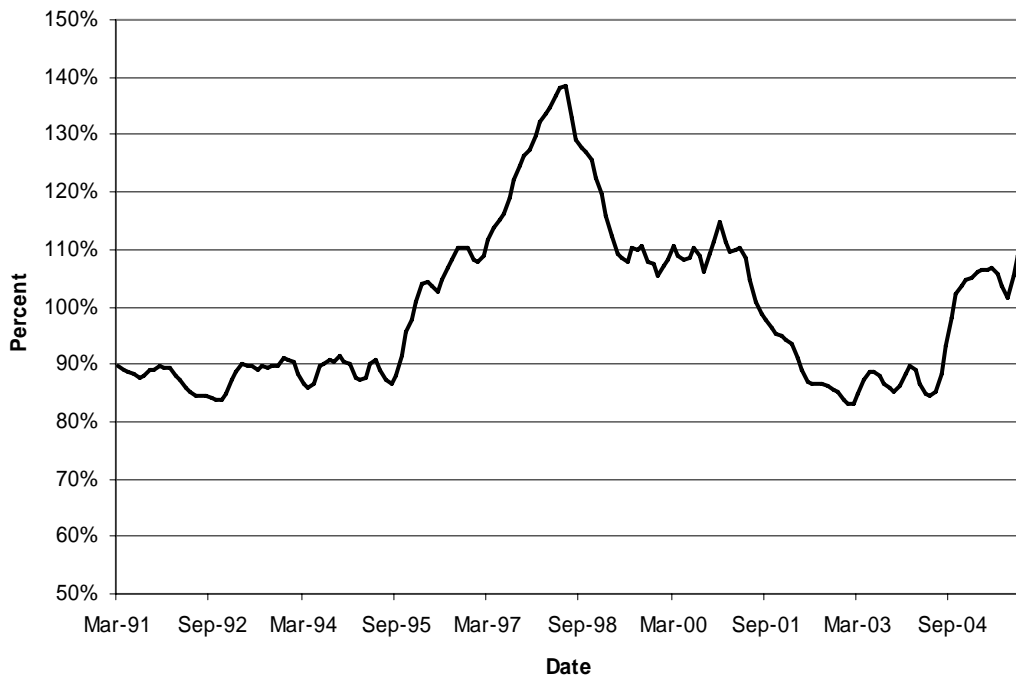
**Figure 4: Measures of Long-Term Unemployment**



Notes: Author's calculations based on data from BLS (2005a).

Even when previously unemployed workers got new jobs, it was more likely for most of the current business cycle that the new jobs would pay less than the old ones. From March 2001 to December 2004, industries that were expanding paid less than industries that were on the decline (figure 5). This trend has reversed since then, with jobs in expanding industries on average paying more than jobs in contracting industries. However, as discussed in the previous section, these improvements do not seem to be enough to counter the effects of other, growing risks for middle-class families.

**Figure 5: Ratio of Wages in Expanding Industries to Wages in Contracting Industries**



Notes: See technical appendix for a description of the calculations. Author's calculations based on data from BLS (2005a).

### *Household Debt*

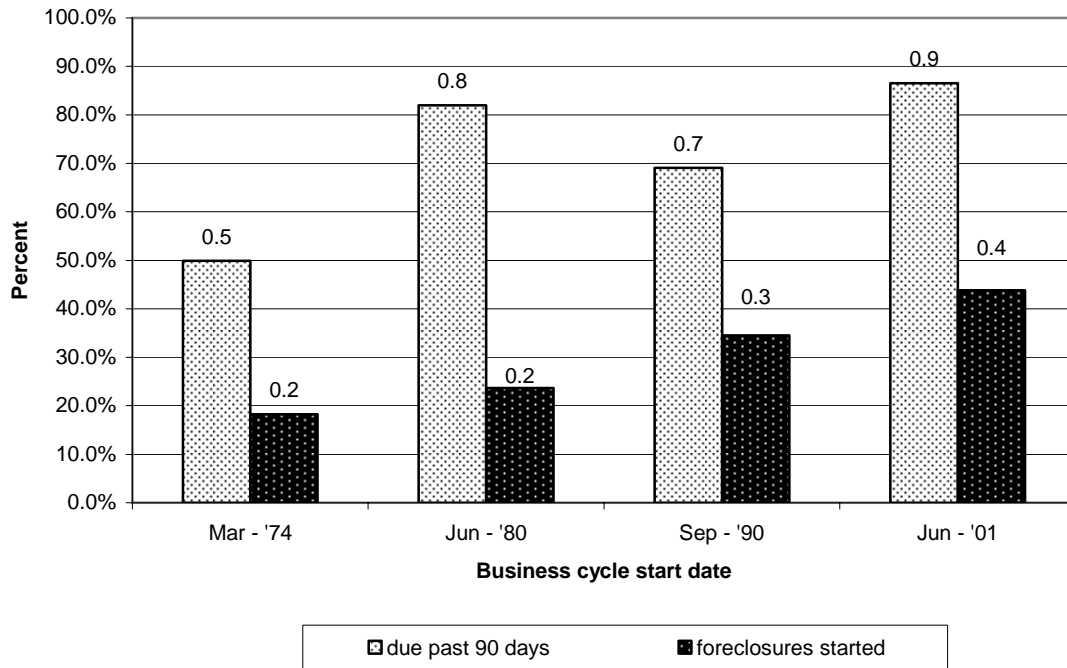
As a result of the middle-class squeeze, many families saw their debt levels rise in an effort to maintain their consumption amid a weak labor market. Total debt levels reached 121 percent of disposable income in the third quarter of 2005, a new record high (Weller, 2005). Much of this increase in debt resulted from a boom in the mortgage market, which was driven by lower interest rates.

However, low interest rates have ultimately been offset by ever more debt, such that the burden an average mortgage has put on middle-class disposable incomes grew. While in March 2001, the average household dedicated 9.3 percent of its disposable income to paying its mortgage, the share rose to 10.8 percent by the third quarter of 2005, despite lower interest rates (BOG, 2005a).

The financial strains that many homeowners are under are already reflected in the data. Both delinquencies and foreclosure rates have risen in the current business cycle (figure 6). On average, 0.9 percent of all mortgages were at least 90 days past due. In fact, close to 5 percent of all mortgages were at least 30 days past due, up from 4 percent in the 1990s (MBA, 2005). At the same time, the foreclosure rate also rose to its highest average level since the early 1970s. That is, in each quarter foreclosures started on

average on 0.4 percent of all outstanding mortgages. At this rate, a household with a mortgage has a one-in-60 chance of being foreclosed on over the course of a year.

**Figure 6: Delinquency and Foreclosure Rates, Mortgages, Business Cycle Averages**



Notes: Author's calculations based on data from the MBA (2005). Data through March 2005.

Much of the new debt has been in the form of adjustable rate mortgages and other variable interest rate debt (Weller and Chaurushiya, 2004). That is, increases in interest rates will quickly translate into higher debt burdens and possibly larger delinquency and default rates, depending on the overall economic situation. Already, in the third quarter of 2005, the default rate on consumer loans other than mortgages rose to over 3 percent for the first time in more than two years (BOG, 2005b).

### *Pensions*

One possibility to counter the rising risks would be to build up more wealth. Over the course of the current business cycle, though, the personal saving rate has fallen to below zero percent (BEA, 2005). Not only are households less likely to save than before, they also receive less support from their employers to do so than in the past. Specifically, the coverage by employer-sponsored pension plans has declined in the private sector, and the trend has gone away from traditional defined benefit (DB) to so-called defined contribution (DC) plans, such as 401(k). Thus, it has become harder for middle-class families to save and their risk exposure with their retirement savings has grown, too.

Pension coverage in the private sector has declined and has remained very uneven. For all private sector workers who were employed year-round and full-time, pension coverage dropped from 57.4 percent in 2000 to 53.4 percent in 2004 (table 1). That is, more than 40 percent of full-time private sector workers were not covered by a pension plan in this business cycle and their share rose to over 45 percent by 2004. The decline in pension coverage was larger for men than for women, which likely was related to the decline of manufacturing employment at the same time. Furthermore, pension coverage was substantially larger for high-income earners and for whites than for their counterparts. The pension coverage for whites was more than double that of African-Americans in 2002 and 2003 (table 1). Consequently, minorities received less assistance from their employers than whites in building private wealth.

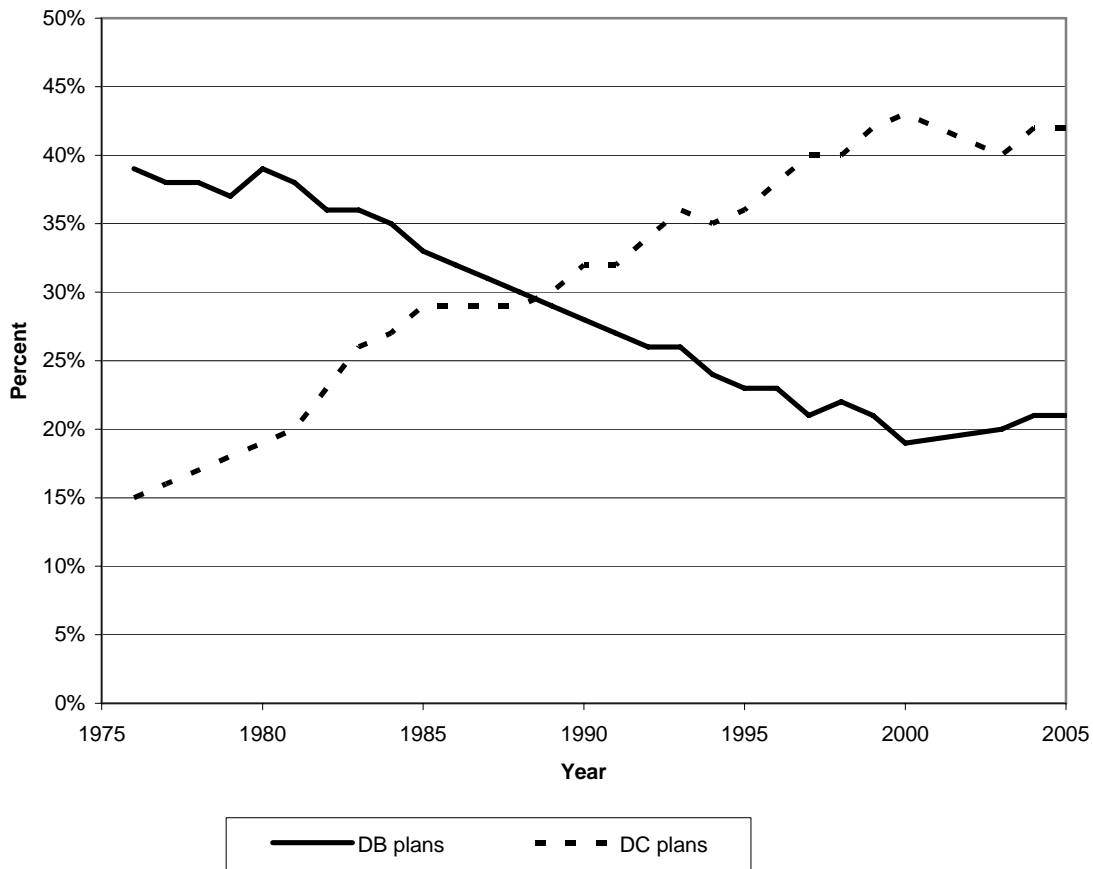
**Table 1**  
**Pension Coverage Trends, 2000 to 2003**

Year	Total	Men	Women	Whites	Blacks	Latinos	Bottom Quartile	Top Quartile
2000	57.4	58.3	56.1	-	-	-	32.1	75.5
2001	55.8	56.5	54.8	-	-	-	31.5	73.3
2002	53.4	53.9	52.9	66.7	47.5	31.1	29.5	71.0
2003	54.1	53.9	54.3	67.6	49.1	32.6	28.4	72.5
2004	53.4	52.9	54.1	66.7	49.7	31.0	29.9	71.4
Change 2000 to 2003	-3.3	-4.4	-1.8	-	-	-	-2.7	-3.0

Notes: All figures are for full-time, year-round employees. Source is Purcell (2004).

There has been a fundamental shift that has exposed private sector workers to more risks, although the trend seems to have stabilized in this business cycle. While 38 percent of private sector workers were covered by a DB plan in 1976, this share had declined to 21 percent in 2004. Instead, the share that was covered by a DC plan rose from 15 percent to 42 percent (figure 7). The shift in coverage from DB to DC plans means that more workers have to take on risks associated with DC plans, such as the chance that the financial markets will experience below average rates of return during a worker's lifetime or that a worker's savings will be exhausted too soon. Over the course of this business cycle, this risk shift seems not to have worsened further, as coverage under each type of pension plan stabilized (figure 7).

Figure 7: Pension Plan Coverage

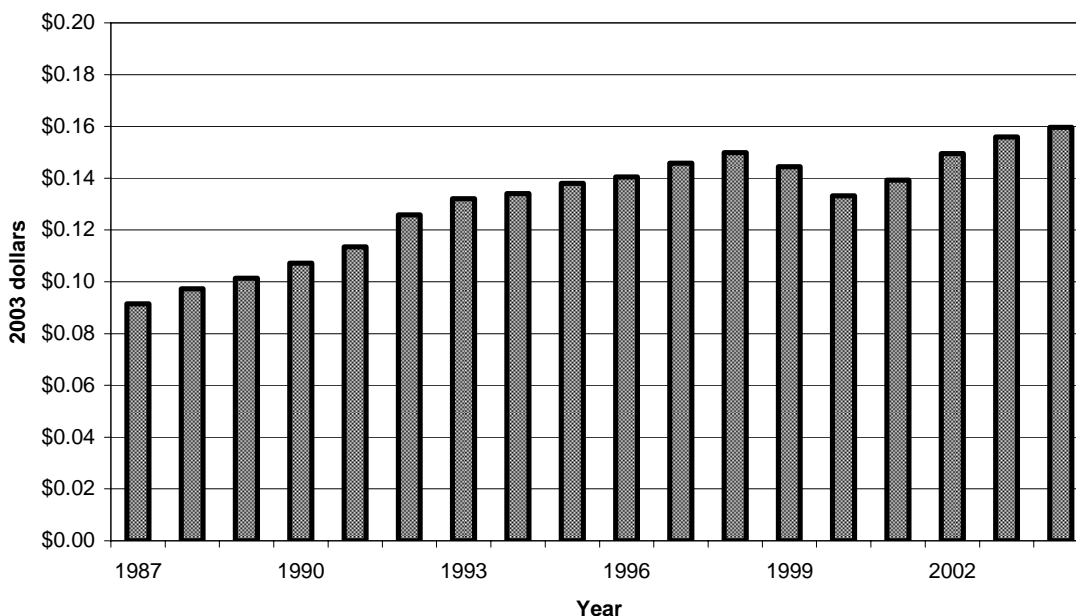


Notes: All figures refer to the private sector. DC plan coverage includes primary and supplemental plans. Data from 1976 to 1999 are from EBSA (2004, 1996). Data from 2000 to 2005 are from BLS (2005b).

### *Health Care*

Middle-class families also face a rising risk exposure in health care. Health insurance coverage has declined at a time when the costs of health care have grown markedly. The share of people without health insurance rose from 14.2 percent in 2000 to 15.7 percent in 2004 and the share of people with employer provided health insurance dropped from 63.6 percent to 59.8 percent during the same period (Census, 2005b). One way of looking at this is to consider the amount of health care expenditures that a worker can expect to pick up out of each dollar of health care expenditures that is uninsured (figure 8). In 2004, this amount had reached its highest level at \$0.16 in 2004 dollars. That is, in 2004, workers faced on average an inflation-adjusted cost of \$0.16 for each dollar of uninsured health care expenditures, up from just \$0.13 in 2000 – a 19.8 percent increase.

**Figure 8: Average Cost for Each Worker of One Dollar of Uninsured Medical Care Expenditures (2004 Dollars)**



Notes: All dollar amounts are in 2003 dollars. The underlying calculation is an expected value calculation that multiplies the share of the uninsured by the price index for medical care, which is adjusted for general price increases. Author's calculations are based on data from BLS (2005c).

Health insurance coverage, though, varies by demographic characteristics, suggesting that some households face greater risks than others. For instance, the share of the population without health insurance tends to be higher for Hispanics than for African-Americans, and higher for African-Americans than for whites. From 2001 to 2004, an average of 10.8 percent of whites did not have health insurance, whereas on average 19.6 percent of African-Americans and 32.8 percent of Hispanics did not (table 2). Furthermore, the share of the uninsured population grew for African-Americans and for whites, but remained constantly high for Hispanics. That is, minorities faced substantially higher risks due to the lack of health insurance than whites, and these risks increased for African-Americans during the current business cycle.

Furthermore, employer-sponsored health insurance coverage has become less important, especially for minorities. While more than 60 percent of whites had employer-sponsored health insurance between 2001 and 2004, only about half of African-Americans and close to 40 percent of Hispanics did (table 2). In addition, the share of the population with employer-sponsored health insurance declined by about one percentage point per year from 2000 to 2004 for all groups (table 2).<sup>2</sup> That is, middle-class families have seen declining access to comparatively affordable health insurance, leaving them either more

<sup>2</sup> The fact that the share of the population with employer sponsored health insurance declined faster than the uninsured share of the population increased reflects growing coverage under government health insurance, most notably Medicaid (Census, 2004).

dependent on more costly directly purchased health insurance, with more government health insurance, especially Medicaid, or with no health insurance at all.

**Table 2**  
**Select Health Insurance Coverage Trends**

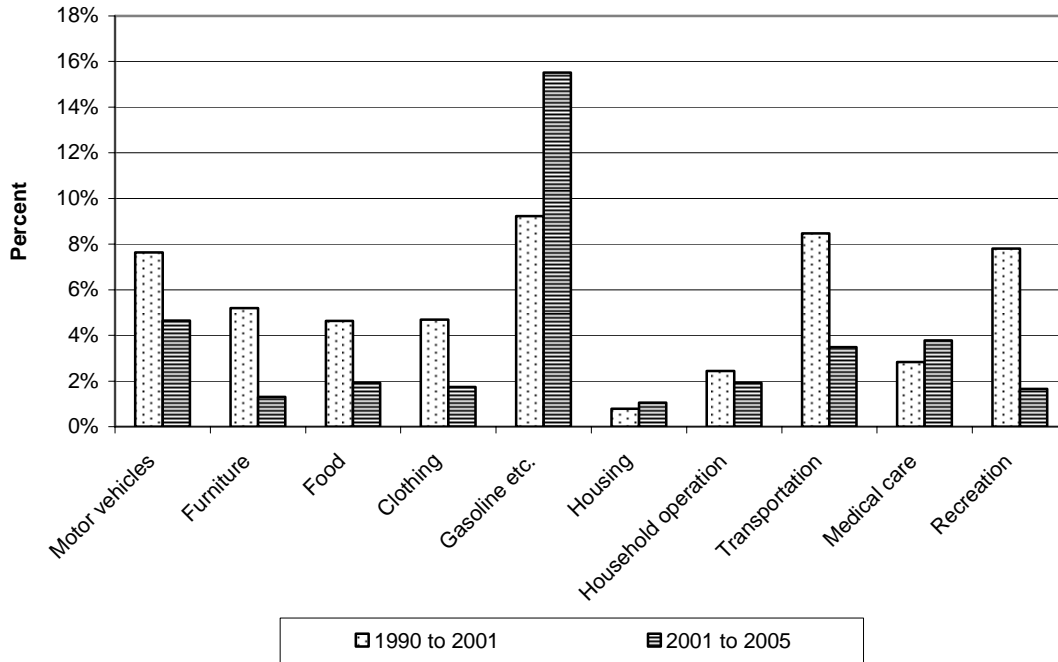
	Total	Whites	African-Americans	Hispanics
No health insurance				
Average 1990 to 2000	15.1%	11.2%	20.5%	33.2%
Average 2001 to 2004	15.3%	10.8%	19.6%	32.8%
Avg. annual change 1989 to 2000	0.1%	-0.1%	0.0%	0.0%
Avg. annual change 2000 to 2004	0.4%	0.4%	0.2%	0.0%
Employer based health insurance				
Average 1990 to 2000	60.8%	66.4%	46.7%	40.8%
Average 2001 to 2004	61.0%	66.9%	50.5%	41.9%
Avg. annual change 1989 to 2000	0.2%	0.3%	0.6%	0.1%
Avg. annual change 2000 to 2004	-1.0%	-0.9%	-0.9%	-0.7%

Notes: Average levels are percent and average annual changes are percentage point changes. Author's calculations based on Census (2005b).

### *Oil Prices*

Energy prices play an important role for middle-class finances. They pose a risk for middle-class families not because they are a large consumption item, but because they are fairly volatile. Given the already low savings rate, unexpected price increases, which are an important cause of this volatility, force households to take on more debt or spend less on other essential items. Out of families' ten large consumption categories (BEA, 2005), energy consumption is the most volatile and thus least predictable. Volatility of consumption can be expressed by how much spending on a particular item can deviate from average spending for said item – the so-called standard deviation. In this case, it shows how much on average consumption of one particular item relative to the average household's disposable income fluctuates. In the 1990s, the standard deviation of household consumption of gasoline, fuel oil, and other energy items was equal to 9.2 percent of the average consumption relative to disposable income (figure 9). Since 2001, energy consumption has increased even further in volatility. In comparison, the volatility of the majority of other consumption items went down, with the exception of small increases in housing and health care.

**Figure 9: Volatility of Consumption Items**



Notes: All figures are in percent. Volatility is measured as the standard deviation relative to the average of each consumption item's share of disposable income. Author's calculations are based on BEA (2005).

## I. Conclusion

The current business cycle has posed serious economic challenges for America's middle class. Incomes have largely been stagnant, while prices for crucial items have risen rapidly. However, this middle-class squeeze is not the whole story. Many economic risks have also increased for America's middle class. These include a lower chance of finding reemployment after lay-offs, greater exposure to rising interest rates with massive amounts of debt, fewer employer-provided health and pension benefits, and rapidly rising energy prices. These risks appear high enough to eliminate many of the modest gains that families may have seen in recent years, such as small increases in employment.

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### **A.1 Middle-Class Squeeze Index and Middle-Class Risk Index**

The Middle-Class Risk Index (MRI) captures the risk of the average family of falling behind in its standard of living. Higher values of the MRI suggest greater risks to the middle class of falling behind and vice versa. The components of the index are:

- The ratio of wages in contracting industries relative to the wages in expanding industries. A higher value indicates that the chance of losing important wage and salary income is increasing and thus is connected to a higher value of the index.
- Per capita wealth holding gains adjusted for wealth inequality, which is proxied by the ratio of house prices to the S&P 500. Greater holding gains suggest a reduction in household risk and are inversely related to the index.
- The share of the population that does not own their own home multiplied by the price index for rents. This measure shows the risk to middle-class families of being exposed to volatility in rents. Greater homeownership reduces this risk, but higher rents increase this risk. Overall, this component is positively linked to the risk of falling behind.
- The unemployment rate times the average length of unemployment, which is meant to capture the risks associated with losing one's job. Higher unemployment rates or longer spells of unemployment raise this risk.
- The share of the population without health insurance multiplied by the inflation-adjusted per capita out-of-pocket expenditures. The risks of falling behind associated with the lack of health insurance have risen over time.
- The ratio of debt service on all consumer debt relative to household disposable income. A higher debt service ratio can be the result of lower incomes, more debt, and higher interest rates. In each case, the risks to households of falling behind increase. A higher debt service ratio is thus associated with a greater index value.

The components are added after linear normalization and are given equal weights.

### **A.2 Ratio of Wages in Expanding Industries to Those in Contracting Industries**

This approach follows closely the methodology developed by the Economic Policy Institute (2004). For each of a series of industries, the change in the employment share is calculated by taking the difference of the average employment share of the past three months including the current month and the employment share of the same months in the previous year. Industries with higher employment shares are considered expanding and those with lower employment shares are considered contracting industries. The average of the past three months, including the current one, is then weighted by the change in the industry share of employment. The weights are normalized separately for expanding and contracting industries. The weighted average wage for expanding industries is divided by the weighted average wage for contracting industries. The selection of industries is detailed in EPI (2004). Data for these calculations are from BLS (2005a).

## About the Author

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Dr. Christian Weller is a Senior Economist at the Center for American Progress, where he specializes in Social Security and retirement income, macroeconomics, the Federal Reserve, and international finance. Prior to joining American Progress, he was on the research staff at the Economic Policy Institute, where he remains a research associate. Dr. Weller has also worked at the Center for European Integration Studies at the University of Bonn, Germany, in the Department of Public Policy of the AFL-CIO in Washington, D.C., and in universal banking in Germany, Belgium and Poland. His publications appear in publications ranging from the *Cambridge Journal of Economics*, the *Journal of Policy Analysis and Management*, the *International Review of Applied Economics*, the *Journal of Development Studies*, and the *Journal of International Business Studies* to the *Atlanta Journal Constitution*, *USA Today*, *Detroit News*, *Challenge*, and the *American Prospect*. Dr. Weller is often cited in the press and he has been a frequent guest on news programs on ABC, NBC, CNN, MSNBC, CNBC, Fox News and Bloomberg Television. Dr. Weller holds a Ph.D. in economics from the University of Massachusetts at Amherst.

# Center for American Progress



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