Financial Crisis in American Households

The Basic Expenses That Bankrupt the Middle Class

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Contents

CHAPTER THREE

Financial Insecurity

> Private school: $32,000 a year per student. Mortgage: $96,000 a year. Co-op maintenance fee: $96,000 a year. Nanny: $45,000 a year. We're already at $269,000, and we haven't even gotten into taxes yet.
>
> Allen Salkin, *New York Times*[1]

The concept of financial insecurity is intuitively straightforward but harder to pin down in concrete terms. Most of us have vague ideas about what it means to be financially secure. It might involve being able to cover the bills and maybe save some extra money for the future. It might involve not staying awake at night worrying about money. Some people see it as having no limits on their spending. Apparently, there are Manhattanites with half-million dollar incomes who feel insecure, even though about half of U.S. households survive on less than that nanny's salary of $45,000 a year (and many probably do so believing that their finances are in order).

These definitional differences can cause people to talk past each other in discussions about financial insecurity, so it is worth being explicit about what is meant by the term. This chapter explores the concept of "financial insecurity," develops a scheme for assessing it, and tries to estimate its prevalence and severity in contemporary U.S. society. The data suggest that most households are insecure. At least one-quarter of the country's households are unable to sustain a very basic livelihood without outside assistance, and thus they seem incapable of functioning as independent financial concerns. Perhaps another quarter of the country lives month-to-month, a tenuous situation that could easily start unraveling if confronted with unanticipated—but reasonably commonplace—shocks, such as illness, injury, divorce, or even a major home or auto repair. Even if a household is able to maintain some degree of financial independence during its working years, the vast majority of Americans are under-saved for old age and seem ultimately destined for eventual dependency on the public rolls.

These findings suggest that Americans' economic security ultimately depends on the government's readiness to help them. Given these findings, one might question the proposition that Americans' economic security and wellbeing could be improved by limiting or diminishing the government's role in economic life. It is hard to envision how households could become more economically secure by weakening an institution upon which the vast majority of them depend. It is reasonable to ask whether a society can even maintain modern living standards without "government handouts."

Financial Insecurity as an Emotional State

Many people understand "financial insecurity" as an affective (or emotional) state. By this standard, people are considered to be financially secure if they *feel* secure. Surveys suggest that somewhere between one-third and one-half of Americans view their financial situation negatively,[2] so we might infer that this is the percentage of society facing financial struggles.

There are several reasons to pause before relying on people's self-perceived situations as a basis for assessing the prevalence and severity of financial insecurity. First, such sentiments can be divorced from people's objective financial situation. A 2012 U.S. Trust survey of multimillionaires found that more than one-tenth of respondents felt financially secure in the present, and roughly 30 percent do not expect to be financially secure into the future.[3] Likewise, many people are probably oblivious to the precarious state of their finances or have come to accept their own precariousness as normal, reasonable, fair, or a fact of life. Most people do not even track their finances,[4] and much of society lacks the tools to make sense of any financial information they might possess.[5] All of this is to suggest that most people's capacity to assuredly diagnose their financial situation as "secure" is questionable.

Moreover, feelings of financial insecurity may not reflect an objectively dire financial situation. Many fears surround the potential loss of comfort, privilege, or luxury, rather than of some more absolute form of deprivation. People often define their present lifestyles as being minimally acceptable.[6] So, for example, a wealthy household's distress may be rooted in fears of not being able to enjoy a lifestyle that most people could never maintain, or not being able to insulate their families from the financial pressures that most people deal with on a regular basis. While these types of worries produce emotional distress, it is hard to see them as sufficiently serious as to warrant a societal reaction.

Self-perceived financial insecurity is also a problematic measure of financial insecurity because there are people who are anxious in general, and this generalized anxiety extends to money matters. Emotional dispositions may be ingrained personal traits. For example, research suggests lottery winners eventually return to baseline negative affective states after the initial thrill of winning subsides, just as those who have experienced a serious personal loss (e.g., of a limb) can eventually come to terms with their new situation and return to their baseline positive attitude about their lives.[7] To some degree, people are emotionally disposed to anxiety or calm, and those generalized dispositions influence their personal financial assessments.

All of this suggests that subjectively perceived financial insecurity is probably an unreliable and potentially invalid measure of people's objective financial situation. For this reason, we might try to develop objective standards of financial security, which are divorced from people's personal goals, feelings, lifestyle expectations, risk tolerance, and so on. To do this, we can delve into the particulars of people's income statements and balance sheets.

People's Money Needs

While it may be true that life's most important things are free—family, friendship, sunrises, and such—it is also true that free things cannot sustain a modern livelihood on their own. Money buys food, shelter, basic utilities, clothing, hygiene products, education, medical care, transportation, and a range of other products that shape a person's prospects for survival, health, safety, and a meaningful place in society. Moreover, people need money to make legally obligatory payments—a person can go to jail for not paying taxes or child support—so money, to some extent, purchases one's freedom. At its root, financial insecurity involves the risk that money shortages will force people to forgo things that they genuinely need.

If financial insecurity involves not having enough money to cover basic essentials, we need some conception of what is included in these essentials. We need some idea of what goods and services people need to maintain a basic living standard. Much poverty research presumes that these money needs are roughly captured by the official poverty line. As discussed in Chapter Two, the official poverty rate is a very crude measure. Implicitly, it assumes that people's basic living costs (BLCs) are reasonably approximated by taking the inflation-adjusted cost of what the U.S. Department of Agriculture deemed to be a "minimum" diet in 1963, multiplied by three. Crude measures are a fact of life in the analysis of household finances, but this particular measure is so rough that it can reasonably considered to be meaningless. Yet, these estimates are the basis for determining people's eligibility for social assistance, redistributive tax credits, or health insurance subsidies.

More recently, researchers have sought to develop a better-specified view of people's money needs by explicitly specifying and pricing out the out-of-pocket costs incurred in the acquisition of necessary goods and services.[8] Doing so involves making determinations about the goods and services people need, as opposed to those that they want. *Needs* are things (e.g., goods, services, rights) whose acquisition is essential in the sense that their denial causes some kind of harm.[9] People need food, shelter from the elements, or emergency medical care because they help prevent death. It is unhealthy for someone not to use personal hygiene products (e.g., toothpaste or soap). It is hard to play a meaningful role in society without clothes or some means of conveyance to work. It might be hard to find a meaningful role in the economy if you lack basic education or training. Not paying taxes can land you in jail.

The expansiveness of our definition of "needs" will influence the proportion of society that we see as financially insecure. For example, health insurance is expensive. If we deem it necessary, then the many families who forgo health insurance due to affordability problems can be deemed to have forgone a necessity for lack of money and are thus construed to be in a state of financial failure. However, if we deem it optional—more like a video game console than indoor heating or plumbing—then this family is not forgoing a necessity, and thus not in a state of financial failure.

In contrast, *wants* are things that people desire, but their denial seems likely to have little to no impact on people's basic levels of well-being. So, for example, people need a diet with protein, but might want that protein to be delivered through high-quality cuts of beef, as opposed to eggs and beans. People might want to wear designer clothing, but their basic needs for warmth or the social need to be clothed in public are just as easily satisfied with generic label clothes.

Arguments about what constitutes a "need" versus "want" can go on interminably. Some basic products are clearly necessary (e.g., basic shelter, food, clothing, or emergency medical care), and others are clearly nonessential (e.g., designer clothing, video games, or premium cuts of beef in lieu of eggs). In between these two extremes, there are products whose necessity or essentiality is the subject of disagreement. For example, people may harbor different views about whether people need preventative healthcare, postsecondary education, child care, cell phones, Internet access, fresh vegetables, or organic milk. Some see these things as genuine necessities that everyone in society should be able to access, and others see them more as the perquisites of economic success, which can reasonably be denied to someone who does not have the money to pay its costs.

At some point, an analysis must settle on some provisional definition about what constitutes a need. By the principle of conservatism, we should set this provisional definition in a way that makes it harder for us to arrive at the findings we anticipate seeing. Concretely, this means that, if we think that financial insecurity is prevalent, our case would be helped by adopting a minimalist definition of people's needs. A minimalist definition means that our analyses are disposed to *underestimate* the prevalence of insecurity. If we find high rates of insecurity, then we can be assured that these are low-ball estimates and that financial insecurity is probably even more widespread (by more commonplace notions of what constitutes needs).

Table 3.1 describes the products used to calculate households' Basic Living Cost (BLC), which try to estimate the costs of a basic, market-secured livelihood. The products included are adapted from the Census Bureau's *Supplemental Poverty Measure* and Economic Policy Institute's *Family Budget Calculator* projects.[10] They are not intended to be an accurate estimate of people's basic needs but rather a strongly conservative estimate that is disposed to under-estimate the true prevalence of financial insecurity. So, if the reader believes that things such as health insurance, child care, home furnishings and appliances, higher education, cell phones, or home Internet access are part of a minimum living standard, then they should read financial insecurity estimates based on these BLCs as underestimating the true prevalence of genuine insecurity.

Note that these BLC estimates do not consider questions about what constitutes minimally acceptable quality levels. It does not ask whether a person's diet is genuinely adequate if their budget is restricted to the USDA's *Thrifty* plan. It does not consider whether inexpensive housing is located in an adequate school district or whether crime levels are reasonable.

What Are the Costs?

Our estimates, which are based on cost estimates for the basket of products described previously, suggest that the median U.S. household needs about \$19,574 a year to cover the basic rental housing, utility, food, transportation, apparel, personal care, and minor healthcare expenditures. A family of two adults and two children are expected to need \$24,966. This is a minimal living standard, which presumes that public or interpersonal assistance will provide free health insurance, child care, and any other essential goods and services that readers might seem necessary. These costs can escalate quickly in the absence of assistance. For example, if we were

Table 3.1 Assessing the Burden of Basic Necessities

Product Category	Based on Premise That Minimum Standard of Living Includes:	Standard Used for Defining "Minimum"	Data Source
Shelter	Personal living quarters	Median national rent ($850).	ACS
Food	Basic nutrition	Average national costs of USDA Low-Cost Food Plan.	CNPP
Utilities	Basic plumbing and power	Expenditures on natural gas, electricity, other fuels, and water for households summed with other CEX-derived estimates, and basic costs assumed to be empirical 25th percentile for total CEX-measured costs.	CEX
Transportation	Means of accessing workplace, markets, and other out-of-home amenities or enterprises	Expenditures on vehicles, vehicle financing, fuel, service and repairs, insurance, public transportation, and other charges summed with other CEX-derived estimates, and basic costs assumed to be empirical 25th percentile for total CEX-measured costs.	CEX
Medical Care and Drugs	Out-of-pocket costs of medicine and medical care	Expenditures on medical services, prescription drugs, and medical supplies summed with other CEX-derived estimates, and basic costs assumed to be half of empirical median for total CEX-measured costs.	CEX
Apparel	Clothing and footwear	Expenditures on clothing, footwear, and apparel-related services summed with other CEX-derived estimates, and basic costs assumed to be empirical 25th percentile for total CEX-measured costs.	CEX
Personal Care Items	Access to basic hygienic products	Expenditures on soaps, shaving products, deodorants, haircuts, and so on summed with other CEX-derived estimates, and basic costs assumed to be empirical 25th percentile for total CEX-measured costs.	CEX

Sources: Data from ACS = American Community Survey, CCA = Child Care Aware (2013), CEX = Survey of Consumer Finances (Federal Reserve Board, 2015), CNPP = Center for Nutrition Policy and Promotion (2013).

U.S. Department of Agriculture, Center for Nutrition Policy and Promotion. (2013). *USDA food plans: Cost of food report for September 2013*. Retrieved from https://www.cnpp.usda.gov/sites/default/files/usda_food_plans_cost_of_food/CostofFoodSep2013.pdf

U.S. Census Bureau. (2015). American community survey. Retrieved from https://www.census.gov/programs-surveys/acs to include Affordable Care Act partially subsidized insurance and market-rate child care,[11] this two-adult, two-child family would require $34,127 per year. Note that, for 92 percent of our households, estimated BLCs are higher than their official poverty-line income. On average, an official poverty-line income was about $2,700 a year (or $225 a month) lower than their estimated BLCs. Of course, these living costs might overestimate the living costs facing nominally "poor" or "near-poor" households. What about government assistance programs, such as Medicaid, housing vouchers, food stamps, and the like? What about parental aid? Shouldn't these single parents be receiving child support? We turn to this issue next.

Economic Independence and External Aid

Exposure to financial insecurity is shaped by personal finances as well as the degree to which government programs and interpersonal (mostly familial) aid allow us to secure the basics off markets. In other words, you don't need money if family, charity, or the government can help you secure life's necessities. To the extent that other agents or institutions step in to safeguard our living standards when we're short on money, financial pressures present a less menacing threat to people's living standards. There are three major sources of such aid: public assistance, private charity, and interpersonal assistance.

Public assistance refers to government policies and programs that provide people with essential products, defray the out-of-pocket costs of accessing essentials, or directly give people money to buy essentials. The United States has a wide array of social programs that do all of these things. Governments deliver free K–12 education, libraries, parks, road infrastructure, and emergency services. They provide some people with subsidized postsecondary tuition (or at least educational loans), mortgages, and health insurance. They give money aid to the poor, the unemployed, the disabled, and the elderly. These programs either provide supplemental income or control households' out-of-pocket expenses, and help insulate people from the well-being consequences of running out of money.

Public assistance varies across states and countries. For example, healthcare is fully socialized in the United Kingdom, such that people's budgets are not strained by the cost of premiums, so the risk of losing health insurance due to financial problems is minimal. In contrast, health insurance costs weigh heavily on many U.S. household budgets, and many Americans forgo health insurance as a result of money strains. Tuition-free college or child care is more common in Northern Europe (much like K–12 education is in the United States), and the strain of postsecondary schooling on household budgets is lower in these countries, and being short on money seems less likely to result in people having to forgo these services. Likewise, public funding for public higher education is higher and tuition lower in Alaska and Wyoming, whereas it is more expensive in New Hampshire and New Jersey.[12] Publicly assisted child care is more generous in New Jersey, for example, than in Georgia.[13] Public assistance also differs in how readily it is granted to different demographic groups; for example, the U.S. federal government more readily offers money and health insurance coverage to the elderly but is less generous with the working-age population and, to a lesser extent, children.

Institutionalized private charity is a second mechanism by which people's basic well-being is insulated against economic failure. These are the local food banks, soup kitchens, clothing drives, and other assorted privately funded and administered delivery of essentials to cash-constrained households. In 2014, Americans are estimated to have donated $359 billion to charitable endeavors.[14] This is a considerable amount, though a lot of this money is not directed toward causes that help financially distressed households. Many large-scale donations ultimately benefit causes that serve privileged people (e.g., donations to elite schools, nonprofit cultural institutions, or public goods in wealthy communities). Others finance donors' personal consumption of goods and services but are structured as donations for tax purposes (e.g., religious institution memberships, private nonprofit club membership fees). Even if all philanthropy in the United States were directed toward programs that help shore up household finances, they would be far underfunded relative to major government social programs. The Old Age and Survivors Insurance benefits from the Social Security program cost more than $700 billion annually on their own—double the amount of the whole country's annual charitable donations. One government program (albeit a big one) dwarfs the entirety of all private charity.

Interpersonal assistance refers to situations in which a household receives products, money, or some form of economic insurance from a personal relation (a relative, co-parent, or cohabitant). Interpersonal transfers also play an important role in shaping household finances. For example, child support or alimony payments can strengthen the finances of a single-parent household. The independently poor children of wealthy parents enjoy higher living standards and more economic security than their personal finances warrant. Students who receive parental help in their postsecondary education are better positioned to graduate free of debt (or even graduate at all).[15] The bedroom in Mom and Dad's basement is a form of economic insurance, and parental gifts, loans, or inheritances can confer instant home ownership, retirement savings, or wealth in general.

Interpersonal assistance can be a major factor in determining someone's ultimate vulnerability to financial problems. For many households, friends or relatives can provide some form of economic assistance in times of need. Having a parent with a room into which someone can move is a major form of economic insurance. However, personal relationships can also incur financial liabilities. Studies find household often go bankrupt as a result of obligations to care for a relation.[16] Family obligations can make it hard for people to work and raises living costs. They can do harm as well as help.

Financial security is a matter of people being able to access the money they need. People's money needs are a matter of the out-of-pocket costs associated with securing access to the essential goods and services for well-being. These out-of-pocket costs can be defrayed by governments, private charity, or personal relations. After these out-of-pocket costs are established, assessing people's financial insecurity involves developing some sense of the likelihood that a household will not be able to cover its essential expenses. A household with a higher likelihood of running out of money is more insecure.

Prevalence and Severity of Financial Insecurity

Financial insecurity is not a black-and-white issue in the sense that someone either is or isn't secure. Instead, it is a matter of degrees—people are more or less secure. That being said, our understanding of these various shades of gray can be aided by some simplification. One way to think about household insecurity is through a typology of four states, which range from less secure to more secure.

Economically Dependent

The economically dependent lack the earnings or accumulated wealth to cover BLCs. Their access to life's necessities depends on public assistance or private charity. One might characterize a household situation as having "failed" in the sense that it is unable to sustain itself independently as an ongoing enterprise. This is the least secure kind of household, whose livelihood is sustained by external aid.

Short-Term Precarious

Short-term precarious households are earning or receiving enough money to cover BLCs, but they lack the resources to withstand the financial demands of an unanticipated, but reasonably commonplace, financial shock. These kinds of households might be characterized as "living paycheck to paycheck." Their economic independence is precarious, and many of these households cycle through states of dependency and precariousness.

Long-Term Unsustainable

Long-term unsustainable households are able to cover living costs and save some money. However, a household needs considerable savings if it wishes to cover its living costs in its later years. These are years in which people find it more difficult to earn income and when a household can confront considerable healthcare and long-term care bills, even with U.S. socialized health insurance for its elderly. Households that seem financially viable during its working years, yet unprepared to weather the costs of old age, are considered to be long-term unsustainable.

Long-Term Sustainable

Finally, there are households that seem well-positioned to maintain a comfortable lifestyle into old age. Although they may collect Social Security, they seem unlikely to depend on it to sustain a basic livelihood. This group includes older households who seem well-positioned to enjoy this level of security in old age, as well as younger households who seem on track to accumulate enough money to finance a secure, independent retirement.

Income Inadequacy

Our most basic standard of economic security is short-term basic financial independence. If a household is not able to come up with enough income to finance a most basic lifestyle, it is taken to be in a state of financial dependency. In effect, the household fails as an ongoing financial concern, and relies on external aid to maintain a most basic living standard. Here, we try to assess the prevalence of financial dependency by seeing how many of the country's households are earnings-adequate.

The concept of *earnings adequacy* asks whether people earn enough money to cover their BLCs. *Earnings* include money received through market transactions, such as wages, financial investments, personal businesses, private pensions, and other transactions resulting in proceeds from personal labor or personal property. An earnings-inadequate household does not earn enough money on markets to cover the market costs of basic housing, food, and other essentials. Such households requires outside assistance, debt, or accumulated wealth to cover the shortfall and ensure their access to basics.

To draw comparisons, we also consider the prevalence of income inadequacy. A household is *income inadequate* when its total income (e.g., from public aid, personal transfers, and market earnings) are not enough to cover

BLCs. Most of the difference between earnings and income inadequacy is a matter of government aid, such as welfare, food stamps, Medicare, Medicaid, or Social Security. This difference can be used to gauge the degree to which different groups are treated preferentially by society's social safety net. Where income and earnings-adequate rates are similar, governments don't really channel much in the way of payments to group members. Where the differences between these rates are larger, government programs are more aggressively edifying household finances through income payments.

How many households lack enough earnings or income to cover the costs of a very basic livelihood? One way to develop estimates is to see how much of the country has market earnings that are sufficient to cover a household's estimated BLCs. Remember that these are intended to be rock-bottom living cost estimates, so the resulting estimates of earnings or income inadequacy are minimum levels. A more extensive definition of basic living standards—including healthcare, child care, basic household appliances and furniture, Internet access, telephone access, and a range of other products—would result in higher estimates of economic dependency across society at large.

Table 3.2 depicts the prevalence of earnings and income inadequacy across U.S. households. It shows that more than one in four households don't earn enough money to sustain a basic livelihood without government or interpersonal aid. More than a quarter of U.S. households do not earn enough money on their own to cover the costs of a very basic livelihood. Earnings inadequacy is more prevalent among the unpaired, the unemployed, the less-educated, nonwhites, and the elderly. A substantial part of these groups needs external support to secure access to the most basic necessities.

Despite arguments that U.S. capitalism affords easy opportunities to save money and accumulate wealth, a surprisingly large plurality of households fail to do so. If an economic system has a 28 percent failure rate on something as basic as putting people in a position to earn enough to secure basic food, clothing, shelter, and personal care items—forget about healthcare or education—it is hard to see that system as one that easily delivers high living standards on its own. Raw capitalism on its own cannot produce the high living standards that we enjoy today. At least, no society has ever accomplished it on capitalism alone. All highly developed societies widely sustain access to life's necessities through government programs. They are all effectively somewhat socialist.

Nowhere is the failure of market-sustained livelihoods so clear, and the profound impact of U.S. social policies so obvious, as with the elderly. Earnings inadequacy is particularly high when the heads of households

Table 3.2 Incidence of Income Inadequacy across U.S. Households, 2013

Income Basis	Earnings Inadequacy (%)	Income Inadequacy (%)
Overall	**28**	**16**
Young (Head < 35 Years)	30	26
Older (Head > 65 Years)	49	17
Married	13	7
Nonmarried	38	27
Household with Children	23	18
Household without Children	30	16
Whites	24	12
Nonwhites	38	27
Head Fully Employed	12	10
Head Not Fully Employed	53	27
College-Educated	7	4
Not College-Educated	31	18

Source: U.S. Federal Reserve (2014).

are 65 or older, a group in which just under half lack sufficient earnings to cover basic costs. Other demographic groups that are vulnerable to earnings inadequacy include the unmarried, nonwhites, and those whose head of household was not fully employed (i.e., the head experienced unemployment, was disabled, or retired). In contrast to seniors, these groups receive less help from public programs, at least insofar as income payments are concerned. While government payments seem to halve the proportion of society that lacks enough income to cover the costs of a basic livelihood, the unmarried and nonwhites receive far less help from guaranteed income programs, as do parents, those without college degrees, and those from the working-age population. The elderly also receive socialized healthcare.

Of course, cash aid is not the only form of help extended by social programs. The government also subsidizes or directly provides many essentials to financially strained households, such that their money shortage does not directly translate into material deprivation. For example, the poor are eligible for housing vouchers, child care and education grants, and Medicaid. Eligibility for these programs often requires that a family be officially impoverished, which, as noted earlier, often involves incomes that are well below people's BLCs. In other words, someone can earn too little to cover basic costs but earn too much to be poor. This means that many earnings-inadequate families do not officially qualify as poor and are thus at risk of being denied help from programs for the poor.

How many households are ultimately denied access to necessities after the effects of these programs are considered? These questions have been pursued in detail by the Census Bureau's Supplemental Poverty Measure project, whose estimates found that about 15.5 percent of Americans might not be able to secure access to basic necessities even after government payments and subsidized provisions are considered.[17]

Liquid Assets

Some households are able to cover the costs of a basic livelihood, but their situation is a precarious one that could unravel if faced with unanticipated problems. For this reason, financial planners often recommend that households keep at least three months of replacement income or regular expenditures in cash accounts. The idea is that, if a household runs into some type of unanticipated financial shock (e.g., a job loss, medical event, or some other financially damaging incident), they have enough money to cover their costs without fast and dramatic cutbacks, onerous debts, or the liquidation assets at inopportune times (and thus at fire-sale prices).

How much of society meets that three-month liquidity standard? Table 3.3 describes households' *liquid asset coverage*, which is the amount of time that a household's accrued assets could sustain its basic costs without receiving any income. Gross income coverage is the sum of households' cash savings, money market accounts, and certificates of deposit, divided by its monthly pretax income. The resulting figure tells us how long a household could substitute completely lost income by using its liquid assets. *Basic cost* coverage uses our BLC estimates from earlier and suggests how long families could sustain a minimum living standard with liquid holdings.

In 2013, just under half of the country's families had less than $4,100 in liquid assets, and two-thirds had less than $15,000. Only about one-third of the country's households hold three months' worth of gross income in liquid assets. About half have less than one month in income, and a quarter have less than one week. About 22 percent have less than $500 in liquid assets, putting them at considerable risk of a cash shortage if they needed to cover the typical co-pay of an insured auto accident. This suggests that roughly half of the country subsists on a nearly month-to-month basis and that their cash reserves could be exhausted if confronted with an expenditure exceeding a few thousand dollars.

Table 3.3 Liquidity Metrics, U.S. Households, 2013

Type of Income Coverage	Gross Income	Basic Costs
Median Time Coverage:	4.3 w	11.0 w
Less than 3 months	67%	52%
Less than 1 month	50%	37%
Less than 1 week	26%	20%
Younger (head under 35)	3.0 w	5.0 w
Older (head over 65)	3.8 m	8.7 m
Married	6.3 w	5.0 m
Nonmarried	3.0 w	5.3 w
Minors in Household	2.4 w	5.5 w
No Minors in Household	6.5 w	3.8 m
White	6.8 w	4.6 m
Nonwhite	12 d	2.7 w
College-Educated	4.7 m	1.8 y
Not College-Educated	3.5 w	8.2 w

d = days, w = weeks, m = months, y=years.

Source: U.S. Federal Reserve (2014).

Liquid coverage varies across demographic groups. Age plays an important role, in part because older households have had a longer time to accumulate wealth, because they are supposed to keep a greater proportion of their wealth in low-risk liquid assets, and because older household's incomes tend to be lower than that of the working-age population (so there is less income to replace). The median household with a head older than 65 had about 3.8 months of gross income, whereas younger households only had enough to cover about 3 weeks of income. Married households had about twice the level of liquid asset coverage as unmarried households, a sensible result given that they generally have twice as many earners in the household unit. The differences between whites and nonwhites is striking (4.7 months versus 12 days, respectively), as was that between the college and noncollege-educated (5 months versus 3.5 weeks, respectively).

Gross income replacement is arguably a comparatively liberal standard with which to measure the adequacy of people's emergency savings. It assumes that we use the continuation of people's current living standards (as approximated by their gross income) as a basis for judging whether or not they have enough cash holdings. Arguably, people can tighten their belts when confronted with financial problems. What if we adopt a more restrictive standard, which considers people's ability to cover their BLCs instead? The median household comes closer to reaching financial planners' 3 months of coverage standard—it has enough cash to cover about 11 weeks of living costs. Groups who already tended to be better insulated by their cash holdings seem capable of covering their basic costs for extended lengths of time—the median elderly household is able to cover almost 9 months of basic costs, married people and whites are covered for about 5 months at the median, the childless have enough for almost four months, and the median college graduate enjoys a whopping 1.8 years.

However, demographics that seemed to have liquidity problems under the former standard also register as such using the BLC standard because their regular incomes are near-subsistence level from the outset. The median household headed by a nonwhite has an estimated 2.7 weeks of basic expenses in liquid assets. The median younger household has just over a month. The unmarried and parents have about a month and a half. And those without college degrees have nearly 2 months at the median. About one-third of all U.S. households have less than a month in BLCs, and one-fifth have less than a week.

Overall, a large proportion of U.S. households do not have much money with which to confront unanticipated financial problems. About two-thirds register as having less than the prescribed three months in income replacement. According to research by Lusardi and colleagues, those without cash savings would expect to resort to liquidating other assets (e.g., nonhome physical property, retirement accounts), borrowing money from family, using credit cards or other forms of debt, or working overtime to make ends meet.[18] These strategies work if someone has assets, access to debt, family or friends who are able and willing to lend money, or opportunities to work overtime. Not everyone has these recourses and are thus dependent on government aid unless they are to forgo essentials.

What About Insurance?

Households are expected to carry insurances to protect themselves against unforeseen calamities. While we do not directly examine insurance coverage here, other sources suggest that much of the country lacks major forms of coverage. In 2014, about 13 percent lacked health insurance coverage.[19] According to industry advocates' estimates, 13 percent of drivers are said to lack auto insurance.[20] About 30 percent of households have no life insurance.[21] A majority of Americans lack short- or long-term disability insurance.[22] It is estimated that only about a third of renters have rental insurance.[23] Large parts of society face the risk of commonplace calamities with only their (often limited) personal assets and government aid to protect them.

Wealth Accumulation

Our final criterion for assessing financial security is accumulated wealth. The topic of wealth was engaged in Chapter Two. It shows how about 8 percent or so of society has enough wealth to sustain a squarely middle-class lifestyle into perpetuity (as long as they are willing to settle for such a living standard). Most of society does not have so much accumulated wealth. Half of the country has less than $81,000 in net worth, and a quarter has less than $9,000. While a majority of households are able to self-finance a basic livelihood in the present, they are not accumulating wealth. Low wealth accumulation portends a situation of eventual economic dependency. It might not happen during a household's working years, but it seems hard to avoid in old age.

An analysis has to engage three questions to estimate the adequacy of people's accumulated wealth. First, it needs some sense of how much money the household needs in retirement. Second, it requires an understanding of how much a household needs to have accumulated to be reasonably assured of having enough money in retirement. Finally, it needs to examine how much wealth has already been accumulated and judge whether the households is "on track."

The Poor Financial Shape of Older Americans

The U.S. Federal Reserve's *Survey of Consumer Finances* (SCF) data suggests that the median net worth of a household headed by someone in their sixties is $162,180, including their homes. Without homes, median net worth is about $60,000, or about five years of poverty-line income at 2014 prices. To avoid absolute poverty, people need to cover the difference with jobs, public assistance, family help, or charity.

Public assistance plays a key role in preventing elderly poverty. About 9 percent of seniors are officially poor.[24] This low rate (relative to many other demographic groups) is primarily due to Social Security payments. The median senior household received just over $14,000 in Social Security payments in 2013. In 1959, about 35 percent of seniors were poor, compared to 27 percent of children. More than 50 years into the program, senior poverty has dropped by almost 75 percent, whereas child poverty has dropped by less than a quarter (to 22 percent).[25] Moreover, seniors benefit from a wide range of social programs that are quite generous, compared to those extended to other Americans. For example, they receive socialized basic health and prescription drug insurance. These benefits are in addition to those offered to other Americans, like food stamps and Medicaid. Without this extensive Social Safety net, the United States would likely have a far bigger and more severe elderly poverty problem.

Many seniors expect to cover living costs by working longer. The problem is that many seniors are involuntarily pushed out of their jobs, if not thrust out of the workforce entirely. Although older workers are often better protected from layoffs because they tend to have more seniority, those who do lose their jobs often face considerable difficulty finding work and are often forced to accept considerable pay cuts[26] (assuming they are able to work). A recent survey by the Associated Press and National Opinion Research Center found that about one-third of retirees report feeling that they were forced into retirement.[27] Roughly 61 percent of those who leave the workforce involuntarily do so as a result of health-related issues, and another 18 percent did so to care for a spouse or other family member who needed help.[28] In a labor market environment that has been unforgiving to the working-age population, it is hard to envision how a rising tide of elderly Americans will be able to sustain themselves by working well into retirement.

If personal savings, work, and public assistance aren't enough to cover the costs of one's livelihood in old age, family support is another possibility. Parental support has become more commonplace, just as it has become more common to provide financial aid to one's adult children. This phenomenon has produced what is widely known as the "Sandwich Generation"—a generation of middle-aged Americans who are pressed into supporting both their predecessors and successors financially. According to Pew Research Center estimates, about 15 percent of all middle-aged adults provided financial support to both a parent aged 65+and a child in 2012.[29] Roughly 58 percent of this survey's respondents reported either already providing care for an aging family member or see it as "very likely" that they will do so in the future.

How Much Money Do You Need to Retire?

Our first task is to discern how much wealth is required to finance a retirement. We adopt three standards. The high—or moderately "wealthy"—standard follows our discussion in Chapter Two, which proposed that a net worth of about $1.4 million could deliver a median income into perpetuity with reasonably low financial risk. We will term this a moderately "wealthy" retirement. This is probably a lofty retirement savings target for most households, which delivers an income that is better than about half the country without public aid or loss of investment principle. Our second, "basic" retirement saving goal is for a portfolio whose principle and investment returns could yield an inflation-adjusted median lower-middle-class income ($25,000) over the household heads' life expectancy. Our third, "poverty-line" retirement goal seeks to secure a poverty-line income over the life expectancy of the household heads.[30] Here, we use the assumption of a $14,000 per year income as near-poverty.

To calculate the amount of savings required to finance a "basic" or "poverty-line" retirement, we need a sense of how long someone will live, how much prices will rise, and the returns one can yield from financial investments in retirement. We use the inflation (3.1 percent per year) and investment returns (6.4 percent)[31] assumptions established in Chapter Two. We calculate the net worth requirements to render these incomes by calculating each retirement plan as a *discounted cash flow*, a financial formula for determining the present value of a regular payments plan that incorporates consideration of principle investment appreciation. Using life expectancy estimates from the Social Security Administration,[32] along with the preceding assumptions about retirement income, investment returns, and inflation, we can estimate that a household would need $376,623 and $210,909 to finance a $25,000 and $14,000 per year retirement, respectively, over its life expectancy. Households whose heads have survived until age 80 are expected to need $217,558 to receive an inflation-adjusted income of $25,000 per year for its predicted remaining 8.8 years, or about $121,000 for a $14,000 a year retirement. These assumed cash needs over all elderly years will be drawn out momentarily.

Being "On Track"

Younger households are expected to accrue their retirement funds over a lifetime, and these savings are expected to be bolstered by compounded investment returns. We describe a younger household as being "on track" if their current net worth, along with some presumed future savings commitment, is sufficient to render the target retirement nest egg of $1.4 million, $377,000, or $210,000 (depending on whether one is aiming for a wealthy, basic, or poverty-line retirement as described previously).

Like our calculations of required retirement nest eggs, we need some estimate of investment returns and inflation, and we opt for a rough estimate that assumes a real return rate of about 7.4 percent per year[33] (a figure that can be altered by assuming more or less risk, or by historical overperformance or underperformance on the markets). We presume that an on-track household will put 10 percent of its gross income into sheltered retirement investments (an obviously optimistic estimate for most of the country, given that so few households have *anything* saved) and that their incomes will roughly pace general prices.

With these basic inputs, we are in a position to estimate how much a household should have acquired to be on track for a particular retirement goal. We do so by calculating the present value of a households' expected future retirement contributions (10 percent of gross income) from the present value of its target retirement nest egg.[34] Figure 3.1 presents the results.

Lower-income households will have needed to accumulate more in wealth because they are presumed to be unable to contribute more to retirement in the future. A person earning $25,000 per year is estimated to need a net worth of more than $16,000 to be on track toward a $1.4 million nest egg. In contrast, a person earning $50,000 per year does not need to start saving until 22 years old. A $100,000 a year salary allows savings to be postponed to 31. A $250,000 yearly income can postpone savings until 43.

Although a higher income allows people to delay retirement savings, most households need to start saving relatively early in their working years to have adequate retirement savings. Even a household earning $250,000 a year needs to start saving in its late forties to reach our modest basic retirement goal, unless they plan on saving more than a tenth of their income annually. To finance a poverty-line income, these high-income households still need a decade of savings. A more typical home, earning a median wage, needs to start saving a tenth of their income in their early- to mid-forties.

Retirement Savings Adequacy

So how much of the country is adequately saved? Using our three retirement goals, our assumptions about long-term inflation and financial returns, and the presumption of a 10 percent rate of gross income saved, we can arrive at some crude estimates. Given that these estimates depend on many assumptions—reasoned ones but assumptions nevertheless—readers should focus on gross magnitudes rather than finer distinctions.

Our results suggest that about 23 percent of U.S. households have either accumulated $1.4 million in net worth or appear to be on track to do so. About 48.5 percent of households are either adequately saved for, or on track to save enough for, a basic retirement of $25,000 per year. Roughly

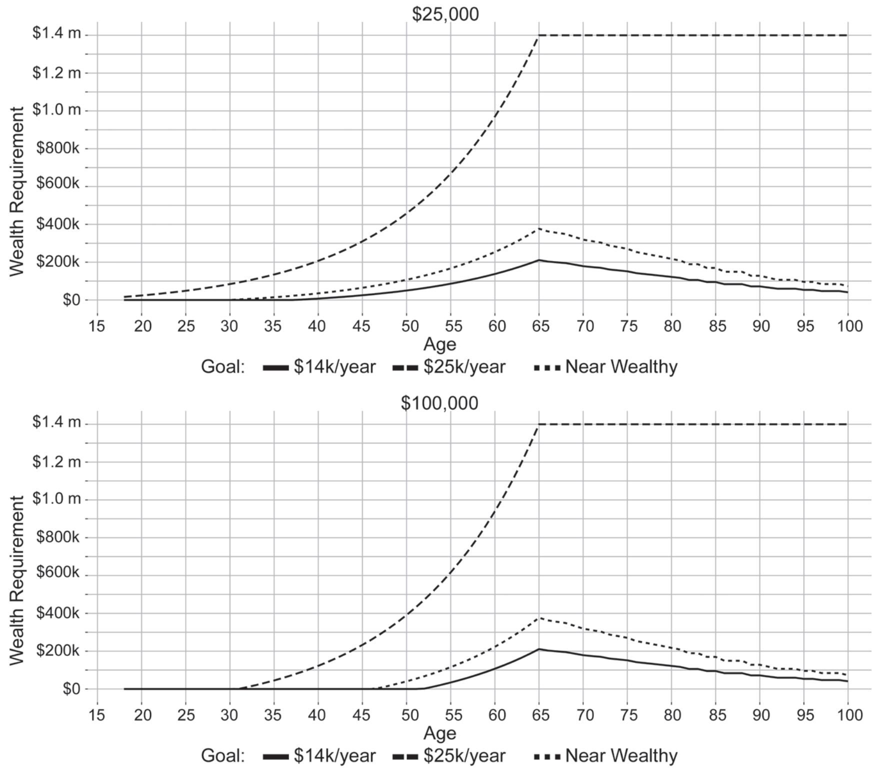

Figure 3.1 Savings Requirements for Four Hypothetical Income Levels, by Age and Retirement Goal.

64 percent are on track to finance a poverty-line retirement. Nearly two-fifths of U.S. households have either failed to save enough to finance, or be on track to finance, a poverty-line retirement.

Moreover, two caveats are in order. First, keep in mind that these savings goals are based on households' total net worth. They are assumed to liquidate all of their assets into a financial portfolio that will finance their retirement, including their residences. Many elderly people are reluctant to let go of their homes—it is cheaper to live in a home after it is paid off, an owned home may provide some economic security for younger family members, and a person may consider their home to be a major facet of their living quality. If we were to consider only nonhome investments, only about 54 percent seem prepared for retirement, and we approach half of the country being unready to finance a poverty-line retirement.

Who tends to be prepared for retirement? Aside from those with higher incomes, retirement savings are more likely to be adequate in households

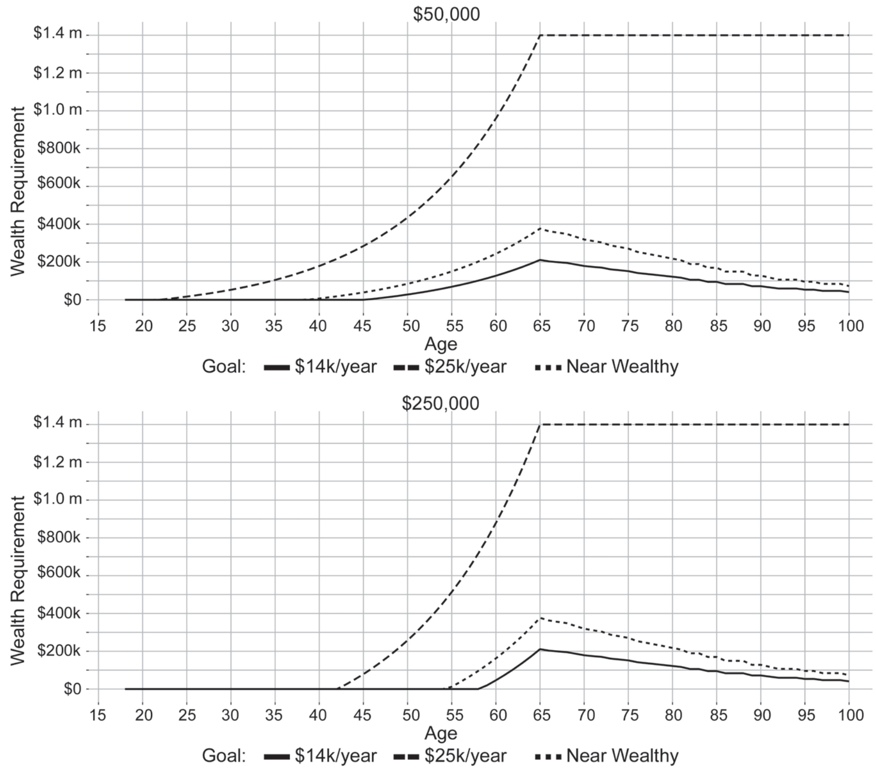

Figure 3.1 (Continued)
Source: Author's calculations.

headed by the college-educated, the employed, and the very young (although this is most likely a by-product of the fact that this last group requires no savings to be considered on track for more modest retirement goals).

What About Social Security?

At present, the average elderly Social Security recipient receives $1,335 per month from Social Security payments. In and of itself, these payments are sufficient to finance a poverty-line retirement, and they greatly reduce the need for savings to cover a basic, $25,000-per-year retirement. As we saw previously, Social Security plays a major role in providing the elderly in the United States with enough income to cover their basic bills. In effect, the United States avoids a massive elderly poverty problem through what is nearly tantamount to a guaranteed income program for older people.

How do we interpret the effects of Social Security on our estimates of people's preparedness for retirement? This analysis maintains the view that Social Security is a social program, like welfare or food stamps. As such, any program that relies on these payments is construed to be economically dependent. They do not function as independent financial concerns.

That being said, the existence of Social Security shields the elderly from the consequences of their having under-saved for their older years. Social Security enables older households who lack assets or employment income to subsist, and it lowers the consequences of money problems for today's elderly. What about younger households? As noted earlier, it depends on the continuance of the program. Social Security is under persistent pressure to be cut, and these cuts are often made salable by only applying them to younger people (e.g., those under 55). Doing so allows older voters to champion austerity and "fiscal responsibility" without biting the hand of the social program that feeds them personally. If these cuts materialize, then today's younger Americans will be more subject to the well-being consequences of having inadequately saved for retirement. If the program continues without cutbacks, today's youth will enjoy the same benefits as the older Americans who are the recipients of their payroll taxes.

Most of the Country Relies on Public Assistance

Although people often like to consider themselves to be financially independent, in reality, the vast majority of people seem to be in a financial position that is either highly dependent on a public safety net at present or ultimately destined for future dependency. Many of those who maintain some level of present-day financial independence are just one unanticipated—but not altogether rare—disruption (e.g., job loss, illness, etc.) away from financial dependence.

Given this level of dependency, it is hard to understand how cutting social supports could ultimately improve people's security and well-being. Public assistance is stigmatized in U.S. culture, despite the fact that so much of society relies on it. Americans seem obsessed with the possibility that some people cheat the welfare system, use it to avoid work, or spend public assistance money in unsavory ways. It draws their ire, leads to questions about why people should waste their tax money on dishonest or slothful people, and often marshals support for policy-makers who favor a broad abolishment of the welfare state to the greatest extent possible. In so doing, they may be lending support to a policy movement that will cut the financial legs out from under them.

Americans are broadly dependent on the government to provide an economic backstop. It is not only lazy young people, welfare cheats, and other assorted unsavory caricatures who rely on public assistance. Virtually everyone, except society's wealthiest third or so, lack the resources to establish secure financial independence. Dismantling the welfare state means dismantling the ultimate guarantor that members of a society that is widely insecure financially will be able to get what they need.

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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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