Financial Crisis in American Households

The Basic Expenses That Bankrupt the Middle Class

Joseph Nathan Cohen

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CHAPTER ONE

Household Financial Crisis in the United States

For years, economic analysts have spoken of a long-term decline in the economic fortunes of the U.S. middle class. Stable, well-compensated jobs are disappearing. Wages have barely paced living costs. People save less, borrow more, and go bankrupt more often than a generation ago. The ranks of the middle class in the United States are said to be emptying out[1] on their way to becoming a modern-day proletariat.[2]

For years, many experts treated this sense of middle-class decline with some degree of credulity. They maintained that regular Americans' living standards had never been higher. Upward mobility partly explained the middle class's disappearance.[3] People have never been so well fed, enjoyed so many amenities, received so much education and healthcare, and lived so long. Our streets have never been safer. Obesity—not starvation—is the principal nutritional problem facing the poor. Critics often rejected talk of a declining middle class as an exaggeration.

The 2016 U.S. presidential elections made it clear that the voting public did not agree. There appeared to be a strong, widespread sense that the U.S. economy was not serving regular Americans well. Both political parties seemed to be running against American capitalism. Economic policies that once would have been celebrated as responsive to business and in accordance with modern economic theory were now painted as part of a corrupt conspiracy against families. There seemed to be a strong, bipartisan demand that politicians find ways to protect people from an economy that seems to offer little promise for a better future.

A closer look at the data suggests that there is merit to the view that Americans' living standards have never been higher. However, economic fortunes seem to be deteriorating in one clear respect: people are becoming less economically secure. Economic life is more of a tightrope walk. Work is becoming more precarious.[4] People's incomes have become more volatile.[5] The employer-provided insurances and pensions that sustained previous generations are disappearing.[6] Most families have little to nothing saved for retirement. Many of them don't have enough saved to cover a missed paycheck and don't know anyone who could lend them a few thousand dollars if they found themselves in a bind. Being short on money is a particularly serious problem in the United States, where running out of cash can endanger a person's access to healthcare, education, and work opportunities. The public institutions that might have helped compensate for these changes are widely seen as deteriorating under long-term neglect.

When discussions arise regarding the money problems faced by U.S. households, attention immediately turns to earnings problems. Explanations focus on the problems people face in getting money: income volatility, job precariousness, the decline of unions, income stagnation, and so on. Less attention is paid to the role of spending. In part, spending is not a focus because living costs are presumed to have been falling. In an era of $1 restaurant hamburgers, $50 Walmart touchscreen tablets, $12 Costco jeans, or free online newspapers and telephone calls, it makes sense to pay less attention to the role that living costs play in sowing money problems.

We should not ignore overspending, however. It is partly responsible for many Americans' financial problems. Even though incomes have stagnated for years, the presumption is that families could have kept saving by tightening their belts. Although it has never been easier to cut spending, people just haven't been doing it. Spending has continued to grow as it did during the golden age of the U.S. middle class in the mid-20th century—even if income has not.

This observation can lead many to conclude that Americans' money problems are the product of personal failures. They see growing household spending as the result of the United States' culture of consumerism, impulse control problems, gluttony, financial imprudence, or some other character flaw. In turn, this portrayal can foster an attitude that is more opposed to using public resources or regulation to help those with money problems. After all, if people's excessive lifestyle expectations or inability to exercise self-control is the cause of their money problems, wouldn't subsidizing their excess consumption be wasteful and unfair to those who manage their money well? Wouldn't people be more likely to correct their bad behavior if they were exposed to its natural consequences? Moreover, wouldn't these

kinds of government intrusions in the free market ultimately undermine capitalism's capability to raise living standards by creating more, better, and cheaper products?

Although there are kernels of truth to this view, it also has a very critical weakness. Roughly ten years ago, research by then-Harvard law professor (and now U.S. senator) Elizabeth Warren and colleagues[7] found that families facing bankruptcy had fallen into trouble in part because they had difficulty keeping up with more basic expenditures, such as housing or medical care. This book presents a range of analyses suggesting that, a decade later, these spending pressures still drive the bulk of rising household spending, and they may have gotten worse. It is not that Americans are frittering away their savings on frivolous consumerism, but rather that the rising costs of key basic necessities (e.g., education, child care, or housing in nondistressed communities with access to jobs) have been spiraling upward. Moreover, these costs have risen during a period in which these necessities are become more essential to securing income. With the passage of time, sustaining a household without these types of basics is becoming more difficult.

In part, the cost of these necessities has been rising because the institutions that once would have absorbed them—such as employer-sponsored benefits, public services, and public assistance programs—have been disappearing, while the public institutions that would have picked up the slack have not kept up with rising needs. Political scientist Jacob Hacker[8] speaks of a Great Risk Shift, in which those who oppose these vestiges of mid-20th century welfarism sold a "Personal Responsibility Crusade" to policy-makers and voters. This Crusade maintained that people needed to stop relying on others to secure life's essentials and to seize responsibility for their own well-being. They argued that society would be stronger and living standards would ultimately be higher if they were to reject such communal welfarism.

What happened? Why did this Crusade not work? As discussed a bit later, part of the problem was an implicit assumption that unfettered capitalism would unleash innovations and efficiency enhancements that would ultimately deliver top-notch education, healthcare, housing, and other products at rock-bottom prices. This scheme ultimately worked across much of the economy, which is why we enjoy such low prices on apparel, autos, electronics, furnishings, food, reading materials, telecommunications, entertainment, personal care items, and many other products. While free markets have generally worked, they appear to have failed in key markets for basic essentials. The past thirty years' shift toward laissez-faire has not created a bounty of high-quality, inexpensive medical care, higher education, child care, or housing in the United States.

Along with examining these rising cost pressures and their effects on household finances, this book provides a data-intensive exposition of the proposition that the rising cost of basic necessities plays a role in deteriorating household finances. It probes the finer details of households' balance sheets and income statements while exploring the historical context in which these financial problems developed. This book engages some of the complicated social-scientific and philosophical problems with which one must grapple when formulating diagnoses of and prescriptions for these financial problems. Furthermore, it looks to other countries to explore whether there are viable alternatives to the approach taken by the United States.

While there are probably limits to what governments can do to stop the decline in household incomes, U.S. policy-makers might at least mitigate the problem by emulating other highly developed countries' practice of ensuring universal access to high-quality essential services. Doing so would help households restrain their spending and cut many financial obligations, which would ultimately buffer people from the negative well-being consequences of running out of money. Doing so will require that Americans confront some deeply held cultural beliefs about how the economy works.

A Thirty-Year Deterioration in Household Finances

We often assume that the middle class's financial problems were caused by the 2008 financial crisis and Great Recession. The presumption makes sense. The 2008 downturn was severe. It destroyed 8.1 million jobs and caused the unemployment rate to double.[9] An estimated 170,000 to 200,000 small businesses were lost.[10] The stock market lost roughly half its value, and home prices dropped by about one-quarter.[11] Even though the ensuing Great Recession was said to have ended in the summer of 2009,[12] much of the public continues to believe that these are bad economic times.[13] The gross domestic product (GDP) may be rising and the stock market booming, but much of the country feels as if it has not benefited considerably.

In seeing the middle class's money struggles as a product of a recession, we understand the problem as a by-product of economic cycles. Americans' money problems are understood to be a result of the economy's natural rhythms of ups and downs. Such a perspective makes it seem sensible to wait for things to turn around. There is no reason to doubt that the economy will rebound, and it makes sense to presume that everything will eventually return to the pre-Recession "normal."

The main problem with such a view is that households' money problems are long-term developments that have persisted across economic cycles.

Household finances have been deteriorating since at least the early 1980s, if not the end of the 1960s. It is not as if regular Americans' finances were generally in order before the 2008 crash, and then they got bad. By historical standards, household finances had deteriorated substantially during the economic boom that preceded the crash, and then people's money problems became much more noticeable (or less ignorable) after the crash. Rising financial insecurity looks more like a secular development than a cyclical one. These are not short-term problems caused by a temporary economic downturn. Instead, they more likely reflect a structural problem.

A Look at the Data

Figure 1.1 describes some of the ways in which household finances deteriorated over recent decades. It depicts four broad trends: (1) income stagnation (as represented in the top left using median real household incomes), (2) falling savings (bottom left, as a secular fall in the personal savings rate), (3) rising indebtedness (top right, in the exponential growth of household debt to GDP), and (4) an increased incidence of financial failure (bottom right, measured by the personal bankruptcy rate).[14]

Income Stagnation

One of the most widely noted manifestations of the middle class's economic struggles is *real income stagnation*, a situation in which household incomes are not rising relative to general living costs. This trend is depicted in the top-left quadrant of Figure 1.1. It shows how household incomes rose quickly during the mid-20th century but slowed in the decades that followed.

During the 1950s and 1960s, incomes grew at an average annual rate of about 3 percent per year. At that growth rate, a household earning $50,000 today would have an inflation-adjusted income of $67,196 ten years from now. Beginning in the 1970s, this rapid and steady pace of income growth slowed down. Median real wages stopped rising during economic downturns, and the overall pace of household income growth fell to just under 0.8 percent per year between 1970 and 2000. As a comparison, at that era's growth rate, a person who earns $50,000 today would have an income of $54,687 in ten years—roughly $13,000 less than would have been obtained mid-century. Between 2000 and 2012, median incomes fell from roughly $68,642 to $62,241. Since 2000, incomes have been stagnating across the income scale—not just at the median.[15] In essence, the vast majority of those who sustain a living through employment are not earning more money.

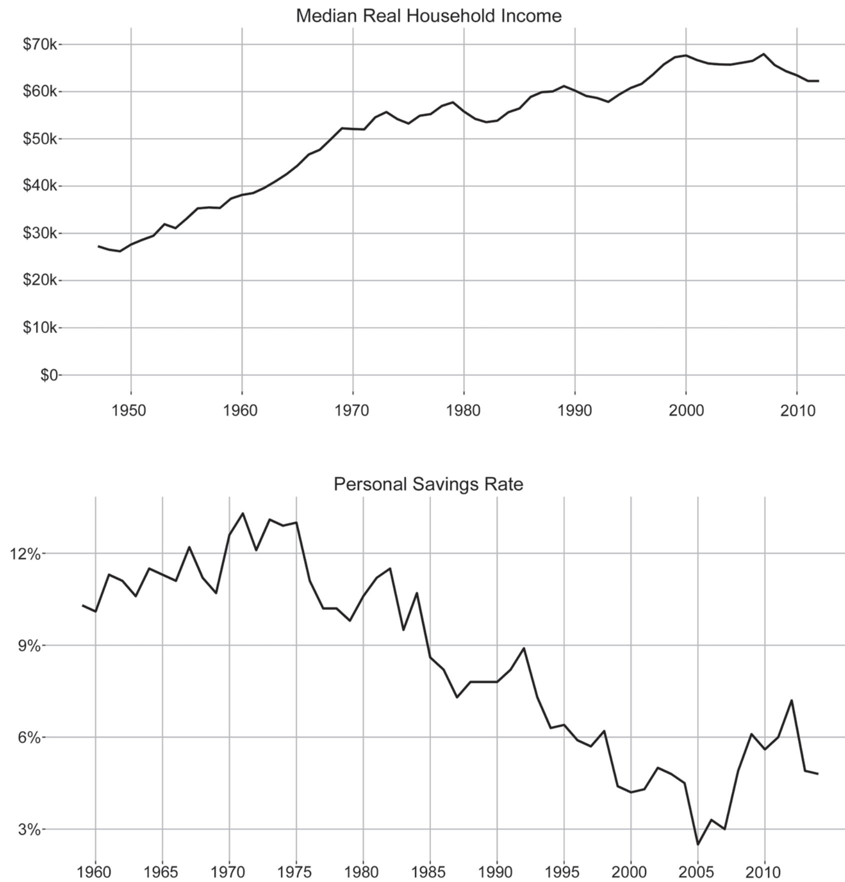

Figure 1.1 Signs of a Long-Term Deterioration in Household Finances.

Much of this stagnation is attributable to more difficulty securing jobs and pay raises. Hourly wages have barely moved for decades.[16] Getting more money often means working longer hours or sending more household members to the workforce, rather than finding better-paying jobs. People's access to work has become more precarious,[17] which means that even those who are earning good money today are more likely to lose those jobs or see their pay fall behind prices than in previous generations.

Slow wage growth is not the only factor at play. Incomes from private pensions have been declining as well.[18] Households' income from financial investments have also fallen, primarily because cash accounts yield little to no interest.[19] Personal incomes from businesses have stagnated with wages, perhaps as a result of an environment in which it is hard to compete with

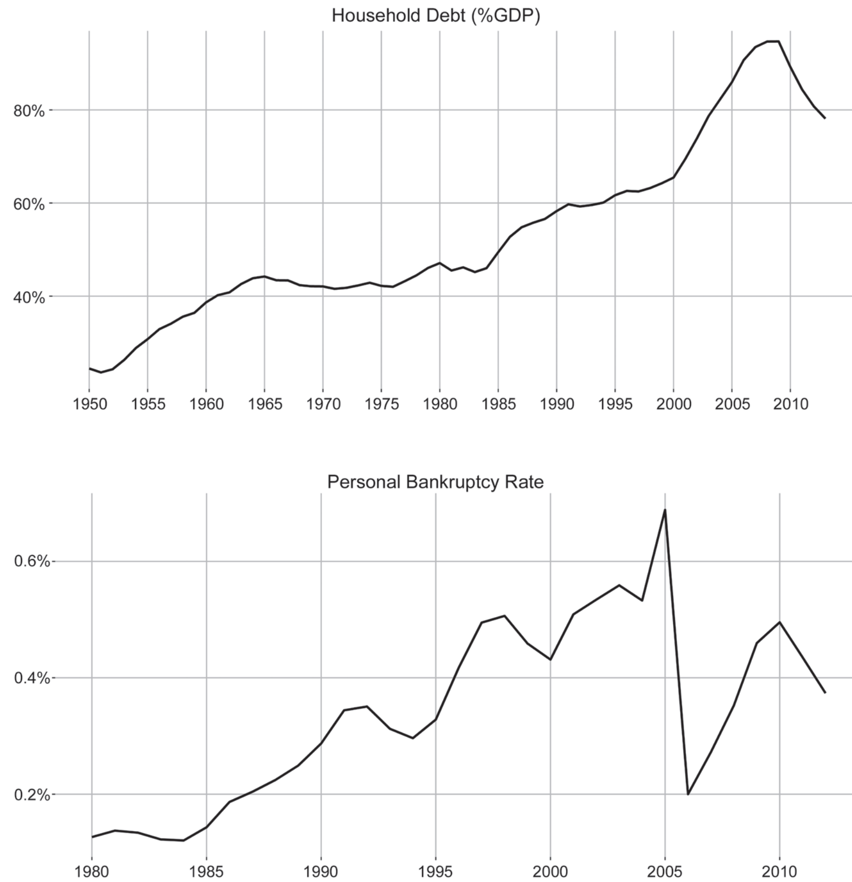

Figure 1.1 (Continued)
Sources: American Bankruptcy Institute (2014); Federal Reserve Bank (2014); Census Bureau (2014).

large firms and foreign enterprises.[20] Government assistance has tightened up for the working-age population, although Social Security recipients did well over the past several decades.[21]

Falling Savings

In the midst of these earning problems, household savings collapsed. The lower-left graph in Figure 1.1 depicts changes in the *personal savings rate*, the percentage of after-tax dollars that the average family saves in lieu of spending. Between 1960 and 1975, the personal savings rate fluctuated in the 10 percent to 14 percent range. After 1976, the personal savings rate

declined steadily, eventually reaching near-zero right before the 2008 crisis. Since the Great Recession, many observers have celebrated a purported resurgence in savings, but the magnitude and expected durability of this rebound can easily be overstated. When savings rebounded to about 5 percent in 2013, it was reverting to levels that prevailed in the mid-1990s, not the mid-1960s.

This decline is enough to produce a substantial diminishment in long-term wealth accumulation. At mid-century rates, a household earning a $60,000 yearly salary would put aside between $6,000 and $8,400 a year. Over 30 years of compounding 5 percent real annual returns,[22] such savings would result in a nest egg of between $400,000 and $558,000. If that same $60,000-a-year family were to save at more recent rates (between 2 percent and 5 percent of their income, as opposed to between 10 percent and 14 percent), they would be left with a nest egg of $78,000 to $199,000. As we will see in Chapter Three, this is a very optimistic estimate of what people actually save and accrue over a lifetime.

Falling savings are often explained as the product of three factors: earning problems, easy debt, and excessive spending. Cheap debt is discussed in the following section, and spending choices are examined in depth in Chapter Five. Whatever its cause, the falling saving rate portends a situation in which people do not have adequate savings to cope with a rainy day or foreseeable financial shocks such as college or retirement. Differences in the savings rates of today versus the 1960s can amount to hundreds of thousands of lost dollars accumulated over a lifetime.

Rising Indebtedness

When people lack savings, they often rely on debt in its stead. Household debt ballooned in proportion to the overall economy over the past several decades. The overall value of household debt rose from about 24 percent of GDP[23] in 1950 to nearly 95 percent of GDP by 2009. In other words, household debts have quadrupled relative to overall economic output. More people borrow, and people borrow more.

Since 1950, household debt has grown in three bursts. The first burst occurred from 1950 to 1964, when household debts rose from 24 percent to around 42 percent of GDP. We might surmise that this is a result of the post-World War II reconstruction of consumer debt markets. Thereafter, household debts remained relatively stable until about 1984, after which they grew at an accelerated rate. This second boom in household lending followed substantial deregulation in credit markets, for example, by repealing legal restrictions on interest rates and interstate lending. Consumer debt

also grew with the development of the U.S. financial sector, which was rapidly creating new markets for extending, trading, and liquidating loans. Opportunities to borrow began to proliferate.

Household debts then ballooned from 2000 to 2007, a period in which debt became cheap and bountiful. Several factors helped loosen debt markets, including financial deregulation, "innovative finance" schemes that allowed lenders to quickly extend and then sell off their loans, and an insatiable foreign hunger for U.S. dollars and debt. All of this resulted in a glut of consumer debt and that era's extraordinarily low cost of credit. We experienced these changes when it became much easier to get credit cards with larger credit limits, although they often had high and unpredictable charges attached to them. New mortgages (e.g., adjustable-rate or low down payment mortgages) made it easier for people to borrow more. Check cashing outlets proliferated. Stores more readily offered customers credit through co-branded credit cards. Debt became much cheaper and easier to incur.

Even if credit is cheap and abundant, this debt boom requires willing borrowers, and American households readily obliged. You need a spender to be a borrower. As discussed in Chapter Five, households' penchant to borrow is often portrayed as the product of some combination of materialism, impulse-control problems, short-termism, inflated lifestyle expectations, and social status jockeying. The implication of these views is that people's assumption of debt is mostly wasteful, avoidable, and tied to the sins of envy, vanity, gluttony, sloth, and so on. However, a closer look at household spending data suggests that the types of household products typically featured in these arguments—clothes, cars, leisure products, beauty and personal care products, and so on—are not driving rising spending and debt. Instead, much of the momentum driving household spending comes from a set of essential products that have not been getting more affordable over time.

Rising Incidence of Financial Failure

As households accumulate debt, they walk toward the precipice of financial breakdown. Their finances become a high-wire balancing act, and this balance can be thrown off by a job loss, medical event, or even a major car or home repair. With more people sitting closer to the financial precipice, more fall over the edge. The bankruptcy rate has risen steadily (bottom right of Figure 1.1), from 126 per 100,000 people in 1980 to 373 in 2012. This represents a 296 percent increase. In 2006, the federal government confronted this rising tide by making it harder to qualify for debt discharge under bankruptcy proceedings. These changes create the impression

that financial failure fell in that year; but this decrease was more a product of the lack of availability of bankruptcy than a matter of people not being in a deeply troubled financial situation. In any case, the returns pressed bankruptcy rates down to levels that prevailed in the late 1990s, not the early 1980s.

A Structural Problem

There is clear evidence that household finances have experienced some long-term deterioration. Sometime between the late 1960s and mid-1980s, people stopped getting raises, cut their savings, started borrowing more, and went bankrupt more often. This long-term deterioration in household finances suggests that we are not dealing with the temporary effects of an extraordinarily bad economic downturn. Because this deterioration is an enduring problem, it seems unlikely that household financial problems will simply self-correct after the economy recovers. If economic recoveries have generally failed to produce substantially higher wages, better quality jobs, more savings, less debt, and so on, why would this recovery be so different?

In characterizing these problems as the result of "structural problems," we are implying that U.S. capitalism, as it is practiced today, has design flaws. It is not reacting to broader changes in the economy, politics, technology, or society in ways that strengthen regular Americans' financial situations. It may be that the United States requires substantial reforms before the middle class finds itself on firmer ground. The possibility of structural reforms makes this a high-stakes political and societal issue. Reform can create big winners and losers, and thus political conflict. We turn to these conflicting political views next.

The Politics and Science of Financial Problems

Polls suggest that these trends are not lost on the American public. An overwhelming majority of Americans register consistent disapproval of the U.S. economy's path. Economic issues are regularly cited as top electoral concerns. There is a widespread perception that the political system has been captured by and serves elites—not the interest of regular Americans. The pressure felt by the middle class is argued to help propel the antiestablishment politics experienced in the 2016 election.[24]

Attitudes vary widely with regard to what—if anything—to do about households' purported financial problems. Some believe that there is no serious problem with household finances and that many complaints about money come from those who want handouts. Some believe that U.S.

households' money problems exist but are temporary and that they will be resolved by the economy's impending recovery. Others believe that the problem is real but is a matter of people causing their own difficulties by mismanaging their money. Still others argue that these problems are the product of an economic system that fails to serve the interests of regular people.

Is It a Serious Problem?

Many observers believe that talk of Americans' money problems is overblown. These skeptics' views should not be dismissed out of hand. Policies designed to reverse these trends have the potential to divert resources away from other goals. They also carry the risk of negative unintended consequences. Before endeavoring to solve a problem, it is worth pondering whether we are in fact dealing with a serious issue. Our answers will hinge on the problem's prevalence (how much of society is affected by it) and its severity (the harm done by it).

Financial Insecurity Is Prevalent

On one hand, insecurity is part of regular life. It should not be surprising that most Americans face some kind of financial insecurity. On the other hand, the data suggest that a very high proportion of society is, by basic financial planning standards, in very poor financial shape.

Chapter Three uses U.S. household finance surveys to gauge the state of U.S. families' financial security. It finds that (depending on the criteria used) between one-quarter and one-third of U.S. households are *economically dependent* in the present; that is, they are unable to sustain a very basic livelihood without outside help from family, friends, charity, or the government. Another third or so are *precariously independent*; that is, they are able to make ends meet but do so as a delicate balancing act. They effectively live check to check, and they are generally unprepared to weather the demands of unanticipated financial shocks, such as joblessness, illness, injury, divorce, or even a major home or auto repair.

This leaves us with about two-fifths of households that seem capable of covering their bills and withstanding minor bumps in the financial road. However, most of them seem destined for eventual dependency on public assistance. Most households have nothing saved in private retirement accounts (e.g., a 401(k) or IRA), private pensions are slowly disappearing,[25] and many of those with any retirement savings only have enough to cover a few years at the poverty line. Ultimately, their living standards will depend

on public assistance programs such as Social Security and Medicare. Only a minority of households—around one-tenth—seem well positioned to maintain economic independence into old age.

Is the Problem Serious?

But is this a serious problem, or are people panicking over nothing? Isn't adversity and insecurity part of life? Isn't there a social safety net that keeps money problems from becoming life and death situations? Aren't a lot of money complaints a matter of inflated lifestyle expectations, efforts to jockey for social status (i.e., "keeping up with the Joneses"), or an inability to control their impulses in money matters? Moreover, if insecurity creates an incentive to work and manage our finances prudently, wouldn't we do harm by completely squashing it?

The criticisms underlying these kinds of questions have some substance. On one hand, there are reasons to see talk of a declining or impoverished middle class as overblown. In both a comparative and historical sense, the vast majority of Americans enjoy high and rising living standards, including many officially "poor" Americans. No previous generation of Americans has been more amply fed, better housed, more insulated from violence, more thoroughly entertained, and more surrounded by wondrous material possessions. There is no doubt that, in many respects, the average person today lives better than royalty lived in past eras. Some of the discontent surrounding the economic affairs of the middle class involves relative, rather than absolute, deprivation.

On the other hand, financial insecurity and money shortages have nontrivial implications for both those afflicted by the problem and society at large. Money buys access to life's necessities, and the personal onus of securing access to basic necessities is high in the United States. A recent analysis of the 2014 *American Values Survey* suggests that roughly 36 percent of Americans cut food consumption for financial reasons, and 29 percent put off seeing a doctor for financial reasons.[26] Financial concerns can prevent college-qualified students from pursuing higher education.[27] Those without money can face considerable difficulty securing child care.[28] Other highly developed societies subsidize or socialize medical care, higher education, or child care, much like K–12 education and policing services are socialized in the United States. There, money problems do not restrict access to nonemergency medical care, college, or the ability to work while parenting small children.

Beyond concerns about absolute material deprivation, there is much research suggesting that the experience of financial insecurity or poverty

can adversely affect people's health and development. Some research suggests that, under economically adverse circumstances, populations are more likely to abuse alcohol and drugs, to experience depression and other mental health disorders, and to commit suicide.[29] Children and young adults who come of age in economically bad environments tend to self-report lower health levels later in life.[30]

Often, people approach the topic of household finances by asking why a person should care if their personal affairs are in order. Mass financial insecurity is not just a concern for those who are afflicted with financial problems. When financial problems become prevalent, their ill effects can spill over to the wider community, affecting those whose finances are otherwise in order. For example, people's home values are often hurt by neighbors' mortgage defaults.[31] Many working-age adults' finances are strained by the aid they extend to relatives, and people often go bankrupt as a result of having to care for family members.[32] A rising tide of distressed people can strain social assistance programs, erode local tax bases, and exacerbate public budget deficits. Mass financial insecurity can also increase the economy's exposure to systemic financial and economic risks. It is worth considering whether things would have turned out differently in 2008 had people saved enough collateral to get high-quality mortgages, put aside enough emergency savings to cover the costs of temporary joblessness, or hadn't been so under-saved for an imminent (and possibly involuntary early) retirement that they were speculating with money that they couldn't afford to lose.

Setting aside any concerns related to 2008, the fact remains that the weak state of household finances may tie our policy-makers' ability to make decisions they deem fit. For example, it is hard to tighten consumer lending when so many under-saved households and businesses rely on cheap consumer credit, even if policy-makers feel that the economy would be better off with less consumer debt. When so many people's personal retirement plans or pension funds depend on a booming stock market or housing market to make up for years of under-saving, a central banker faces some disincentive to let the air out of financial bubbles. When much of the country's wealth is tied up in homes whose values depend on ultra-cheap mortgages and tax inducements to buy homes, it is practically difficult to stop funneling societal resources into buoying real estate markets. Of course, these problems do not, in and of themselves, prevent the government from making economic policies that prevent over-indebtedness or market bubbles, but they do create additional disincentives to do so.

Widespread financial insecurity is not a good thing for society. If we do concede that society ought to try to do something about the problem, what are its best options?

Generic Responses

The political conflicts involved in debates about how to respond to household financial insecurity involve three poles of thought. The first is to do nothing. The second is to use government power and resources to engage and, hopefully resolve, the problem. The third is to maintain—or even strengthen—our commitment to laissez-faire, free market capitalism.

Do Nothing

It is probably fair to say that doing nothing is society's default response to social problems in general. There are many reasons to favor doing nothing as a rule of thumb. Government attempts to micromanage the world around it have a historically demonstrable risk of negative unintended consequences.[33] Societal problems are often transitory, and an ill-conceived response can be unnecessarily expensive, disruptive, and self-defeating. Governments cannot solve all of society's problems, and there may be more pressing problems that merit attention and resources. There are reasons for that disposition to do nothing in the face of households' financial problems.

Doing nothing seems like an unlikely solution in this particular case. Deteriorating household finances is a chronic problem that seems to have been developing over decades. As we will see in the chapters that follow, many of the forces that have been damaging household finances remain intact and may even by strengthening. This does not seem like a problem that will self-resolve, and its consequences may be harder to ignore over time.

Government Initiative

Another possibility to address households' financial problems is to use the government's power and resources to ease whatever pressures are causing household finances to deteriorate. This may involve developing laws, regulations, and government programs that socialize the cost of essential goods and services, redistribute money to those under financial pressure, or alter the rules (and bargaining power) underlying private economic transactions. In short, these solutions involve socialism, redistribution, and regulation, which are concepts that Americans have widely viewed negatively during the past several decades, although such views have been softening in recent years.[34]

Often, discussions involving the concept of socialism and redistribution can quickly descend into Cold War-style polemics that contribute little to sensible policy discussions. Some level of socialism and redistribution are

deeply engrained features of just about any modern economy. Moreover, there is ardent bipartisan support for some forms of socialism, redistribution, or regulation, even if they denounce them in principle. Political differences over redistribution mainly involve disagreements about the relatively small proportion of social spending directed toward the working-age poor. While such programs include those explicitly targeted to the poorer households (e.g., food stamps, Medicaid, the Children's Health Insurance Plan, Pell Grants, or minimum wages), they also include programs that benefit wide swaths of the U.S. economic hierarchy's lower and middling ranks (e.g., public schools, libraries, the interstate highway system, Stafford Loans, first-time home buyer help, public recreational facilities, and the two giant social programs—Social Security and Medicare).

Over the past several years, policy proposals of this sort included things such as free community college, raising the minimum wage, expanding public housing or transportation, or raising tax cuts and credits for lower income people. The largest program of this sort, which this study's findings ultimately suggest will be of great consequence if successful, is the Affordable Care Act (ACA). It is hard to pass final judgement on the ACA's effectiveness, but it represents the United States' clearest and most substantial step in this direction.

Redoubling Our Commitment to Neoliberalism

Others see these problems as the result of ill-conceived government intrusions on private markets and believe that a redoubled commitment to neoliberalism is key to restoring household finances. *Neoliberalism* is an economic paradigm or ideology that stresses the societal benefit of deregulated, private markets and an economic system that channels resources through private businesses and investors. It is reviewed at length in Chapter Four.

This view sees household financial struggles as the product of the types of social policies mentioned previously. Adherents of this view often maintain that the high taxes and economic regulations that come with social programs often discourage growth and jobs creation, which makes it harder for people to earn income. Moreover, it sees policies that insulate people from financial pressures as preventing the kind of market discipline that inculcates financially prudent decisions. It sees the pains of poverty as motivating people to work harder to earn money, while encouraging them to make the types of financially prudent decisions that prevent financial failure.

Concretely, those who believe that household finances would ultimately be fortified by neoliberalism favor policies such as labor market

deregulation, low minimum wages, social program cutbacks, and tax cuts (especially on businesses and investors). They often describe such reforms as catalysts for virtuous cycles of private investment, job creation, innovation, and ultimately the material enrichment of society. Conversely, they see socialism, redistribution, regulation, and other government intrusions on private people's or businesses' prerogatives as damaging.

Conclusion

Opinions about how to respond to the deterioration of U.S. household finances often gravitate among these three poles of thought. The first is inclined to do nothing. The second is to strengthen social programs. The third is to redouble our commitment to free market capitalism. Ultimately, the discussions that follow engage these three poles and use data to explore the viability, possible benefits, and potential costs of each.

Value Neutrality

Discussions about household finances are politically contentious and fraught with philosophical differences and value judgments that make them difficult to resolve conclusively using the tools of science. Many such questions involve concerns about how people *ought to* live, the lifestyles or level of economic security that people *ought to* expect, or the degree to which the government *ought to* accept responsibility for people's financial situations. To paraphrase the early-20th-century psychologist Viktor Frankl, these "ought to" questions are largely moral matters that are more in the wheelhouse of philosophers or clergy than social scientists. Science cannot answer "ought to" questions. It is better at making inferences about what has already happened, which is different from telling people what they ought to do in the future. But that doesn't mean that the tools of science are useless.

The defining hallmarks of science are that it uses observable information to test ideas about how things operated during an experiment or quasi-experiment. Scientists strive to explain how certain facets of an observed phenomenon cause other facets to occur. A scientist might look for causal relationships in physical objects, chemical interactions, or living organisms, as many natural scientists do. Or they may look for such relationships in observed human societies, as many economists, sociologists, or political scientists do. In this particular case, we are searching through observable demographic, macroeconomic, public finance, and household finance data

in an attempt to discern the historical incidence, causes, and consequences of heightened household financial insecurity.

One major problem with these types of endeavors is that in order to observe phenomena such as household insecurity, its various possible causes, and many possible consequences, we have to define them. If we are going to present data on concepts like financial insecurity, public insurance, economic adversity, or human well-being, we have to establish their concrete meaning or referent explicitly. We are forced to develop provisional answers to the "ought to" arguments described earlier.

The requirement to develop provisional definitions unavoidably sullies the scientific purity of any attempt to engage politically or philosophically contentious issues. Some people use this insight as a launching point to question the neutrality of any scientific venture to study such issues. In other words, they argue that every scientist has an implicit agenda and, perhaps by extension, that there is no reason to treat scientific commentary on these issues as having anything special to say.

These arguments have some element of truth, but this does not mean that scientific information is useless. Just because we cannot fully and unequivocally reach some ideal (e.g., honesty, kindness, ethicality, or value-neutrality) does not mean that we shouldn't strive for it. Likewise, it does not imply that such efforts are necessarily fruitless. If social scientists can develop provisional answers to morally or philosophically complicated questions, be open and explicit about these assumptions, and do their utmost to adopt reasonable assumptions that would be widely accepted, then they can contribute to public debate on these types of contentious issues by testing ideas or gleaning impressions from historical records.

The tools of science and modern statistics provide us with an occasion to test some of the common wisdom that prevails in public discussions. Scientists and nonscientists develop arguments about economic or other social affairs by making assumptions or speculations about how the world works. Disagreements often hinge on the fact that two parties are approaching a common problem with different assumptions or beliefs about the objective facts surrounding household finances. The tools of science provide some means of testing the strength of these assumptions. Where it is assumed, for example, that welfare spending improves human well-being or that higher taxes cause unemployment, a scientific engagement of socioeconomic data helps us discern whether these theories seem to have been true in the past. Assumptions that have some root in past experience are perhaps more worthy of credibility. To the degree that we can use the tools of science to sift less credible arguments out of public debate, we can improve the quality of our collective problem-solving.

The View That Emerges

Several key points emerge from the study that follows. The first key insight, established previously, is that the deterioration of household finances is a long-term phenomenon. This deterioration has developed slowly over the past 30 to 40 years and seems more likely to be an enduring, structural problem rather than a temporary consequence of the Great Recession. This implies that household financial problems are structural in nature and are rooted in some combination of long-term environmental changes and/or long-term problems with the organization of the economy.

The deterioration of household finances cannot be boiled down to one simple cause. Multiple factors are at work. Part of the problem is with earning incomes. Many U.S. workers have fought a losing battle for work against foreigners and machines, and they are not being absorbed elsewhere. The population is aging, and older people face many challenges finding gainful employment. Pensions, benefits, cost-of-living adjustments, and even steady work are becoming rarer, and more of the country ekes out a living through short-term contract work and the "gig economy." More people live alone, and single people tend to be poorer.

Earnings problems clearly cause some of the financial hardship facing the middle class, and many of the societal forces that cause these earnings problems are practically difficult—if even possible—to reverse. However, part of the problem seems more squarely within people's ability to control: their spending. Runaway spending is part of what is causing household finances to deteriorate. Arguably, in an era of cheap imports and low-markup retail (e.g., Walmart, Costco, and Amazon), it has never been easier to cut spending. Given the tough jobs environment, it would make sense for people to save money. Americans have both reasons and opportunity to tighten their belts—but it isn't happening.

The long-term rise of household spending in the midst of earning problems leads many observers to conclude that those with money problems are chiefly responsible for their situations. Most households do not budget[35] or even understand basic concepts of personal finance.[36] Many analysts cite the emergence of a spendthrift culture of consumerism, whereby people's materialistic impulses push them to spend money on frivolities that they cannot afford. These types of diagnoses can color our attitudes about how to respond to the middle class's financial problems. If wastefulness and irresponsibility are to blame for people's money problems, then using public resources to help them seems tantamount to pouring money down a black hole. There is no limit to what people can spend on impulse, hedonism, or keeping up with the Joneses. One might even argue that the

pains of money problems are necessary to push people to manage their money responsibly.

In several respects, there is substance to this "culture of consumerism" argument, but a closer look at household finances suggests that this line of reasoning misses an important dimension of household overspending, and this oversight may ultimately hinder the development of productive responses to the problem of financial insecurity. Over the past several decades, it appears that families have been spending less, relative to incomes, on the products typically featured in "culture of consumerism" arguments: clothing, cars, home furnishings, appliances, grooming products, electronics, food, and so on. It is not so much that people are buying less of these things, but rather that the modern U.S. economy has become very good at delivering these products at rock-bottom prices. During this period, household cash flows have been strained by a more specific set of expenditures, particularly housing, healthcare, child care, and education. For several reasons, our economic strategy of relying on technology, foreign outsourcing, and market competition has not resulted in a similar bounty of affordable, high-quality products as in many of the aforementioned consumer markets. Prices for these essentials have gone up, and there are several indications that higher prices are not the result of comparatively better products.

In some measure, people's money problems partly represent a failure of the U.S. economy; they are not strictly a product of people's personal failings. Medical care and education are extraordinarily expensive in the United States, and it is not clear that Americans get higher-quality products for the higher cost they pay. Moreover, other societies organize these markets differently, such that securing these basics does not have such a strong impact on personal finances. If basic medical care bankrupts someone, is it really a personal failure? Canadians and Brits don't have to foot big medical bills, even if they are struck by some serious illness. The Finns don't have to pay for child care. The Dutch and Germans don't pay university tuition. In most highly developed countries, moving into cheap housing need not imply moving into communities with broken schools, severe crime, poor public services, and generally low living standards for one of the world's most developed economies.

This puts people in a difficult dilemma. Even if they were able to tighten their belts and solidify their financial situation by forgoing health insurance, a college education, or a home in a neighborhood with reasonable access to jobs, K–12 schools, or emergency services, it is not altogether clear that doing so is a good choice. The problem is that cutting these expenditures could ultimately endanger people's absolute well-being and even leave them in more financially vulnerable positions. Forgoing health insurance

to balance your books works until you get sick. Saving money on child care and education may ultimately make it even harder to earn a livelihood. It is hard to say whether or not one's children are better served by saving less money by living in a bad school district or by cutting one's financial margin of error while raising the kids in neighborhoods and school districts that seem to produce healthier, safer, and more economically independent children. At the same time, failing to save enough money poses a risk that people will be cut off from these essentials if they run into problems down the line. This dilemma can seem like a "damned if you do, damned if you don't" situation. Families often find themselves enmeshed in a lose-lose dilemma in which they can have sound finances or quality essentials, but not both.

The rising burden of essential products is partly a by-product of government policies. Over the past several decades, U.S. policy-makers have increasingly relied on economic policies that are often described as "neoliberal."[37] This ideology, which is examined in greater depth in Chapter Four, is premised on the principles of laissez-faire and trickle-down economics. The former principle maintains that society benefits when the government maintains a "hands-off" approach to economic governance and leaves control of the economy to largely deregulated private enterprises. The latter principle maintains that if the government is to reallocate resources to any group, it should be investors and businesses, who are expected to use these resources to create more jobs, products, and prosperity, which leads to higher living standards.

Neoliberalism has a strong logic that should not be dismissed out of hand. Arguably, it has helped sow economic prosperity and helped enrich Americans in terms of consumer goods; for example, clothing, food, home furnishings, personal electronics, transportation, telecommunications, and a range of other products have become very inexpensive. It can also claim credit for having helped bolster job prospects at the lower tiers of the job market and for improving Americans' tremendous access to credit.

Whatever their success in other consumer product markets, neoliberal policies have not led to a bounty of high-quality, highly affordable healthcare, education, and housing. Many of the techniques we use to make food, clothes, or electronics cheap—such as importation from low-wage countries, highly automated production, or self-service—do not work as well in these markets. In fact, the rather laissez-faire system in the United States has resulted in *higher* costs and, in some respects, lackluster results, in healthcare, education, and housing. Other highly developed countries do not put their people in such difficult dilemmas. Of course, having money confers advantages in any society. However, other countries offer a range of examples that show how social programs can contain the personal burden

of accessing reasonably good-quality healthcare, child care, education, and housing. While these other societies are certainly not untroubled utopias, their ability to deliver better results in terms of household finances and well-being is worth noting.

Emulating mid-20th century/European-style government-directed policies to ensure universal accessibility is not an uncomplicated solution. It entails costs and sacrifices whose weight will fall harder on some people than others. Moreover, Europe has problems of its own, including household financial ones (see Chapter Seven). On the whole, however, universal accessibility to quality healthcare, education, and housing is likely positive on balance, and such policies could help defray the pressures that are causing household finances to deteriorate and may also reduce the well-being consequences of having money problems.

Ultimately, Americans must collectively face a choice about how society should respond to their money struggles, as they have for decades. Although these choices are difficult and all bear risk of failure, the U.S. public should not presume that they are collectively consigned to struggle with money. Governments do have the capacity to at least ease the burden of these problems, and other countries offer ideas about how this can be done.

Book Preview

Chapter Two provides a snapshot of U.S. household finances and develops a more concrete view of the United States' poor, middle class, and upper class. We typically understand household finances through the prism of our personal situation and generally assume that our personal circumstances are typical or middling. The chapter provides a concrete view of richer and poorer Americans, particularly who they are, how much they earn, and what they own and owe. The analysis makes sense of the perch from which we personally look at household finances.

Chapter Three defines financial insecurity and assesses its prevalence and depth in contemporary U.S. society. The analysis suggests that about one-third of society is economically dependent on others and unable to sustain a basic livelihood on their own. Another third balance their books as a day-to-day juggling act but are ill-equipped to confront life's many unanticipated—but not rare—financial shocks. Much of the remaining third may be able to deal with the shock of a temporary job loss, illness, or home repair, but they have not saved enough to finance an independent livelihood in old age. The vast majority of society seems destined for the public rolls. It is hard to see how society will maintain generally high living standards, or even avoid mass poverty, without extensive social programs.

Chapter Four examines the long-term deterioration of U.S. household finances, and several important concurrent—and possibly contributory—political, economic, and social developments. Although we often think that households' financial problems are the product of a once-in-a-lifetime economic downturn, this deterioration has been developing over decades. While many of the forces that have challenged household finances are being felt across the highly developed world, there is reason to believe that the United States' comparatively strong commitment to neoliberal economic policies makes matters worse.

Chapter Five examines why Americans have not tightened their belts in response to the financial pressures they face. This chapter establishes the degree to which household spending—and in turn financial insecurity—is driven by the rising personal burden of healthcare, child care, education, and housing. Households are overspending in part because the U.S. economy has proven unable to deliver highly accessible, high-quality education, healthcare, housing, and other products that are essential to well-being.

Chapter Six provides a deeper exploration into the rising personal burden of these essentials. It probes questions about what people need, whether or not their spending on essentials is worthwhile, and how the choices of economic policy-makers have contributed to this rising burden. There are clear reasons to believe that education, healthcare, and housing expenditures influence people's overall well-being. Although some of this expenditure is wasted in terms of well-being benefits, the burden for even basic essentials is clearly high and rising. Cutting out these expenditures in the pursuit of financial well-being is a risky gamble.

Chapter Seven looks abroad to describe how other highly developed societies organize these essential markets and asks how their policies affect household finances, public finances, and human well-being. It finds that, despite the United States' comparatively great wealth, both its household finances and overall well-being are rather middling compared to other highly developed societies. The United States may be remarkable in its antipathy toward the socialism and "big government," but it is hard to see how regular Americans have benefited from the policies that stem from this antipathy.

Chapter Eight describes how Americans' deep faith in neoliberalism keeps U.S. society from adapting sensible solutions that have succeeded in other developed countries. Although its proponents warn that the consequences of violating the tenets of their free market faith portend doom, Americans have good reason to shed this orthodoxy. Free markets work sometimes, but not all the time. There are good reasons to violate these orthodoxies in healthcare, education, and housing.

Notes

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These types of securities are priced as

$$PV = \frac{A}{r}$$

where *PV* is the present-day value of the security, *A* is the periodic payout of the security, and *r* is the interest rate associated with the security.

13. In this exercise, we presume a perpetual income of $45,000 in 2013 dollars for the near-wealthy and $90,000 for the wealthy.

14. Our assumptions are to treat T-bills as cash equivalents, for example, if they were laddered. We treat Treasury bonds as an ultraconservative allocation of debt investments, and we consider the S&P 500 index as a reasonably conservative allocation of equity investments (the index is mostly composed of large, blue-chip firms).

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31. For a conservative portfolio with 25 percent invested in T-bills (with a long-term return of 3.6 percent), 50 percent in T-bonds (5.4 percent), and 25 percent in Fortune 500 equity (11.3 percent).

32. We use the average of male and female expectancies from the Social Security Administration's 2016 Actuarial Life Table published at https://www.ssa.gov/oact/STATS/table4c6.html

33. This is a presumed portfolio that is 40 percent S&P 500 shares, 40 percent Treasury bonds, and 20 percent Treasury bills. Many investment professionals would consider this to be a highly conservative portfolio for a young person and a very aggressive one for someone near retirement.

34. The present value of a target retirement nest egg is calculated as $PV=FV/(1+r)^n$, were P = present value, FV = future value, r = rate of return, and n = compounding periods. We discount the estimated value of future payments, presumed to be 10 percent of gross income, which is obtained by $PV=(INC*0.1)*[((1+r)^n - 1)/r]$, where INC = current gross income, and other terms are as in the previous formula.

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