HEARING ON ECONOMIC CHALLENGES FACING MIDDLE CLASS FAMILIES

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

JANUARY 31, 2007

Serial No. 110–4

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

34–736 WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office,
http://bookstore.gpo.gov. For more information, contact the GPO Customer Contact Center,
U.S. Government Printing Office. Phone 202–512–1800, or 866–512–1800 (toll-free). E-mail, gpo@custhelp.com.

COMMITTEE ON WAYS AND MEANS

CHARLES B. RANGEL, New York, *Chairman*

FORTNEY PETE STARK, California
SANDER M. LEVIN, Michigan
JIM MCDERMOTT, Washington
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
MICHAEL R. MCNULTY, New York
JOHN S. TANNER, Tennessee
XAVIER BECERRA, California
LLOYD DOGGETT, Texas
EARL POMEROY, North Dakota
STEPHANIE TUBBS JONES, Ohio
MIKE THOMPSON, California
JOHN B. LARSON, Connecticut
RAHM EMANUEL, Illinois
EARL BLUMENAUER, Oregon
RON KIND, Wisconsin
BILL PASCRELL JR,, New Jersey
SHELLEY BERKLEY, Nevada
JOSEPH CROWLEY, New York
CHRIS VAN HOLLEN, Maryland
KENDRICK MEEK, Florida
ALLYSON Y. SCHWARTZ, Pennsylvania
ARTUR DAVIS, Alabama

JIM MCCRERY, Louisiana
WALLY HERGER, California
DAVE CAMP, Michigan
JIM RAMSTAD, Minnesota
SAM JOHNSON, Texas
PHIL ENGLISH, Pennsylvania
JERRY WELLER, Illinois
KENNY HULSHOF, Missouri
RON LEWIS, Kentucky
KEVIN BRADY, Texas
THOMAS M. REYNOLDS, New York
PAUL RYAN, Wisconsin
ERIC CANTOR, Virginia
JOHN LINDER, Georgia
DEVIN NUNES, California
PAT TIBERI, Ohio
JON PORTER, Nevada

JANICE MAYS, *Chief Counsel and Staff Director*
BRETT LOPER, *Minority Staff Director*

Pursuant to clause 2(e)(4) of Rule XI of the Rules of the House, public hearing records of the Committee on Ways and Means are also published in electronic form. **The printed hearing record remains the official version.** Because electronic submissions are used to prepare both printed and electronic versions of the hearing record, the process of converting between various electronic formats may introduce unintentional errors or omissions. Such occurrences are inherent in the current publication process and should diminish as the process is further refined.

CONTENTS

January 31, 2007

HEARING ON ECONOMIC CHALLENGES FACING MIDDLE CLASS FAMILIES

WEDNESDAY, JANUARY 31, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The Committee met, pursuant to notice, at 2:07 p.m., in room 1100, Longworth House Office Building, Hon. Charles B. Rangel (Chairman of the Committee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE CONTACT: (202) 225–1721
January 24, 2007
FC–4

Chairman Rangel Announces a Hearing on Economic Challenges Facing Middle Class Families

House Ways and Means Committee Chairman Charles B. Rangel today announced the Committee will hold a hearing on the economic challenges facing middle class families. The hearing will take place on Wednesday, January 31, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m. It is the fourth and final in a series of hearings the Committee is holding on the state of the American economy.

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

FOCUS OF THE HEARING:

In the decades after World War II, standards of living for middle-class families grew along with the American economy. Millions of American families moved into larger and more modern homes. Many consumer goods like telephones, televisions, and automobiles became commonplace items. Educational opportunities expanded, opening new doors to the children of middle-class and working families. Retirement became a real option for most workers rather than a luxury enjoyed only by the wealthiest Americans or an economic hardship forced upon those no longer able to work. Employer-provided health insurance became widespread.

In recent years, middle-class families have found their economic circumstances increasingly precarious. Many workers face wage stagnation, or even prolonged unemployment, and fewer workers have guaranteed pension benefit plans, causing many to worry about retirement. All of this uncertainty comes at a time when families face increasing costs for education, health care, and energy. This hearing will examine these challenges and related pressures facing middle-class families and their economic future.

In announcing the hearing, Chairman Rangel said, “Many American families are finding it harder and harder to hold on to the American dream. Too often, we hear about parents worried that their children will not be able to build on their success and create a higher standard of living for themselves. We need to take a deeper look at what is driving these concerns so we can build and maintain an economy that works for all Americans.”

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select “110th Congress” from the menu entitled, “Committee Hearings” (*http://waysandmeans.house.gov/Hearings.asp?congress=18*). Select the hearing for which you would like to submit, and click on the link entitled, “Click here to provide a submission for the record.” Once you have followed the online instructions, completing all informational forms and clicking “submit” on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You MUST REPLY to the email and ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Wednesday, February 14, 2007**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman RANGEL. The Committee on Ways and Means will come to order.

This is the third broad-based hearing that we have had on taxes, poverty and now on the economic challenges that are facing the middle class. We are not looking immediately for legislation to come out of these hearings, but we want the Members to have a broader base as to areas where we do have jurisdiction and whether or not they should receive some type of priority as we set our legislative calendar up.

So, I would like to yield at this time to the Ranking Member, Mr. McCrery, for any statement he would like to make.

Mr. MCCRERY. Thank you, Mr. Chairman. I have a written statement that I would offer to the Committee.

Just a few brief remarks. This is an important topic to all of us in this country, as we are certainly aware of our Nation's proud history of having a strong, vibrant middle class; and, indeed, the middle class makes up the vast majority of the people in this country. So, we are all concerned about learning of anything that might be threatening that history and the future of the middle class. So, it is certainly appropriate to investigate this matter.

I would submit just briefly that one of the areas that has come up in our other hearings, and I think we ought to devote more time to it at some point, is the issue of health care, health insurance, health benefits and how the increase in the cost of health care and the increase in premiums for health insurance plays a role in this feeling among some in the middle class that they are being squeezed because, to some extent, their wages are not as high as they otherwise would be because of the tremendous increases in health care costs.

So, I would submit that that is one of the things we should examine further at some point, and I include in my written statement a little further explanation of my concerns with respect to health care as part of this question.

Thank you, Mr. Chairman.

Chairman RANGEL. Thank you.

[The prepared statement of Mr. McCrery follows:]

Opening Statement of The Honorable Jim McCrery, a Representative in Congress from the State of Louisiana

Thank you, Mr. Chairman.

Today's hearing deals with a broad topic, the economic challenges facing the middle class. I would like to focus on one area—the rapidly rising cost of health coverage—and what it illustrates about the larger reforms we need.

For several decades, the employer-based system has been the primary means of providing health insurance. That model is showing serious signs of strain. We must adopt better ways of organizing our health insurance system, so that potential increases in middle class wages are not siphoned off by ever-higher health costs.

The employer-sponsored health care system is a historical accident, born of wage and prices controls during World War Two. Though it was never intended to be permanent, it served us well for a time. But now many of the economic assumptions it was based on have changed. For example, workers today rarely work for one company their entire lives. Instead, it is not uncommon for individuals to change jobs—and even occupations—several times during their lives.

Last Fall, the Bureau of Labor Statistics released a study finding that the average person born between 1957 and 1964 held an average of more than ten jobs from ages 18 to 40. In an era with this more mobile workforce, our goal should be a health insurance system tied to the individual, not to the employer.

In addition, when employees receive their health care for "free" from their employer, they have no motive to shop for the best price, or to seek out cost-effective preventative care. That is one of the many factors fueling the increase in health care costs, which rose up 6.9 percent in 2005 and 7.2 percent in 2004.

Though American workers often fail to realize it, the "free" health coverage they receive from employers has real and substantial costs—generally in the form of lost wages or other benefits. That point bears repeating: wages for working Americans would clearly be higher if it were not for the rapid increase in health care costs.

As the CEO of General Motors has noted, each of his company's vehicles produced in North America includes an average embedded cost of $1,525 in health care benefits. That makes GM the world's largest private provider of health care benefits. Former Chrysler CEO Lee Iacocca has observed, "it is a well-known fact that the U.S. automobile industry spends more per car on health care than on steel."

It is no surprise that the Employee Benefits Research Institute found the percentage of adults getting health insurance through their employer declined from a high of 68.7 percent in 2000 to 63.8 percent in 2005. The erosion in employer-sponsored coverage was steady each year, even as unemployment rates rose and then fell over the past 6 years.

The situation is particularly difficult for low-income Americans. If they do not receive employer-sponsored health coverage, they are likely to find themselves completely priced out of the individual insurance market. They will join the 43 million Americans with no health insurance at all.

The current tax code is clearly part of the problem, because it provides large subsidies to employer-sponsored plans, but practically nothing for those in the individual market.

President Bush has put forward a creative and bold revision of the tax treatment of health care. I do not agree with every detail. For example, I would prefer to provide assistance to the low-income individuals through a tax credit rather than a deduction, and the proposal should be combined with market reforms to address the affordability and availability of insurance in the individual market. But I believe his proposal should get us thinking about ways the tax code could be modernized to better reflect today's market realities.

We see a similar situation with respect to pensions. Old-fashioned defined-benefit plans make sense for workers who are going to stay with one employer for many years. But in the modern economy, mobile workers are better served by defined-contribution plans.

Last January, EBRI quantified the dramatic shift from defined-benefit to defined-contribution plans. The percentage of workers whose primary retirement plan was a defined benefit had declined from 56.7 percent in 1998 to just 40.5 percent in 2003. In that same five-year period, the percentage of workers whose primary retirement plan was based on defined contributions rose from 35.8 percent to 57.7 percent.

There are greater risks, as well as greater rewards, in a defined-contribution system, and we should protect workers from some of those risks. By including provisions in the pension bill last year expanding the ability of individuals to obtain investment advice from their 401(k) provider, the Congress took an important step toward helping workers make more informed choices about how to save for the future.

Similarly, I am pleased the Congress last year, as part of the pension bill, made permanent the savings and investment tax incentives that were developed with the strong input of two former Members of this panel, Rob Portman and Ben Cardin. Both have gone on to bigger, if not necessarily in our minds, better places.

Nevertheless, more needs to be done to help promote retirement security. And that includes all three legs of the stool, personal savings, employment-based plans, and Social Security.

The challenges we face, as a nation, are particularly acute with respect to the future financing of Social Security, and I am hoping that we can work, on a bi-partisan basis, to address the long-term solvency of the program. The longer we wait, the more difficult the solutions become. And if we do nothing, we will soon see double-digit cuts in Social Security benefits or massive tax increases. THAT would "squeeze" the middle class.

Mr. Chairman, there are many challenges facing American families. Some, like those I mentioned, are within this Committee's jurisdiction. I look forward to the discussion today, and the dialogue to come, as we examine ways to ensure the tax code is responsive to our changing workforce.

Thank you, and I yield back the balance of my time.

[The prepared statement of Mr. Weller follows:]

Opening Statement of The Honorable Jerry Weller, a Representative in Congress from the State of Illinois

One of the topics being discussed today is income inequality. When most people hear "income" they think of earnings. But it's more than that, and includes for many families other income sources such as pensions, government benefits, and so on.

During testimony today before the Joint Economic Committee, Dr. Richard Vedder, a visiting scholar at the American Enterprise Institute, noted that "the conventional measures that are typically cited to denote greater inequality are fundamentally flawed and grossly overstate inequality in this nation, and the growth in it over time." (p. 1)

He goes on to point out that Medicaid benefits, food stamps and housing subsidies, among other benefits, are ignored in such calculations. He suggests that "Any comparison of income levels or income inequality today with, say what existed in 1960 using published income data will tend to overstate any reported rise in inequality, and understate any estimate of income gains for lower income Americans." (p. 2)

This is the same dynamic we saw in last week's poverty hearing—the "official" poverty rate does not include data on all the anti-poverty benefits the government provides, which has the effect of making poverty seem deeper and more widespread. The same goes for income inequality—by not counting as "income" many of the government benefits designed to raise the wellbeing of low-income families, inequality seems worse than it really is.

Consumption data suggests more of the same. Dr. Vedder noted that instead of looking solely at income inequality, "what we should truly be interested in is the economic well-being of Americans, and a far better measure of that economic well-being is consumption spending." He goes on to note that "Roughly speaking, conventional measures show consumption inequality is at least one-third less than for income inequality."

I commend Dr. Vedder's testimony to the Committee, as it provides much-needed context related to the well-being of all families, including middle class families.

TESTIMONY BEFORE THE JOINT ECONOMIC COMMITTEE OF CONGRESS, JANUARY 31, 2007

Economic Growth, Economic Justice, and Public Policy

By Richard Vedder

Visiting Scholar, American Enterprise Institute

Distinguished Professor of Economics, Ohio Univeristy

Good morning Senator Schumer and Members of the Committee. The JEC has just completed 60 years of existence, and during those six decades it has assisted importantly in the making of economic policy, and I am pleased to be part of today's proceedings. My distinguished colleagues on this panel have painted a somewhat pessimistic and perhaps mildly alarming picture of the American economy. We learn that many Americans have not shared in our nation's rising prosperity. The income and wage gap between the rich and the poor is growing. We are told we are becoming a more economically divided nation.

My message is somewhat more optimistic and skeptical of the analysis suggesting that vast portions of the American populace are languishing economically. Let me very briefly touch on three points. First, the conventional measures that are typically cited to denote greater inequality are fundamentally flawed and grossly overstate inequality in this nation, and the growth in it over time. Second, even if one accepts the proposition that America has insufficient equality of economic condition, history tells us that public policy efforts to deal with the problem often are ineffective. Third, some policies that conceivably might lower inequality as conventionally measured would, if adopted, have serious adverse consequences to the economy as a whole.

Turning to the first point, looking at conventional statistics on income distribution, three factors lead us to overstate inequality. First, and probably least important, those statistics are traditionally based on money income, excluding a variety of in-kind, non-cash payments that primarily benefit lower income persons—Medicaid benefits, food stamps, and housing subsidies are three good examples. Any comparison of income levels or income inequality today with, say what existed in 1960 using published income data will tend to overstate any reported rise in inequality, and understate any estimate of income gains for lower income Americans, since non-cash payments have become relatively more important in the intervening time period.

A second factor is that what we should be truly interested in is the economic wellbeing of Americans, and a far better measure of that economic well-being is consumption spending. Dollar for dollar, people derive more joy from what they spend than from what they earn. As many elementary economics textbooks point out in the first chapter, the ultimate purpose of economic activity is consumption.

We know that in any given year consumer spending is far more equally distributed than income. Comparing the income distribution statistics derived from the Current Population Survey with the BLS's Consumer Expenditure Survey is revealing.

For example, the poorest one-fifth last year earned only slightly over 7 percent as much income as the richest one-fifth in 2002, but they consumed more than 24 percent as much. Using the most recent data for 2005, we see the richest one-fifth of the population earned 3.47 times as much as the middle quintile, but consumed only 2.31 times as much. Roughly speaking, conventional measures show consumption inequality is at least one third less than for income inequality.

The third point relating to the overstatement of inequality relates to the remarkable income mobility of the American people. For example, at the request of this Committee, the Treasury Department in the 1990s provided data suggesting that the overwhelming majority of persons in the bottom quintile of the income distribution were in another quintile a decade later, and a large percent even moved up or down the distribution from one year to the next. Researchers at the Urban Institute and other organizations have made similar observations. This phenomenon helps explain the narrowness of the distribution of consumption spending relative to the distribution of income, as observed decades ago by the late Milton Friedman and in a different context by Albert Ando and Franco Modigliani. Failure to consider the income mobility of people contributes to the inadequacies of traditional measures of income distribution and also leads us to create some inequities and inefficiencies when devising tax policies based on single year definitions of income.

While we are talking about measurement problems, they are particularly prevalent in our discussions of changes in earnings over time. Go to page 338 of the 2006 Economic Report of the President. We learn that average weekly earnings of workers in private nonagricultural industries in 2005 were over eight percent less than they were in 1964, the year Lyndon Johnson announced his Great Society initiatives. Yet turn the page, to page 340. Looking at real compensation per hour in the non-farm business sector for the same time period, we learn it has risen 75 percent. Page 338 is consistent with a Marxian or even Malthusian interpretation of the economy—a tendency for wages to fall to near subsistence, and evidence of mass exploitation of the working proletariat by exploitive capitalists. Page 340 is consistent with the view that with economic growth, the earnings of workers have risen sharply, and also consistent with national income accounts data that shows per capita real consumption has increased about two percent annually.

Yet even the data on page 340 suffer from deficiencies. We learn that productivity per hour in the non-farm business sector in 2005 was 2.28 times as great as in 1964, yet compensation rose only 1.75 times, a pretty big difference that is inconsistent with the neoclassical economic theory of factor prices and suggestive that owners of capital are indeed deriving extraordinary profits as a result of paying workers less than what they contribute to output at the margin. This should have resulted in a significant decline in compensation of workers as a percent of national income. Yet the national income data taken from pages 314 and 315 of the same source show a radically different story.

Compensation of employees actually rose from 60.75 to 61.51 percent as a percent of the national income. The share of national income accounted for by corporate profits fell slightly in the same time period.

I am making two points here. First, interpretations of economic data can be exceedingly misleading. Second, the analysis of broader measures of economic performance suggests that workers as a group have shared in our national prosperity of the past several generations. The original wage data I cited suffer from two enormous deficiencies. First, they fail to take into account non-wage forms of compensation, particularly health care and retirement benefits. These have soared in magnitude over time. Second, the calculation of changing values in constant dollars is fraught with peril, and the Consumer Price Index used in these calculations very significantly overstates inflation in the eyes of virtually every mainstream economist, liberal, conservative, vegetarian, Presbyterian, what have you. Similarly, analysis of wage changes by wage or income category suffers not only from these problems, but from the aforementioned phenomenon of the rapidly changing economic status of individual members of our opportunity society over time.

You don't need a Ph.D. in economics to observe that never has a society had a middle class more used to what once were considered goods and services available only to the upper rich. Middle income Americans live in larger homes, buy more gadgets like IPODS and cell phones, live longer, are more if not better educated, and take nicer vacations than either their parents did or do and their counterparts in any other major nation. I returned two days ago from a two week cruise in the Caribbean, traveling less with top business executives or even elite Ivy League professors than with equipment salesmen, butchers, and teachers—ordinary folk. That simply did not happen even 30 years ago.

My second major point relates to public policy dealing with economic inequality. Time does not permit a detailed exegesis of past efforts. But a reminder of some historical experiences is sobering. Policy can come from the tax, spending or regulatory side. I will ignore regulatory matters in the interest of time, although I would hasten to commend Senator Schumer for recent statements showing his concerns about the abusive use of the tort system as a growth-impeding way of redistributing income. Looking at taxes, attempts to make the system more progressive often have unintended effects. For example, sharp reductions in top marginal tax rates in the 1920s, 1960s, and 1980s, viewed by some as favoring the rich, actually led to sharp increases in the tax burden of the rich relative to the poor. I worked for this Committee during the 97th Congress in 1981 and 1982 in a political environment much like today with divided government, with the Republicans controlling the Executive while Congress was more under Democratic control, yet the two branches managed to work together to fashion a more growth oriented tax policy with lower marginal tax rates that contributed mightily to the boom that has followed. I hope the 110th

Congress is capable of similar accomplishments. Taxes have behavioral consequences.

The CBO greatly underestimated revenues that would arise from the reducing in the top capital gains rate to 15 percent, for example. Falling rates unlocked billions in unrealized gains that have helped fund our rapidly expanding government. Similarly, sharp reductions in the number of estates subject to death taxation as a result of reform in those laws has not led to a sharp decline in revenues from that source, as some had expected. It would be a tragedy to reverse the positive effects of the tax reductions of the past few years that, like the Kennedy tax reductions of the 1960s, have had a positive impact on economic activity.

On the spending side, history again shows disappointing results of many initiatives to help the poor or middle class. As the January 20 issue of the Economist notes, government job training programs have internationally been largely failures. Spending initiatives in the areas of education, medical care, and public assistance have usually brought about disappointing results. Despite spending far more in real terms per student than a generation or two ago, American students do not appear to be learning much more, and the education for lower income students is particularly deficient. A tripling of federal aid to college students since 1994 has been accompanied by a decline, not an increase, in the proportion of students from the lowest quartile of the income distribution attending and graduating from our finest universities, which are increasingly becoming taxpayer subsidized country clubs for the children of the affluent. While Medicaid has brought some increase in medical care for the poor, it has done so at an enormous cost to society, and the cost pressures of a highly inefficient system are leading companies to cut back on health care benefits for working middle class Americans. As to public assistance, it is far greater today in real per capita or per poor person terms than in 1973, yet the current poverty rate is higher. The welfare reforms of the 1990s were an important achievement, but the overall picture is, at the very least, mixed.

Speaking of public assistance, I have to make one statement that may sound a bit callous or insensitive to some, but it is an important but often neglected truism. Comparing the rich and the poor, it is worth noting that the rich work a lot more. Of those persons in poverty, only a tiny minority work full-time. We have relatively few working poor in America. And it is worth noting that employment creation is greatest in periods when the government allows the incredible job machine generated by the competitive private sector operating in a market environment to work. The job creation of the 1980s was stimulated by a halt to the growth in government's share of GDP characterizing earlier decades, and by tax reductions that stimulated the spirit of enterprise. The job creation of the 1990s was stimulated by an unprecedented decline in government expenditures as a percent of GDP for eight consecutive years—a reverse crowding out phenomenon that propelled an enormous outpouring of American creative and entrepreneurial endeavor.

Turning to my final point today, there is a temptation to do things in the interest of protecting middle and lower income Americans that might have highly undesirable effects on the economy as a whole. In this regard, the rise in protectionist sentiment in Congress is appalling, particularly as is largely centered in a party which historically has favored free trade, a policy that has brought prosperity to almost all Americans while at the same time has contributed enormously to eliminating global disparities in the distribution of income and wealth. I hope the intelligent wing of the Democratic Party, represented by able persons such as those who preceded me on this panel, will be able to prevent a return to policies reminiscent of that old Democratic bete noire, Herbert Hoover. The Smoot-Hawley Tariff and rising taxes were a factor, along with Hoover's inane wage policies, for the Great Depression of the 1930s. Let us not repeat that today. I hope the Democratic Party will try to emulate Franklin D. Roosevelt, John F. Kennedy and Bill Clinton in the area of trade policy, not Herbert Hoover.

At a macro level, I believe the biggest single factor in the modest slowdown in growth rates in this decade relative to the 1980s and 1990s is the sharp increase in government expenditures. From fiscal year 2001 to fiscal year 2006, total federal outlays rose by 42.4 percent, or $790.1 billion. By the way, the overwhelming majority of that was for non-defense or national security purposes. This was nearly double the percent growth in GDP. Receipts rose well over 20 percent or roughly equal to the growth in GDP, so the burgeoning deficit reflected a spending binge that resulted in some crowding out of private economic initiatives. Dollar for dollar, the evidence is crystal clear that private spending has more productivity-enhancing effects than public spending because of the discipline that competitive markets impose on market enterprise. The tax cuts largely corrected for the natural tendency for taxes to rise relative to national output. Raising taxes again would reduce the deficit, but would have direct unfortunate disincentive effects on human economic behavior and would also reduce the political costs to Congress of incremental spending initiatives, which almost certainly would have severe economic effects. I hope some early indications of spending constraint are maintained in the months and years ahead. While I am not the financial guru that Secretary Rubin is, an analysis that I have conducted with Lowell Gallaway for this Committee in the past suggests that the two best determinants of the growth of wealth as measured in equity prices are the rate of inflation and government spending as a percent of GDP. Rising government spending is associated with falling market values and wealth, with all the adverse consequences that has for pensions. And stable prices are much better than inflation. The Fed has done a pretty good job on the inflationary front, but the Congress and the Executive are guilty of having shown insufficient constraint with respect to federal expenditures.

Again, I praise the JEC for providing a needed forum for the analysis of policy possibilities informed by factual evidence. I hope the next 60 years are as successful for this Committee as the last 60 have been.

Thank you.

Chairman RANGEL. Let me say to the gentleman that I agree with you, and I think in putting together our hearings that, in talking with you, I would hope that this would be an early priority for the Committee to at least set the groundwork to see how we can move forward in this very serious area.

Peter Orszag, or Dr. Orszag, who is the Director of the Congressional Budget Office (CBO), first, let me congratulate you for your appointment as well as the CBO that we rely on so much for nonpartisan views for serious issues that come before this Committee. Once again, I thank your office for your past contributions; and I look forward to your testimony.

STATEMENT OF PETER R. ORSZAG, PH.D., DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Dr. ORSZAG. Thank you very much, Mr. Chairman, Mr. McCrery and Members of the Committee. I appreciate the invitation to participate in today's hearing and very much look forward to working with all of you throughout my term to provide you with timely and high-quality analysis of economic and budget issues.

My testimony today examines both macroeconomic volatility and household income volatility. Macroeconomic volatility, that is the ups and downs of overall economic growth in inflation, has declined and is now relatively low. In particular, year-to-year fluctuations in the economy have become smaller than in the past.

The first chart just shows you the growth rate in Gross Domestic Product that is in the size of the economy. That is kind of hard to read, but if you look at the size of the change from year to year in a standard measure of that variation, it is now much lower than it was during the fifties, sixties, seventies and early eighties, roughly half as large. The same decline has occurred in inflation rates in terms of their variability.

Several potential explanations have been put forward for this so-called great stabilization. Among the leading explanations are that a more flexible economy, itself reflecting developments such as improvements in production processes and investments in information technologies, have made it possible for the economy to adjust much more smoothly to changes in the availability of goods and services. As a result, the macroeconomy can adapt more easily to shocks without large changes in output or large jumps in inflation.

A second potential explanation is that financial innovation since the seventies have provided alternatives to lending by banks, broadened opportunities for various types of financial intermediation between borrowers and lenders and enhanced risk management. The result has been more stable financing for both businesses and households and more resiliency in the financial system which has also helped to stabilize the macroeconomy.

The second main point of the testimony, though, is that, despite the relatively modest volatility in the overall economy, workers in households still experience substantial variability in their earnings and income from year to year. CBO undertook new empirical analysis to explore this earnings and income volatility. Between 2001 and 2002, for example, and after adjusting for inflation, one in four workers saw his or her earnings increase by at least 25 percent over that short time period, while one in five saw his or her earnings decline by at least 25 percent.

You can see in this chart that you have very significant portions of workers—for example, 11 percent of workers saw their earnings decline by at least half, which is the far left bar. That is a very substantial amount of volatility.

Workers with less education tend to experience more volatility in their earnings than do workers with more education, which is illustrated on this chart. For example, 16 percent of workers without a high school education had their earnings decline by 50 percent or more, compared with just 10 percent with more than a high school education; and we give you the figures here for declines or increases of 25 percent or more. Such fluctuations can result from many sources, including job changes, job losses, job gains and voluntary exits from the labor force, such as to care for children or other family members.

It is also worth noting that these figures are for before-tax earnings and income. The tax system can help to smooth fluctuations in income so after-tax income can vary less from year to year than before tax income does. That potential role of the tax system in smoothing income fluctuations can be quite important and I think is worthy of further scrutiny.

Given the high current levels of volatility at the worker and household level, an important question is whether over longer periods of time earnings in income volatility has risen. According to most studies on the topic, earnings now fluctuate more on a percentage basis than they did in the seventies. Relative to other topics, though, the trend in earnings and income volatility has received relatively little research attention. More research is therefore needed before firm conclusions about the precise time trend in earnings and income volatility can be reached.

A final section of my testimony involves job transitions which can contribute to volatility at the worker and household levels. Each year, millions of people become unemployed and find a new job; and many others change jobs without any intervening unemployment. Recent estimates demonstrate the extent to which workers move in and out of jobs. Over the 12 months ending in November, 2006, for example, an average of almost 5 million workers were hired by firms each month, and 4½ million workers per month quit, were laid off or for other reasons left their jobs. So, almost

5 million or 4½ million workers leaving and entering new jobs each month, which is a significant amount of volatility.

Over the past several decades, the percentage of unemployed who remain out of work for long periods of time has increased. About one in six workers who were unemployed in late 2006 had been unemployed for 27 weeks or longer, which is illustrated on this chart, even though the unemployment rate is low, at less than 5 percent of the labor force.

One part of the explanation for the rise in long-term unemployment may be an increasing share of job losses that are permanent separations rather than temporary layoffs. Moreover, research suggests that the adverse consequences of losing a job because of slack work, a plant closing or a position being abolished have increased, which may be one factor contributing to the relatively high level of volatility in earnings in income at the household level.

So, in conclusion, the overall U.S. economy has become less volatile. Macroeconomic fluctuations are now less severe than they were, say, in the sixties and seventies. At the same time, though, households continue to experience very substantial variability in their earnings and income, and that variability may now be higher than it was in the past, perhaps contributing to anxiety among workers and families. This topic seems worthy of more attention from both policymakers and analysts.

Thank you very much.

Chairman RANGEL. Thank you so much.

[The prepared statement of Dr. Orszag follows:]

CBO TESTIMONY

Statement of
Peter R. Orszag
Director

Economic Volatility

before the
Committee on Ways and Means
U.S. House of Representatives

January 31, 2007

This document is embargoed until it is delivered at 2:00 p.m. (EST) on Wednesday, January 31, 2007. The contents may not be published, transmitted, or otherwise communicated by any print, broadcast, or electronic media before that time.

CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

Note

Some of the figures in this testimony use shaded vertical bars to indicate periods of recession. (A recession extends from the peak of a business cycle to its trough.)

Mr. Chairman, Congressman McCrery, and Members of the Committee, I appreciate the invitation to participate in today's hearing. Since this is my first testimony before this Committee as Director of the Congressional Budget Office (CBO), I also want to take this opportunity to say that I am looking forward to working with all of you throughout my term to provide you with timely and high-quality analysis of economic and budget issues.

My testimony today makes four main points:

- First, macroeconomic volatility—the ups and downs of overall economic growth and inflation—has declined and is now relatively low. In particular, year-to-year fluctuations in the economy have become smaller than in the past.

- Second, despite the relatively modest volatility in the overall economy, workers and households still experience substantial variability in their earnings and income from year to year. CBO's analysis shows, for example, that between 2001 and 2002, one in four workers saw his or her earnings increase by at least 25 percent, while one in five saw his or her earnings decline by at least 25 percent. Some of that variability stems from voluntary actions, such as a decision to stay home and rear children, and some stems from involuntary events, such as the loss of a job. Earnings volatility is somewhat higher for people with less education.

- Third, although earnings and income volatility is substantial, more research is required to determine how and when that variability has changed over the past few decades. The evidence that exists suggests that earnings have tended to fluctuate more, on a percentage basis, over the past 25 years than they did during the 1970s. The number of studies on the topic is limited, however, so it is too early to reach firm conclusions about the precise timing or magnitude of any increase. Given their importance, trends in income volatility seem to warrant significant research attention.

- Finally, while the unemployment rate has been relatively low in recent years, the adverse consequences of losing one's job appear to have increased. In particular, a higher fraction of unemployed workers remain unemployed for very long periods, and the average reduction in earnings once they are reemployed appears to have grown.

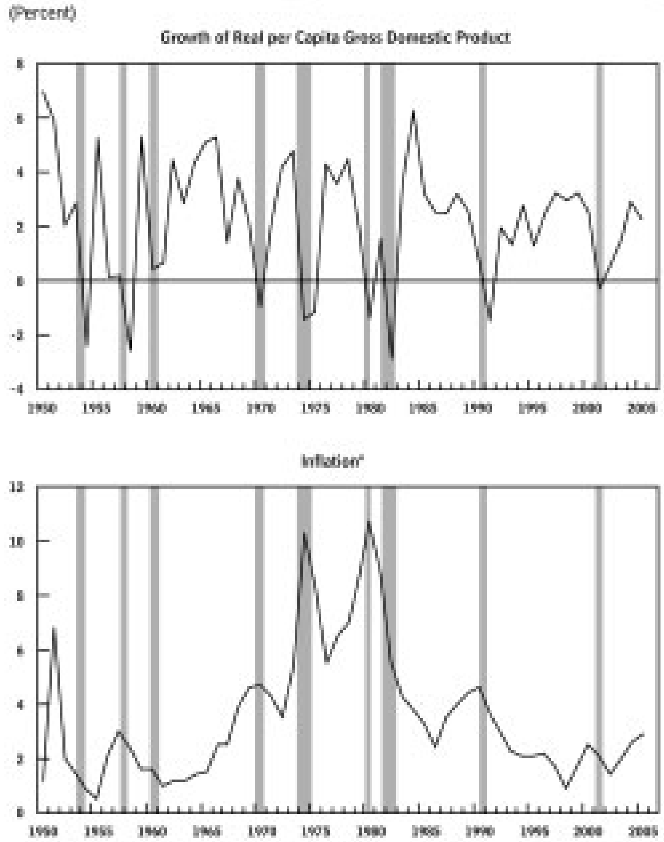
Macroeconomic Volatility

Macroeconomic volatility is now relatively low compared with that in previous periods and has declined significantly during the past 20 years. Although recessions can still be quite painful for particular sectors and workers, recessions have been less severe overall—in duration, frequency, and magnitude—than they were between 1950 and the mid-1980s, and recoveries from recessions similarly have been more tempered. The quarter-to-quarter fluctuations in gross domestic

Figure 1.

Macroeconomic Volatility

(Percent)



Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

a. Inflation as measured by the personal consumption expenditure chained price index.

Table 1.

Changes in Macroeconomic Volatility

(Standard deviation)

	Volatility	
	1950–1984	1985–2005
GDP Growth	3.1	1.4
Inflation	2.9	1.0

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

Note: Standard deviations calculated using quarterly data to measure the change from the previous year in gross domestic product (GDP) per capita and in the personal consumption expenditure chained price index.

product (GDP) have become smaller (see the top panel of Figure 1), and the level and volatility of inflation over the past 20 years have also been relatively low (see the bottom panel of Figure 1). Volatility in more recent years has been less than half that of the previous period (see Table 1). The corresponding reduction in people's uncertainty about prices allows them to plan better for the future. Volatility has declined not only in the overall growth of GDP and inflation but also in virtually all of the major components of GDP and in aggregate unemployment, wages, and income.

Although there is no conclusive explanation for the decline in the volatility of GDP growth and inflation, numerous reasons have been advanced, many of which are closely interrelated. The proposed explanations fall into four broad categories.

- **A More "Flexible" Economy.** Improvements in production processes and investments in information technologies (such as those that facilitate just-in-time inventory management), increases in temporary and flexible work arrangements, and the deregulation of many industries (especially in the transportation sector) have made it possible for the economy to adjust much more smoothly to changes in the availability of goods and services. The economy can more easily adapt to shocks, such as the energy price shock of 2004 and 2005, without large changes in output or large jumps in inflation.[1]

1. See Congressional Budget Office, *The Economic Effects of Recent Increases in Energy Prices* (July 2006). See also Lawrence F. Katz and Alan B. Krueger, "The High Pressure U.S. Labor Market of the 1990s," *Brookings Papers on Economic Activity*, no. 1 (1999).

- **Improvements in Financial Markets and Institutions.** Financial innovations since the 1970s—such as securitization, credit derivatives, and interest-rate swaps[2]—have provided alternatives to lending by banks, broadened the opportunities for financial intermediation between borrowers and lenders, and enhanced risk management. Those innovations, together with changes in financial regulation that allowed more diversification in banking and housing financing, appear to have provided a more stable source of financing for both businesses and households and improved the resiliency of the financial system by spreading the risk of default more widely and efficiently.

- **Management of Monetary Policy.** Three episodes of aggressive efforts to reduce or contain inflationary pressures—in 1981 and 1982, 1988 and 1989, and 1994—and the Federal Reserve's role in keeping inflation low seem to have lessened firms' and households' expectations of future inflation. As a result, the Federal Reserve may not have to respond as forcefully as it had to in the past to dampen such expectations, and the result may be reduced short-term macroeconomic volatility.

- **Fewer Shocks to the Economy.** This explanation—that fewer shocks to the economy, particularly the worldwide economy, have occurred—was proposed before the rapid rise in oil prices from 2004 to mid-2006. Given the mild effect of that oil price shock on economies worldwide, the explanation now seems less persuasive. Moreover, overall U.S. economic growth was little affected by other major shocks during the past 20 years, such as the Asian currency crisis of 1997, the Russian debt crisis of 1998, and the terrorist attacks of September 11, 2001.

Workers' Earnings and Households' Incomes

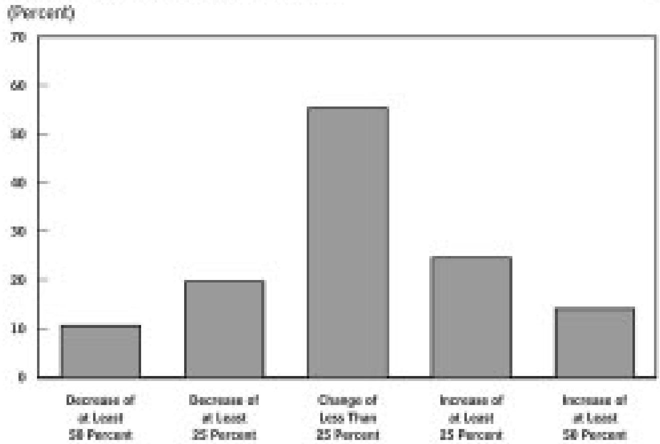
The story at the level of the individual worker or household is different from the story at the macroeconomic level. Individual earnings tend to rise over time, but the data suggest that workers and families experience substantial volatility year to year around that underlying trend.

To examine earnings and income volatility, CBO analyzed recent data from the Survey of Income and Program Participation (a data set collected by the U.S. Census Bureau). The analysis focused on workers who were 25 to 55 years old and

2. Securitization involves the conversion of cash flows into securities; credit derivatives are financial instruments designed to transfer credit risk from one party to another; and interest-rate swaps are an exchange of a series of payments based on different interest rates, which entities undertake to manage their exposure to changes in those rates.

Figure 2.

Distribution of Changes in Workers' Annual Earnings from 2001 to 2002



Source: Congressional Budget Office based on data from the 2001 panel of the Bureau of the Census's Survey of Income and Program Participation.

Note: The sample consists of individuals ages 25 to 55 who had positive earnings in 2001 and were not enrolled in school that year or in 2002. Earnings are inflated to 2002 dollars using the research series of the consumer price index for urban consumers.

not in school and therefore does not capture changes in earnings associated with graduating from school or leaving work for school.[3] Even so, the analysis shows substantial variation in workers' earnings from 2001 to 2002. After an adjustment for inflation, one in four workers saw his or her earnings increase by at least 25 percent, while one in five saw his or her earnings decline by at least 25 percent. A substantial portion of workers, 11 percent, saw their earnings decline by at least half (see Figure 2).

Workers with less education tend to experience more volatility in their earnings than do workers with more education (see Table 2). For example, from 2001 to 2002, 16 percent of workers without a high school education had their earnings

3. For a discussion of wage trends in low-wage labor markets, see Congressional Budget Office, *Changes in Low-Wage Labor Markets Between 1979 and 2005* (December 2006).

Table 2.

Distribution of Changes in Workers' Annual Earnings from 2001 to 2002, by Educational Attainment and Age

(Percent)

	Decrease in Earnings of at Least		Changes in Earnings of Less Than	Increases in Earnings of at Least	
	50 Percent	25 Percent	25 Percent	25 Percent	50 Percent
All Workers	10.7	19.8	55.5	24.7	14.2
Educational Attainment					
Less than high school	15.6	26.1	47.9	26.0	16.4
High school	11.6	19.8	55.0	25.2	14.8
More than high school	9.5	18.8	57.0	24.2	13.6
Age					
25 to 30	11.4	20.0	53.8	26.2	14.6
31 to 40	10.7	19.8	54.5	25.7	14.9
41 to 55	10.5	19.7	56.7	23.6	13.7

Source: Congressional Budget Office based on data from the 2001 panel of the Bureau of the Census's Survey of Income and Program Participation.

Note: The sample consists of individuals ages 25 to 55 in 2001 who had positive earnings in 2001 and were not enrolled in school that year or in 2002. Earnings are inflated to 2002 dollars using the research series of the consumer price index for urban consumers.

decline by 50 percent or more, compared with 10 percent of workers with more than a high school education.

Such fluctuations in earnings can result from many sources, including job changes, job losses, job gains, voluntary exits from the labor force for reasons such as to care for children or other family members, changes in the number of hours worked per year, or changes in the wage rate received by workers. Most workers who experienced at least a 50 percent drop in earnings were not working at least one month and were typically not working eight months in 2002. When those surveyed were asked why they were not working, the most common responses were that they were caring for a child or other family member or were pregnant; were not able to find work or had been laid off; were unable to work because of disability, illness, or injury; or were not interested in working or were retired.[4] The responses appear to be split evenly between those suggesting that the departure from the labor force was voluntary and those suggesting that it was not.

Household income consists primarily of the earnings of household members but also includes other sources of cash income such as unemployment insurance or

4. Only those individuals who had at least four consecutive months without a job responded to the question.

retirement income and nonlabor income like dividends and interest. It thus represents a broader measure than do earnings of the economic resources available to individuals.[5] Like workers' earnings, household income can vary from year to year, though it tends to be less variable than individual earnings. First, if an individual worker in a household with multiple earners loses a job, the earnings of the other members can partially mitigate the consequences of the job loss. Second, a loss in earned income can be mitigated by an increase in other sources of income, like unemployment insurance, payments from a retirement plan, or disability insurance. Neither the mitigating effects of the presence of other earners in the household nor the potential for increases in unearned income is captured in the more narrow measure of individual earnings.

To be sure, households are not fixed entities. They often evolve, as couples marry, separate, or divorce and working children move in or out of the house. Thus, changes in household composition can also affect household income and its variability from year to year.

According to CBO's analysis, the growth of income varied substantially among households between 2001 and 2002 (see Figure 3). Nearly one in four households experienced an increase in income of at least 25 percent, virtually identical to the number of individuals who experienced a similar increase in earnings. Fewer households, one in seven, experienced a decrease in income of at least 25 percent. And 1 in 25 households experienced a decrease in income of at least 50 percent—compared with 11 percent of individuals who experienced such a decline in earnings. Unlike the variability of earnings, however, the variability of household income seems similar across education levels (see Table 3).

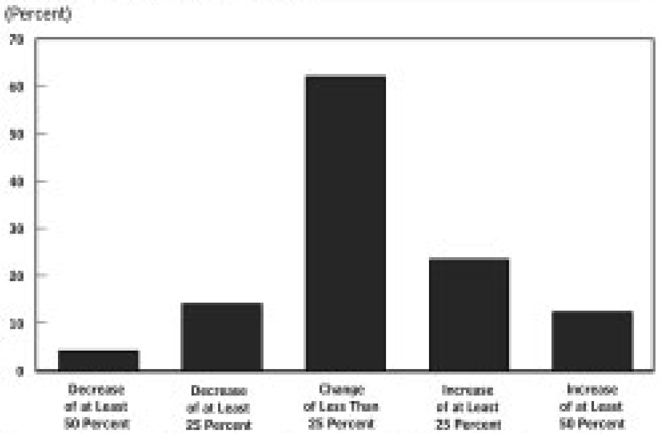
For another point of comparison, CBO conducted a similar analysis using data from 1997 to 1998—a period of relatively rapid economic growth, in contrast to the relatively slow growth from 2001 to 2002—and found similar results.[6] Thus, substantial variability in workers' earnings and income can occur in periods of both strong and weak economic growth. A potentially important question is whether, over longer periods of time, earnings and income volatility has risen. According to most studies on the topic, earnings have tended to fluctuate more, on

5. Household income, as reported here, is before-tax income and excludes capital gains and losses.

6. The data are from the 1996 and 2001 panels of the Survey of Income and Program Participation, conducted by the U.S. Census Bureau.

Figure 3.

Distribution of Changes in Households' Annual Income from 2001 to 2002



Source: Congressional Budget Office based on data from the 2001 panel of the Bureau of the Census's Survey of Income and Program Participation.

Note: The sample consists of households in January 2001 that were surveyed for all of that year and 2002. Income includes earnings, unemployment compensation, workers' compensation, Social Security benefits, Supplemental Security Income, public assistance, veterans' payments, survivor benefits, disability benefits, pension or retirement income, interest, dividends, rents, royalties, income from estates or trusts, alimony, child support, financial assistance from outside the household, and other cash income. Income is inflated to 2002 dollars using the research series of the consumer price index for urban consumers.

a percentage basis, over the past 25 years than they did during the 1970s.[7] Relative to other topics, however, the trend in earnings and income volatility has received relatively little research attention. Furthermore, using surveys to measure the year-to-year variability in earnings and income is complicated by the fact that individuals' responses are often in error (which could either overstate or understate the

7. See, for example, Peter Gottschalk and Robert Moffitt, "The Growth of Earnings Instability in the U.S. Labor Market," *Brookings Papers on Economic Activity*, no. 2 (1994); Costas Meghir and Luigi Pistaferri, "Income Variance Dynamics and Heterogeneity," *Econometrica*, vol. 72, no. 1 (2004), pp. 1–32; Maury Gittleman and Mary Joyce, "Earnings Mobility in the United States, 1967–91," vol. 118, no. 9 (September 1995), pp. 3–13; and Peter Gottschalk and Robert Moffitt, "Trends in the Transitory Variance of Earnings in the United States," *Economic Journal*, vol. 112, no. 478 (2002), pp. 68–73.

Table 3.

Distribution of Changes in Households' Annual Income from 2001 to 2002, by Educational Attainment and Age of the Head of the Household

(Percent)

	Decrease in Income of at Least		Changes in Income of Less Than	Increases in Income of at Least	
	50 Percent	25 Percent	25 Percent	25 Percent	50 Percent
All Households	4.3	14.2	62.2	23.6	12.5
Educational Attainment of the Head of the Household					
Less than high school	4.3	14.6	62.1	23.3	12.6
High school	4.2	13.8	61.9	24.2	12.6
More than high school	4.3	14.3	62.3	23.3	12.4
Age of the Head of the Household					
25 to 30	4.2	14.8	59.3	26.0	13.8
31 to 40	4.3	14.7	59.6	25.7	13.6
41 to 55	4.8	15.1	61.2	23.7	12.3

Source: Congressional Budget Office based on data from the 2001 panel of the Bureau of the Census's Survey of Income and Program Participation.

Note: The sample consists of households in January 2001 that were surveyed for all of that year and 2002. Income includes earnings, unemployment compensation, workers' compensation, Social Security benefits, Supplemental Security Income, public assistance, veterans' payments, survivor benefits, disability benefits, pension or retirement income, interest, dividends, rents, royalties, income from estates or trusts, alimony, child support, financial assistance from outside the household, and other cash income. Income is inflated to 2002 dollars using the research series of the consumer price index for urban consumers.

actual changes in earnings or income).[8] In addition, while the surveys are intended to be nationally representative, they may not capture undocumented workers and can be subject to biases because some people either refuse to respond at all or drop out of the surveys before their completion. More research is therefore needed before firm conclusions about the precise time trend in earnings and income volatility can be reached.

To the extent that earnings and income variability has increased, the phenomenon may be consistent with—and indeed perhaps part of the explanation of—the decreased macroeconomic volatility described earlier. For example, more-flexible labor markets could enable the economy to adjust to changes in the economic

8. See John Bound and Alan Krueger, "The Extent of Measurement Error in Longitudinal Surveys: Do Two Wrongs Make a Right?" *Journal of Labor Economics*, vol. 9, no. 1 (January 1991), pp. 1–24.

environment more quickly but also could mean that individuals change jobs and have their wages change more frequently.

A final point is that these figures are for before-tax income. The tax system can help to smooth fluctuations in income, so after-tax income can vary less from year to year than before-tax income does. That potential role of the tax system in smoothing income can be quite important.

Job Transitions

One reason for volatility at the worker and household levels involves job transitions. Each year, millions of people become unemployed and find a new job, and many others change jobs without any intervening unemployment. Recent estimates from a survey of businesses demonstrate the extent to which workers move in and out of jobs: Over the 12 months ending in November 2006, an average of 4.9 million workers were hired by firms each month, and 4.5 million workers per month quit, were laid off, or for other reasons left their job.[9] That is, in an average month, employers were hiring over 3 percent of their workers (either to expand their workforce or to replace workers who left), while almost as many workers were leaving. The flexibility of the labor market suggested by those statistics is generally considered a source of strength of the American economy.

For many workers, such transitions are smooth; for some, however, they are more difficult and sometimes even traumatic. Some of those who become unemployed remain jobless for many months, and over the past several decades, the percentage of the unemployed who remain out of work for long periods has increased. About one in six of the workers who were unemployed in late 2006 had been unemployed for 27 weeks or longer, even though the overall unemployment rate was low, at less than 5 percent of the labor force (see Figure 4). In several earlier periods with low unemployment rates (such as before the 1975 recession), the percentage who had been unemployed for 27 weeks or longer was lower.

Many workers who lose their job are eligible for unemployment insurance benefits for up to 26 weeks.[10] In the years immediately following the 2001 recession, over 40 percent of the recipients of unemployment insurance benefits exhausted

---

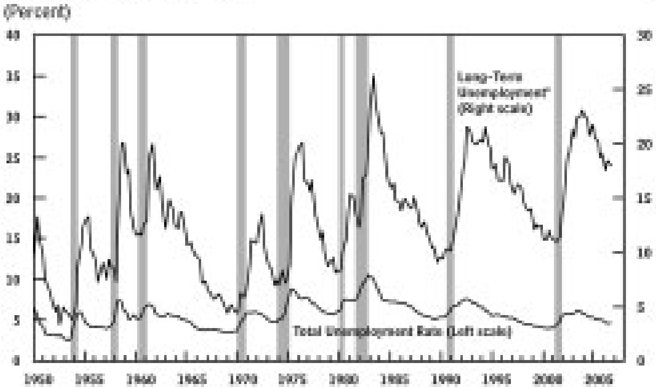
9. Department of Labor, Bureau of Labor Statistics, "Job Openings and Labor Turnover: November 2006," USDL 07-0020 (January 10, 2007).

10. Many unemployed workers do not qualify for unemployment insurance benefits. About half of the people who are unemployed are new entrants to the labor force, reentrants, or workers who quit their last job; generally, they do not qualify for benefits. In addition, some workers who have lost their job do not qualify—for example, because they had not worked long enough to meet their state's eligibility criteria or because they are searching for part-time work—or do not apply for benefits. In December 2006, 3.2 million of the 6.8 million people who were unemployed became so because they had lost their job or completed a temporary job; in recent months, roughly 2.5 million people have been receiving unemployment insurance benefits.

Figure 4.

Long-Term Unemployment and the Total Unemployment Rate

(Percent)



Sources: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics.

a. The percentage of unemployed people who have been so for 27 weeks or longer.

them—an exhaustion rate that was higher than at any time in recent history.[11] Since then, the exhaustion rate has fallen to about 35 percent, as the labor market has strengthened. Although it is not surprising that the exhaustion rate would climb as job opportunities declined and fall as opportunities increased, the gradual long-term rise in the rate is hard to explain. But one part of the explanation for that rise, as well as for the rise in long-term unemployment, may be that an increasing share of job losses are permanent separations rather than temporary layoffs. According to research based on data from surveys conducted by the Census Bureau for the Department of Labor, the percentage of workers who are displaced seems to have risen somewhat over the past two decades (adjusted for overall economic conditions).[12]

---

11. Temporary extensions beyond the 26 weeks of regular benefits were available for part of that period as well as in earlier periods with high unemployment; however, comparable information about exhaustion rates for those temporary programs is not available.

12. Henry S. Farber, "What Do We Know About Job Loss in the United States? Evidence from the Displaced Worker Survey, 1984–2004," *Economic Perspectives* (Federal Reserve Bank of Chicago), vol. 29, no. 2 (2005), pp. 13–28.

Moreover, research based on the same surveys indicates that the adverse consequences of losing a job because of slack work, a plant closing, or a position being abolished have increased, which may be one factor contributing to volatility in earnings and income at the household level. One study found that, on average, workers who lost a full-time job from 2001 to 2003 and found a new job by the time they were interviewed in 2004 earned about 17 percent less than they would have earned had they not been displaced.[13] That amount was roughly double the average loss in earnings incurred by workers who were displaced in the late 1990s. The increase in the size of the average loss in earnings was especially large for better educated workers. Finally, as the author of that study points out, his estimates understate the total economic losses incurred by workers in that the estimates do not take into account workers' forgone earnings while they were unemployed and any losses in fringe benefits.

A previous CBO study also underscores the difficulties associated with job transitions.[14] Examining unemployment insurance benefits provided to people who lost their job in the 2001 recession, the study found that the former recipients of unemployment insurance benefits who went back to work within three months after their benefits ended were earning about 15 percent less than they had earned before they lost their job. About 30 percent of them lacked health insurance; 20 percent of them had been uninsured before they lost their job.

Furthermore, former recipients of unemployment insurance benefits who did *not* find work soon after their benefits ended generally incurred substantial losses of income. Their average family income after their benefits ended was about half of what it had been before they lost their job. About 40 percent of them lacked health insurance—more than double the number before they became unemployed.

Conclusion

The U.S. economy has become less volatile: Macroeconomic fluctuations are now much milder than they were in the past. At the same time, however, households continue to experience substantial variability in their earnings and income, and that variability may now be much higher than in the past—perhaps contributing to anxiety among workers and families. The topic seems worthy of more attention from both policymakers and analysts.

---

13. Ibid.

14. Congressional Budget Office, *Family Income of Unemployment Insurance Recipients* (March 2004).

Chairman RANGEL. Maybe we ought to invite all of our panelists to sit up here together. Jacob Hacker—Dr. Hacker is a Professor of Political Science from Yale University. Welcome. Sit up here.

Dr. HACKER. Thank you very much.

Chairman RANGEL. We ask to join you Dr. Jason Furman, Senior Fellow and Director of the Hamilton Project at Brookings; Dr. John Goodman, President and Chief Executive Officer of the National Center for Policy Analysis, Dallas; Diane Rowland, Doctor, Executive Vice President of Kaiser Family Foundation—do we have chairs for everybody? Great—and Eugene Steuerle—Dr. Steuerle—Senior Fellow At the Urban Institute.

Let me welcome all of you and your taking time out to share your views with us. It is very important to us, and we appreciate the time that you have spent.

Now I will ask Dr. Hacker from Yale, how many books have you written, Doctor?

Dr. HACKER. Four at the moment.

Chairman RANGEL. Okay. How many articles? Any number, right?

Dr. HACKER. Quite a few, thank you. I just spilled my water on me in the excitement of the question.

Chairman RANGEL. I didn't ask you to name them all now, but thank you so much for coming, and we welcome your views.

STATEMENT OF JACOB HACKER, PH.D., PROFESSOR OF POLITICAL SCIENCE, YALE UNIVERSITY, NEW HAVEN, CONNECTICUT

Dr. HACKER. Thank you so much for having me. It is a pleasure to be here before the Committee, and I am honored to speak today about the economic condition of the American middle class.

Now, without mincing words, I think that condition can be described as serious and unstable. Over the last generation in nearly every facet of American middle-class economic life—health insurance, pensions, job security, family finances—economic risk has shifted from the broad shoulders of government and corporations onto the fragile finances of American families. I call this transformation "the great risk shift," and I believe it is at the heart of the economic anxieties that many middle-class Americans have expressed in recent years.

As you well know, the United States has a distinctive framework of economic security, one that relies heavily on employers to provide essential social benefits. Today, however, this framework is eroding, and risk is shifting back onto workers and their families.

Employment-based health insurance, for example, has contracted substantially, leaving nearly one in three non-elderly Americans without coverage for some time every 2 years. Meanwhile, even as overall pension coverage has stagnated, there has been a dramatic movement away from traditional guaranteed defined benefit plans toward individual account style, defined contribution plans which place much of the responsibility and risk of retirement planning on workers themselves.

We hear much today about inequality, the growing gaps between the rungs on our economic ladder, but the term that really captures the shift that I am describing is insecurity, the growing risk of slipping from the ladder itself. Insecurity seems to be what more and more Americans are feeling.

In an election night poll commissioned by the Rockefeller Foundation last year, polling 3/4 of voters, Republicans in almost as large a portion as Democrats said they were worried about their overall economic security.

Let me clearly emphasize that these are not just concerns or problems of the poor or poorly educated. Insecurity today reaches across the income spectrum, across the racial divide, across lines of geography and gender. Increasingly, all Americans appear to be riding the economic roller coaster that was once thought to be reserved for the working poor.

For example, personal bankruptcies and home foreclosures are stunningly more common than they were a generation ago, and most who experience these dislocations are in the middle class when they do. Indeed, the segment of the population that is most vulnerable to these trends is families with children, in part because they are drowning in debt. In 2004, according to the Survey of Consumer Finances, personal debt exceeded 125 percent of income for the median married couple with children.

Now we will hear more at this hearing about the squeeze between income and expenses that helps account for some of this rise in middle-class debt, but another factor to consider, as our new CBO Director said, is that family incomes are unstable and perhaps have become more so. Indeed, research I have done using the Panel Study of Income Dynamics, a survey that has tracked thousands of families from year to year since the late sixties, suggests that not only have the gaps between the rungs on our economic ladder grown but what has also increased is how far people slip down the ladder when they lose their financial footing. For example, a recent study shows that the chance that Americans will spend short periods in poverty has increased substantially since the seventies in every age group.

It is common to say that trends like these either cannot be addressed or that addressing them will hurt our economy. Both claims I think are false. The great risk shift is not an inevitable occurrence. In an economy as rich as ours, there is no compelling reason why we should not and could not shore up an update that buffers to protect families from economic risk so as to help them prosper in our increasingly dynamic, uncertain economy.

Which brings me to the second misleading claim, that providing Americans with a basic foundation of security will drag our economy down. We cannot—we should not—ensure people against every risk they face, but it is a grave mistake to see security as opposed to opportunity. We give corporations limited liability, after all, precisely to encourage entrepreneurs to take risks. If middle-class Americans are to make the risky investments necessary to thrive in our new economy, they need an improved safety net, not an ever more tattered one.

The American dream, the economic promise of this great Nation, is about security and opportunity alike; and ensuring the vibrancy of that dream in the coming decades will require providing security and opportunity alike.

Thank you.

Chairman RANGEL. Thank you so much, Doctor.

[The prepared statement of Dr. Hacker follows:]

Statement of Jacob Hacker, Ph.D., Professor of Political Science, Yale University, New Haven, Connecticut

Thank you, Mr. Chairman. My name is Jacob Hacker, and I am a professor of political science at Yale University. I thank the committee for the honor of speaking today about the economic condition of the American middle class.

Without mincing words, that condition can be described as "serious and unstable." Increasingly, middle-class Americans find themselves on a shaky financial tightrope, without an adequate safety net if they lose their footing.

A major cause of this precariousness is what I call "The Great Risk Shift." [1] Over the last generation, we have witnessed a massive transfer of economic risk from broad structures of insurance, whether sponsored by the corporate sector or by government, onto the fragile balance sheets of American families. This transformation is arguably the defining feature of the contemporary American economy. It has reshaped Americans' relationships to their government, their employers, and each other. And it has transformed the economic circumstances of American families, from the bottom of the economic ladder to its highest rungs.

We have heard a great deal about rising inequality—the growing gap between the rungs of our economic ladder. And yet, to most Americans, inequality is far less tangible and immediate than a trend we have heard much less about: rising *insecurity*, or the growing risk of slipping from the ladder itself. Even as the American economy has performed fairly strongly overall, economic insecurity has quietly crept into American middle-class life. Private employment-based health plans and pensions have eroded, or been radically transformed to shift more risk onto workers' shoulders. Government programs of economic security have been cut, restructured, or simply allowed to grow more threadbare. Our jobs and our families are less and less financially secure.

Insecurity strikes at the very heart of the American Dream. It is a fixed American belief that people who work hard, make good choices, and do right by their families can buy themselves permanent membership in the middle class. The rising tide of risk swamps these expectations, leaving individuals who have worked hard to reach their present heights facing uncertainty about whether they can keep from falling.

Little surprise, then, that insecurity was a central issue in the 2006 midterm elections—during which fully three-quarters of voters, Republicans in almost as large a proportion as Democrats, said they were "worried about their overall economic security, including retirement savings, health insurance, and Social Security." [2] Insecurity also appears to be a major reason for the huge divorce in recent years between generally positive aggregate economic statistics and generally negative public appraisals of the economy.[3] And it is certain to be one of the most pressing domestic challenges faced in the coming years.

In my remarks, I would like to review some of the major evidence that Americans are at increased economic risk, drawing on my recent book, *The Great Risk Shift*. After laying out the problem, I want to discuss the economic and philosophical grounds for addressing it—grounds that, I believe, demand bold and immediate action. My central claim is that economic security is not opposed to economic opportunity. It is a critical cornerstone of opportunity. And restoring a measure of security in the United States today is the key to transforming the nation's great wealth and productivity into an engine for broad-based prosperity and opportunity in a more uncertain economic world.

The Economic Roller Coaster

American family incomes are now on a frightening roller coaster, rising and falling much more sharply from year to year than they did 30 years ago. Indeed, according to research I have done using the Panel Study of Income Dynamics—a nationally representative survey that has been tracking thousands of families' finances

[1] Jacob S. Hacker, *The Great Risk Shift: The Assault on American Jobs, Families, Health Care, and Retirement—And How You Can Fight Back* (New York: Oxford University Press, 2006).

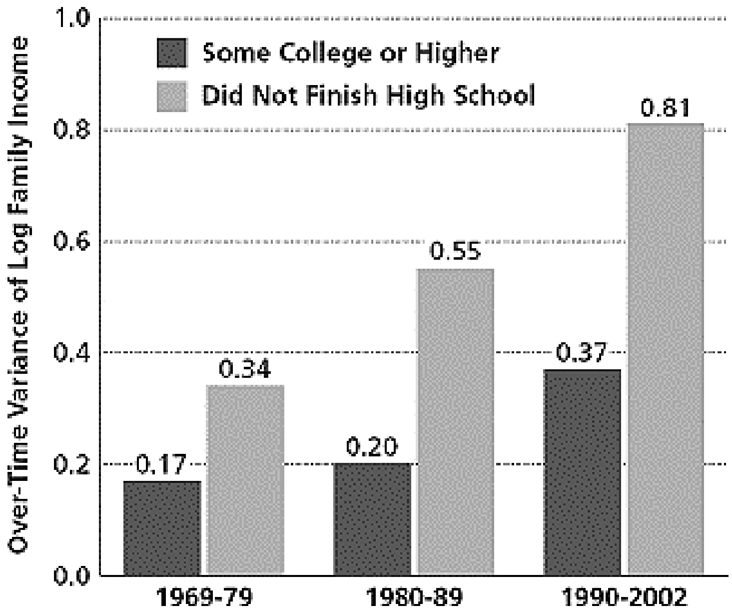
[2] McLaughlin and Associates poll of 1,000 midterm election voters, conducted for the Rockefeller Foundation. I am grateful to the Foundation for making this unpublished data available to me. Sixty-nine percent of Republican voters stated that they were worried, compared with 78 percent of Democratic voters and 76 percent of independent voters.

[3] Hacker, *The Great Risk Shift*, Chapter 1.

from year to year since the late 1960s—the *instability* of family incomes has risen faster than the *inequality* of family incomes. In other words, while the gaps between the rungs on the ladder of the American economy have increased, what has increased even more quickly is how far people slip down the ladder when they lose their financial footing.

FIGURE 1

Income Instability Increased at Both High and Low Educational Levels, 1969–2002



Source: PSID and Cross-National Equivalent File (CNEF), Cornell University. http://www.human.cornell.edu/che/PAM/Research/Centers-Programs/German-Panel/Cross-National-Equivalent-File_CNEF.cfm

Is this just a problem of the less educated, the workers who have fallen farthest behind in our economy? The answer is no. Income instability is indeed greater for less educated Americans than for more educated Americans. (It is also higher for blacks and Hispanics than for whites, and for women than for men.) Yet instability has risen by roughly the same amount across all these groups over the last generation. During the 1980s, people with less formal education experienced a large rise in instability, while those with more formal education saw a modest rise. During the 1990s, however, the situation was reversed, and by the end of the decade, as Figure 1 shows, the instability of income had increased in similar proportions from the 1970s baseline among both groups.[4]

Roller coasters go up and down. Yet when most of us contemplate the financial risks in our lives, we do not think about the upward trips. We worry about the drops, and worry about them intensely. In the 1970s, the psychologists Amos Tversky and Daniel Kahneman gave a name to this bias: "loss aversion."[5] Most people, it turns out, aren't just highly risk-averse—they prefer a bird in the hand to even a very good chance of two in the bush. They are also far more cautious when it comes to bad outcomes than when it comes to good outcomes of exactly the same

[4] Further explication of all the analyses discussed in this testimony are contained in my book.

[5] Daniel Kahneman and Amos Tversky, "Prospect Theory: An Analysis of Decisions Under Risk", *Econometrica* Vol. 47, no. 2 (1979).

magnitude. The search for economic security is, in large part, a reflection of a basic human desire for protection against losing what one already has.

This desire is surprisingly strong. Americans are famously opportunity-loving, but when asked in 2005 whether they were "more concerned with the opportunity to make money in the future, or the stability of knowing that your present sources of income are protected," 62 percent favored stability and just 29 percent favored opportunity.[6]

Judged on these terms, what the Panel Study of Income Dynamics shows is troubling. About half of all families in the study experience a drop in real income over a two-year period, and the number has remained fairly steady. Yet families that experience an income drop fall much farther today than they used to: In the 1970s, the median income loss was around 25 percent of prior income; by the late 1990s, it was around 40 percent. And, again, this is the median drop: Half of families whose incomes dropped experienced larger declines.

Figure 2 uses somewhat fancier statistics to show the rising probability of experiencing a 50 percent or greater family income drop. The chance was around 7 percent in the 1970s. It has increased dramatically since, and while, like income volatility, it fell in the strong economy of the 1990s, it has recently spiked. There is nothing extraordinary about "falling from grace." You can be perfectly average—with an average income, an average-sized family, an average likelihood of losing your job or becoming disabled—and you're still two-and-a-half times as likely to see your income plummet as an average person was 30 years ago.

FIGURE 2

Predicted Probability of 50 Percent or Greater Income Drop, 1970–2002

Source: PSID; CNST.
Note: Probabilities are based on the time trend from a logistic regression, with all other variables set at their annual means. Variables include age, education, race, gender, income (mean of five prior years), and a series of events (such as unemployment and illness) that affect income. The time trend is highly significant and robust to the inclusion of fixed effects; all standard errors are robust and adjusted for clustering.

The most dramatic consequence of financial reversals is, of course, poverty—subsistence at a level below the federal poverty line. According to the sociologist Mark Rank and his colleagues, the chance of spending at least a year in poverty has increased substantially since the late 1960s, even for workers in their peak earning years. People who were in their forties in the 1970s had around a 13 percent chance of experiencing at least a year in poverty during their forties. By the 1990s, people in their forties had more than a 36 percent chance of ending up in poverty.[7]

These numbers illuminate the hidden side of America's economic success story: the growing insecurity faced by ordinary workers and their families. Yet as dramatic and troubling as these numbers are, they vastly understate the true depth of the problem. Income instability powerfully captures the risks faced by Americans today. But insecurity is also driven by the rising threat to family finances posed by budget-busting expenses like catastrophic medical costs, as well as by the massively in-

[6] George Washington University Battleground 2006 Survey, March 24, 2005.
[7] Daniel Sandoval, Thomas A. Hirschl, and Mark R. Rank, "The Increase of Poverty Risk and Income Insecurity in the U.S. Since the 1970's," paper presented at the American Sociological Association.
Annual Meeting, San Francisco, CA, August 14–17, 2004.

creased risk that retirement has come to represent, as ever more of the responsibility of planning for the post-work years shifts onto Americans and their families. When we take in this larger picture, we see an economy not merely changed by degrees, but transformed—from an all-in-the-same boat world of shared risk toward a go-it-alone world of personal responsibility.

America's Unique—and Endangered—Framework of Economic Security

We often assume that the United States does little to provide economic security compared with other rich capitalist democracies. This is only partly true. The United States does spend less on government benefits as a share of its economy, but it also relies more—far more—on private workplace benefits, such as health care and retirement pensions. Indeed, when these private benefits are factored into the mix, the U.S. framework of economic security is not smaller than the average system in other rich democracies. It is actually slightly larger.[8] With the help of hundreds of billions in tax breaks, American employers serve as the first line of defense for millions of workers buffeted by the winds of economic change.

The problem is that this unique employment-based system is coming undone, and in the process risk is shifting back onto workers and their families. Employers want out of the social contract forged in the more stable economy of past, and they are largely getting what they want. Meanwhile, America's framework of government support is also strained. Social Security, for example, is declining in generosity, even as guaranteed private pensions evaporate. Medicare, while ever more costly, has not kept pace with skyrocketing health expenses and changing medical practice. And even as unemployment has shifted from cyclical job losses to permanent job displacements, Unemployment Insurance has eroded as a source of support and recovery for Americans out of work.[9]

The history of American health insurance tells the story in miniature. After the passage of Medicare and Medicaid, health coverage peaked at roughly 90 percent of the population, with approximately 80 percent of Americans covered by private insurance. In its heyday, private insurance was provided by large nonprofit insurers, which pooled risks across many workplaces (and, originally, even charged all subscribers essentially the same rate—a practice favorable to higher-risk groups). The American Hospital Association proudly described the Blue Cross insurance plans that once dominated U.S. health insurance as "social insurance under non-governmental auspices."[10]

Since the late 1970s, however, employers and insurers have steadily retreated from broad risk pooling. The number of Americans who lack health coverage has increased with little interruption as corporations have cut back on insurance for workers and their dependents. From around 80 percent of Americans, private health coverage now reaches less than 70 percent, with nearly 47 million people without any coverage at all.[11] Over a two-year period, more than 80 million adults and children—one out of three non-elderly Americans, 85 percent of them in working families—spend some time without the protection against ruinous health costs that insurance offers.[12] And the problem is rapidly worsening: Between 2001 and 2005, the

---

[8] Jacob S. Hacker, *The Divided Welfare State: The Battle over Public and Private Social Benefits in the United States* (New York: Cambridge University Press, 2002); Willem Adema and Maxime Ladaique, "Net Social Expenditure, 2005 Edition," Paris, Organization for Economic Cooperative for Development, 2005, available online at www.oecd.org/dataoecd/56/2/35632106.pdf.

[9] See Lori G. Kletzer and Howard Rosen, "Reforming Unemployment Insurance for the Twenty-First Century Workforce," Hamilton Project Discussion Paper 2006–06, Washington, D.C., Brookings Institution, September 2006, available online at www1.hamiltonproject.org/views/papers/200609kletzer-rosen.pdf.

[10] Hacker, *Divided Welfare State*, 186, 214, 204.

[11] Current private coverage estimates are available through the Kaiser Family Foundation's "Trends and Indicators in a Changing Health Care Marketplace," available online at www.kff.org/insurance/7031/print-sec2.cfm. The estimate of nearly 47 million uninsured (the actual number is 46.6 million) comes from Carmen DeNavas-Walt, Bernadette D. Proctor, and Cheryl Hill Lee, "Income, Poverty, and Health Insurance Coverage in the United States: 2005," Current Population Reports (Washington D.C.: U.S. Census Bureau, August 2006), 20, available online at www.census.gov/prod/2006pubs/p60–231.pdf.

[12] Families USA, "One in Three: Nonelderly Americans Without Health Insurance, 2002–2003," Washington, D.C., Families USA, 2005, available online at www.familiesusa.org/assets/pdfs/82million__uninsured__report6fdc.pdf.

share of moderate-income Americans who lack health coverage has risen from just over one quarter to more than 40 percent.[13]

The uninsured, moreover, are hardly the only ones at risk because of rising medical costs. Among *insured* Americans, 51 million spend more than 10 percent of their income on medical care.[14] One out of six working-age adults—27 million Americans—are carrying medical debt, and 70 percent had insurance when they incurred it. Of those with private insurance and medical debt, fully half have incomes greater than $40,000, and of this group a third are college graduates or have had post-graduate education.[15] Perhaps not surprisingly, as many as half of personal bankruptcies are due in part to medical costs and crises—and most of these medical-related bankruptcies occur among the insured.[16]

As employment-based health insurance has unraveled, companies have also raced away from the promise of guaranteed retirement benefits. Twenty-five years ago, 83 percent of medium and large firms offered traditional "defined-benefit" pensions that provided a fixed benefit for life. Today, the share is below a third.[17] Instead, companies that provide pensions—and roughly half the workforce continues to lack a pension at their current job—mostly offer "defined-contribution" plans like the 401(k), in which returns are neither predictable nor assured.[18]

Defined-contribution plans are not properly seen as pensions—at least as that term has been traditionally understood. They are essentially private investment accounts sponsored by employers that can be used for building up a tax-free estate as well as for retirement savings. As a result, they greatly increase the degree of risk and responsibility placed on individual workers in retirement planning. Traditional defined-benefit plans are generally mandatory and paid for largely by employers (in lieu of cash wages). They thus represent a form of forced savings. Defined-benefit plans are also insured by the federal government and heavily regulated to protect participants against mismanagement. Perhaps most important, their fixed benefits protect workers against the risk of stock market downturns and the possibility of living longer than expected.

None of this is true of defined-contribution plans. Participation is voluntary, and due to the lack of generous employer contributions, many workers choose not to participate or contribute inadequate sums.[19] Plans are not adequately regulated to protect against poor asset allocations or corporate or personal mismanagement. The federal government does not insure defined-contribution plans. And defined-contribution accounts provide no inherent protection against asset or longevity risks. Indeed, some features of defined-contribution plans—namely, the ability to borrow against their assets, and the distribution of their accumulated savings as lump-sum payments that must be rolled over into new accounts when workers change jobs—exacerbate the risk that workers will prematurely use retirement savings, leaving inadequate income upon retirement. And, perversely, this risk falls most heavily on younger and less highly paid workers, the very workers most in need of secure retirement protection.

According to the Center for Retirement Research at Boston College, the share of working-age households who are at risk of being financially unprepared for retirement at age 65 has risen from 31 percent in 1983 to 43 percent in 2004. Younger Americans are far more likely to be at risk than older Americans: Roughly half of those born from the mid-1960s through the early 1970s are at risk of being financially unprepared, compared with 35 percent of those born in the decade after World

---

[13] Sara R. Collins, et al., "Gaps in Health Insurance: An All-American Problem," New York, Commonwealth Fund, 2006, available online at www.cmwf.org/usr_doc/Collins_gapshltins_920.pdf.

[14] Families USA, "Have Health Insurance? Think You're Well Protected? Think Again," Washington, D.C., February 2005, available online at www.familiesusa.org/assets/pdfs/Health_Care_Think_Again.pdf.

[15] Robert W. Seifert and Mark Rukavina, "Bankruptcy Is The Tip Of A Medical-Debt Iceberg," *Health Affairs* 25:2 (2006): w89-w92.

[16] David U. Himmelstein, et al., "MarketWatch: Illness And Injury As Contributors To Bankruptcy," *Health Affairs*, Web Exclusive, February 2, 2005.

[17] John H. Langbein, "Understanding the Death of the Private Pension Plan in the United States," unpublished manuscript, Yale Law School, April 2006.

[18] Geoffrey Sanzenbacher, "Estimating Pension Coverage Using Different Data Sets," Center for Retirement Research Issues in Brief Number 51, Boston College, August 2006, available online at www.bc.edu/centers/crr/issues/ib_51.pdf.

[19] Alicia H. Munnell and Annika Sundén, "401(k) Plans Are Still Coming Up Short," Center for Retirement Research Issues in Brief Number 43b, Boston College, March 2006, available online at www.bc.edu/centers/crr/issues/ib_43b.pdf.

War II. The least financially prepared are low-income Americans—in every age group.[20]

As private and public support have eroded, in sum, workers and their families have been forced to bear a greater burden. This is the essence of the Great Risk Shift. Rather than enjoying the protections of insurance that pools risk broadly, Americans are increasingly facing economic risks on their own—and often at their peril. In the new world of work and family, the buffers that once cushioned Americans against economic risk are become fewer and harder.

The New World of Work and Family

The erosion of America's distinctive framework of economic protection might be less worrisome if work and family were stable sources of security themselves. Unfortunately, they are not. Beneath the rosy economic talk, the job market has grown more uncertain and risky, especially for those who were once best protected from its vagaries. While the proportion of workers formally out of work at any point in time has remained low, the share of workers who lose a job through no fault of their own every 3 years has actually been rising—and is now roughly as high as it was during the recession of the early 1980s, the worst economic downturn since the Great Depression.[21]

No less important, these job losses come with growing risks. Workers and their families now invest more in education to earn a middle-class living, and yet in today's post-industrial economy, these costly investments are no guarantee of a high, stable, or upward-sloping path. For displaced workers, the prospect of gaining new jobs with relatively similar pay and benefits has fallen, and the ranks of the long-term unemployed and "shadow unemployed" (workers who have given up looking for jobs altogether) have grown. These are not just problems faced by workers at the bottom. In the most recent downturn, the most educated workers actually experienced the worst effects when losing a full-time job, and older and professional workers were hit hardest by long-term unemployment.[22]

Meanwhile, the family—once a refuge from economic risk—is creating new risks of its own. At first, this seems counterintuitive. Families are much more likely to have two earners than in the past, the ultimate form of private risk sharing. To most families, however, a second income is not a *luxury*, but a *necessity* in a context in which wages are relatively flat and the main costs of raising a family (health care, education, housing) are high and rising.[23] According to calculations by Jared Bernstein and Karen Kornbluh, more than three-quarters of the modest 24 percent rise in real income experienced by families in the middle of the income spectrum between 1979 and 2000 was due to increasing work hours, rather than rising wages.[24] (Some of this overall gain has been reduced by recent family income declines.) In time-use surveys, both men and women who work long hours indicate they would like to work fewer hours and spend more time with their families—which strongly suggests they are not able to choose the exact mix of work and family they would prefer.[25]

With families needing two earners to maintain a middle-class standard of living, their economic calculus has changed in ways that accentuate many of the risks they face. Precisely because it takes more work and more income to maintain a middle-class standard of living, the questions that face families when financially threat-

---

[20] "Retirement at Risk: A New National Retirement Risk Index," Center for Retirement Research, Boston College, Boston, MA, June 2006, available online at www.bc.edu/centers/crr/special__pubs/NRRI.pdf.

[21] Henry S. Farber, "What Do We Know About Job Loss in the United States?" *Economic Perspectives* 2Q (2005): 13, 14, available online at www.chicagofed.org/publications/economicperspectives/ep__2qtr2005__part2__farber.pdf.

[22] Ibid.; Katharine Bradbury, "Additional Slack in the Economy: The Poor Recovery in Labor Force Participation During this Business Cycle, Federal Reserve Bank of Boston Public Policy Brief No. 05–2, Boston, 2005, available online at www.bos.frb.org/economic/ppb/2005/ppb052.pdf; Andrew Stettner and Sylvia A. Allegretto, "The Rising Stakes of Job Loss: Stubborn Long-Term Joblessness amid Falling Unemployment Rates," Economic Policy Institute and National Employment Law Project Briefing Paper No. 162, 2005, available online at www.epi.org/briefingpapers/162/bp162.pdf.

[23] Elizabeth Warren and Amelia Warren Tyagi, *The Two-Income Trap: Why Middle-Class Mothers and Fathers Are Going Broke* (New York: Basic Books, 2003).

[24] Jared Bernstein and Karen Kornbluh, "Running Faster to Stay in Place: The Growth of Family Work Hours and Incomes," New America Foundation, Washington, D.C., June 29, 2005, available online at www.newamerica.net/publications/policy/running__faster__to__stay__in__place.

[25] Jerry A. Jacobs and Kathleen Gerson, *The Time Divide: Work, Family, and Gender Inequality* (Cambridge, MA: Harvard University Press, 2004).

ening events occur are suddenly more stark. What happens when women leave the workforce to have children, when a child is chronically ill, when one spouse loses his job, when an older parent needs assistance? In short, events within two-earner families that require the care and time of family members produce special demands and strains that traditional one-earner families generally did not face.

The new world of work and family has ushered in a new crop of highly leveraged investors—middle-class families. Consider just a few of the alarming facts:

- Personal bankruptcy has gone from a rare occurrence to a routine one, with the number of households filing for bankruptcy rising from less than 300,000 in 1980 to more than 2 million in 2005.[26] Over that period, the financial characteristics of the bankrupt have grown worse and worse, contrary to the claim that bankruptcy is increasingly being used by people with only mild financial difficulties. Strikingly, married couples with children are much more likely to file for bankruptcy than are couples without children or single individuals.[27] Otherwise, the bankrupt are pretty much like other Americans before they file: slightly better educated, roughly as likely to have had a good job, and modestly less likely to own a home.[28] They are not the persistently poor, the downtrodden looking for relief; they are refugees of the middle class, frequently wondering how they fell so far so fast.
- Americans are also losing their homes at record rates. Since the early 1970s, there has been a fivefold increase in the share of households that fall into foreclosure—a process that begins when homeowners default on their mortgages and can end with homes being auctioned to the highest bidder in local courthouses.[29] For scores of ordinary homeowners—one in sixty mortgage-owning households in recent years—the American Dream has mutated into what former U.S. Comptroller of the Currency Julie L. Williams calls "the American nightmare."[30]
- American families are drowning in debt. Since the early 1970s, the personal savings rate has plummeted from around a tenth of disposable income to essentially zero. In 2005, the personal savings rate was –0.5 percent—the first time since 1993, in the midst of the Great Depression, that savings has been negative for an entire year.[31] Meanwhile, the total debt held by Americans has ballooned, especially for families with children. As a share of income in 2004, total debt—including mortgages, credit cards, car loans, and other liabilities—was more than 125 percent of income for the median married couple with children, or more than three times the level of debt held by married families without children, and more than nine times the level of debt held by childless adults.[32]

As these examples suggest, economic insecurity is not just a problem of the poor and uneducated, as is frequently assumed. It affects even educated, middle-class Americans—men and women who thought that by staying in school, by buying a home, by investing in their 401(k)s, they had bought the ticket to upward mobility and economic stability. Insecurity today reaches across the income spectrum, across the racial divide, across lines of geography and gender. Increasingly, all Americans are riding the economic roller coaster once reserved for the working poor, and this means that, increasingly, all Americans are at risk of losing the secure financial foundation they need to reach for and achieve the American Dream.

---

[26] Data courtesy of Elizabeth Warren, Harvard Law School. 2005 was, of course, an unusual year because of the rush of filings before the 2005 bankruptcy bill took effect. The number in 2004, however, still exceeded 1.56 million.

[27] Warren and Tyagi, *Two-Income Trap*.

[28] Elizabeth Warren, "Financial Collapse and Class Status: Who Goes Bankrupt?" *Osgoode Hall Law Journal*, 41.1 (2003).

[29] Calculated from Peter J. Elmer and Steven A. Seelig, "The Rising Long-Term Trend of Single-Family Mortgage Foreclosure Rates," Federal Deposit Insurance Corporation Working Paper 98–2, n.d., available online at www.fdic.gov/bank/analytical/working/98-2.pdf.

[30] Christian Weller, "Middle Class in Turmoil: High Risks Reflect Middle Class Anxieties," Center for American Progress, Washington, D.C., December 2005, 7, available online at www.americanprogress.org/kf/middle_class_turmoil.pdf; Joe Baker, "Foreclosures Chilling Many US Housing Markets," *Rock River Times*, March 22–28, 2006, available online at www.rockrivertimes.com/index.pl?cmd=viewstory&id=12746&cat=2.

[31] "U.S. Savings Rate Hits Lowest Level Since 1933," *MSNBC.com*, January 30, 2006, available online at www.msnbc.msn.com/id/11098797.

[32] Calculated from Federal Reserve Board, Survey of Consumer Finance 2004, available online at www.federalreserve.gov/PUBS/oss/oss2/2004/scf2004home.html; all results are appropriately weighted.

A Security and Opportunity Society

Most of us think of our nation's safety net as a way of helping those who have had bad fortune or fallen on hard times. Yet providing economic security has far broader benefits for our economy and our society. Corporate law has long recognized the need to limit the downside of economic risk-taking as a way of encouraging entrepreneurs and investors to make the risky investments necessary to advance in a capitalist economy. The law of bankruptcy and principle of limited liability—the notion that those who run a firm are not personally liable if the firm fails—allow entrepreneurs to innovate with the security of knowing they will not be financially destroyed if their risky bets fail.[33]

By the same token, families need a basic foundation of financial security if *they* are to feel confident in making the investments needed to advance in a dynamic economy. All of the major wellsprings of economic opportunity in the United States—from assets to workplace skills to education to investments in children—are costly and risky for families to cultivate. Providing security can encourage families to make these investments, aiding not just their own advancement but the economy as a whole.

Providing economic security appears even more beneficial when considered against some of the leading alternatives that insecure citizens may otherwise back. Heavy-handed regulation of the economy, strict limits on cross-border trade and financial flows, and other intrusive measures may gain widespread support from workers buffeted by economic turbulence, and yet these measures are likely to reduce growth. The challenge, then, is to construct a twenty-first century social contract that protects families against the most severe risks they face, without clamping down on the potentially beneficial processes of change and adjustment that produce some of these risks.

In achieving this vision, there can be no turning back the clock on many of the major changes that have swept through the American economy and American society. Yet accepting these changes does not mean accepting the new economic insecurity that middle-class families face. Americans will need to do much to secure themselves in the new world of work and family. But they should be able to do it in a context in which government and employers act as effective advocates on working families' behalf. And they should be protected by an improved safety net that fills the most glaring gaps in present protections, providing all Americans with the basic security they need to reach for the future—as workers, as parents, and as citizens.

First and foremost, this means health coverage that moves with workers from job to job. In a policy brief released earlier this month, I have outlined a proposal that would extend good insurance to all non-elderly Americans through a new Medicare-like program and guaranteed workplace health insurance, while creating an effective framework for controlling medical costs and improving health outcomes to guarantee affordable, quality care to all.[34]

A new social contract should also include enhanced protections against employment loss (and the wage and benefit cuts that come with it), and an improved framework for retirement savings. And I believe it should include a new flexible program of social insurance that I call "Universal Insurance"—a stop-loss income-protection program that insures workers against very large drops in their income due to unemployment, disability, ill health, and the death of a breadwinner, as well as against catastrophic medical costs. For a surprisingly modest cost, Universal Insurance could help keep more than 3 million Americans from falling into poverty a year and cut in half the chance that Americans experience a drop in their income of 50 percent or greater.[35]

Such a "security and opportunity society" will not be uncontroversial or easy to achieve. But it will restore a simple promise to the heart of the American experience: If you work hard and do right by your families, you shouldn't live in constant fear of economic loss. You shouldn't feel that a single bad step means slipping from the ladder of advancement for good. The American Dream is about security and opportunity alike, and rebuilding it for the millions of middle-class families whose

---

[33] David Moss, *When All Else Fails: Government as the Ultimate Risk Manager* (Cambridge, MA: Harvard University Press, 2002).

[34] Jacob S. Hacker, "Health Care for America: A Proposal for Guaranteed, Affordable Health Care for all Americans Building on Medicare and Employment-Based Insurance," EPI Briefing Paper #180, Economic Policy Institute, Washington, D.C., January 11, 2007, available online at www.sharedprosperity.org/bp180.html.

[35] Jacob S. Hacker, "Universal Insurance: Enhancing Economic Security to Promote Opportunity," Discussion Paper 2006–07, The Hamilton Project, Brookings Institution, Washington, DC, September 2006, available online at www.brook.edu/views/papers/200609hacker__wp.htm.

anxieties and struggles are reflected in the statistics and trends I have discussed will require providing security and opportunity alike.

Chairman RANGEL. Next will be Dr. Furman, who has taught at Yale, Columbia and is now at New York University in the great city of New York, the Wagner School, and has made an outstanding contribution in so many issues including Social Security. We not only thank you for coming today, but I have an impression that we will be calling upon you again for some help in this subject matter I mentioned. Welcome.

STATEMENT OF JASON FURMAN, PH.D., SENIOR FELLOW AND DIRECTOR OF THE HAMILTON PROJECT, BROOKINGS INSTITUTE

Dr. FURMAN. Well, I would be happy to help in any way I can; and thank you for the invitation to come here again today to this Committee.

I currently serve as the Director of The Hamilton Project at the Brookings Institution, an initiative dedicated to developing policies that promote broad-based growth and opportunity. Today, I want to focus on one particular issue of tremendous importance to middle-class families and the anxiety they face, which is their retirement security.

Preparing for retirement is substantially more complicated for today's work force than it was for yesterday's workers. Old mechanisms to secure retirement income, such as defined benefit pension plans, are being displaced by new savings vehicles, such as defined contribution plans. This change offers major opportunities but leaves many families at risk of being behind.

When I submitted my prepared testimony, I wrote the personal savings rate has been negative for six straight quarters. This morning, the Bureau's economic analysis reported that it has now been negative for a seventh straight quarter for the first time since the thirties. This not only threatens the well-being of working families, it also endangers our entire economy.

There is wide variation in retirement savings. Many families are accumulating enough assets to ensure a comfortable retirement, but at least one-third of families are not adequately prepared, according to a number of studies by economists. This latter group needs more supportive public policy initiatives.

Financial planners generally recommend that retirement income replace about 70 percent of pre-retirement income. Social Security gets the typical family about halfway to this goal. For a typical worker retiring at age 65, Social Security replaces 40 percent of pre-retirement income. As the normal retirement age rises, the replacement rate for workers retiring at age 65 will fall to 36 percent.

While Social Security remains the core tier of retirement security, the rest of the system has shifted beneath the feet of today's work force. The percentage of workers participating in the pension plan has been roughly constant at 50 percent for at least the last 25 years, but the types of pension plans workers are participating in has changed dramatically. In 1983, 88 percent of workers with pension coverage were offered a defined benefit plan. By 2004, that percentage had fallen to 37 percent. For defined contribution plans, the trend is the exact opposite.

The shift to defined contribution plans creates two types of risks for workers. The first type of risk is easy to understand, the risk that a worker's chosen investments will perform poorly. This risk is mostly unavoidable in a defined contribution context, and policy-makers would not want to eliminate this risk since its flip side is the high average returns in the stock market. The fact that the percentage of families holding stocks directly and indirectly has risen from 40 percent in 1995 to 48 percent in 2004 is a good thing. The challenge we face is helping the remainder of Americans enjoy the benefits of investing in stocks without weakening the core tier of retirement security.

The second risk associated with defined contribution plans is more troubling but also completely fixable. Traditional defined benefit plans do not require workers to make many choices. In contrast, defined contribution plans shift the burden of frequently complex decisionmaking to workers. As Brookings economist Bill Gale says, you don't have to be a mechanic to drive a car, and you shouldn't need a Ph.D. in financial economics to navigate the pension system.

I can add that I have been a Brookings employee for a month, and I have a Ph.D. in economics. It was only in the course of preparing this testimony I realized I have yet to sign up for the pension plan.

The Pension Protection Act of 2006 will improve matters for many employees by making it easier for companies to set up automatic 401(k)s, but it is only the first step of many that can be taken to help families prepare for retirement, and we should not forget that a substantial fraction of Americans must save for retirement without any help from their employers and without the administrative tax and financial advantages afforded by a company retirement plan.

Finally, I urge this Committee to consider the unique retirement security challenges facing low- and moderate-income families. While Social Security benefits are progressive, one feature of particular importance to low-income workers has shrunk in recent years. Enacted in 1972, the special minimum benefit was designed to provide a robust floor to people who had worked hard and contributed all their lives. Since it is not indexed to wage growth, the benefit has eroded over time. Today, few workers receive it. Within a few years, none will.

Furthermore, low- and moderate-income workers who manage to set aside modest retirement savings may be forced to deplete their nest eggs before getting help during times of hardship. Assets tests for food stamps, Medicaid, Temporary Assistance for Needy Families (TANF) and Supplemental Security Income (SSI) all mean low-income families can face a higher effective tax rate on their savings than high-income families. To make matters worse, many of the assets tests are not indexed for inflation, and balances in some defined contribution plans count toward some of the asset tests, even though the defined asset replacement tests did not.

Working Americans need new policies for a modern era of retirement planning. The Hamilton Project as well as the Retirement Security Project are working to develop such policies. I look forward to discussing some of them in response to your questions.

Chairman RANGEL. Thank you so much, Doctor.

[The prepared statement of Dr. Furman follows:]

Statement of Jason Furman, Ph.D., Senior Fellow and Director of the Hamilton Project, Brookings Institute

Mr. Chairman and other Members of the Committee, thank you for the invitation to testify to you today regarding retirement security. I currently serve as Director of The Hamilton Project at The Brookings Institution, an initiative dedicated to developing policies that promote broad-based growth and opportunity. Enhancing retirement security is an important part of our efforts.

Preparing for retirement is substantially more complicated for today's workforce than it was for yesterday's workers. Old mechanisms to secure retirement income, such as defined benefit pension plans, are being displaced by new savings vehicles such as defined contribution plans. This change offers major opportunities but leaves many families at risk of falling behind. As this change continues many families risk being left behind. Social Security benefits, meanwhile, provide an increasingly important bedrock for retirement security.

The challenge could not be more stark. The personal saving rate has been negative for six straight quarters, the first time it has gone negative since the 1930s. A negative personal saving rate not only threatens the economic wellbeing of working families, it also endangers our entire economy. Low national saving leads the United States to borrow nearly 7 percent of GDP annually from foreign countries. This high current account deficit increases the chances of an economic crisis that could adversely affect the economic security of all Americans. And it requires that a fraction of our future national output be devoted to repaying foreign lenders, rather than raising the living standards of future generations of workers and retirees.

At the individual level, many families are approaching retirement with very little in the way of savings. According to Survey of Consumer Finances data, two-thirds of families headed by a worker between the ages of 55 and 64 had under $88,000 in their retirement savings accounts in 2004. To put this in perspective, $88,000 would be enough to purchase an annuity paying just $653 per month.

There is wide variation in retirement savings and many families are accumulating substantial assets that will be enough to ensure a comfortable retirement. But it is safe to say that at least one-third of families are not adequately preparing for retirement, according to a number of studies by economists. And it is this latter group which most needs—and can most benefit from—supportive public policy initiatives.

Financial planners generally recommend that retirement income replace about 70 percent of pre-retirement income. Social Security gets the typical family about halfway to this goal. For a typical worker retiring at age 65, Social Security replaces 40 percent of pre-retirement income. As the normal retirement age rises to 67, the replacement rate for workers retiring at 65 will fall to 36 percent. For the plurality of families that claim benefits starting at age 62, the replacement rates are even lower.

In practice, Social Security makes up more than half of retirement income for 70 percent of people over age 65. It is the only source of retirement income for a quarter of the people above age 65. In addition, Social Security benefits have several important features that make them a uniquely important part of retirement security: in particular, benefits are inflation-indexed, last until death, are not subject to market risk, and cover virtually the entire workforce.

But while Social Security has remained the core tier of retirement security, the rest of the system has changed rapidly. The percentage of workers participating in a pension plan has been roughly constant—at 50 percent—for at least the last 25 years. But the types of pension plans workers are participating in have changed dramatically. In 1983, 88 percent of workers with pension coverage were offered a defined benefit plan that would provide a retirement benefit linked to earnings and tenure, not to the individual investment portfolio of the worker. By 2004 that percentage had fallen to 37 percent. For defined contribution plans, (for example, 401(k)s, in which retirement benefits are linked to the performance of an investment account) the trend is almost the exact opposite. In 1983, 38 percent of workers offered a pension were offered a defined contribution plan while in 2004 it was 80 percent. And the trend away from defined benefit plans in corporate America continues apace. In 2006, IBM, Verizon, and a number of other prominent companies stopped offering defined benefit plans to new employees.

The shift to defined contribution plans creates two types of risks for workers. The first type of risk is easy to understand—the risk that a worker's chosen investments will perform poorly. This risk is mostly unavoidable in a defined contribution context (although some steps could reduce risks, such as not investing primarily the stock of one's employer). And policymakers would not want to eliminate this risk since the flip side of stock market risk is the high average returns in the stock market. Over the past century, equities have outperformed bonds by nearly 5 percentage points annually. Although there is no guarantee the equity premium will persist in the next century, and stocks are much more volatile than bonds, the fact that the percentage of families holding stocks, directly or indirectly, has risen from 40 percent in 1995 to 48 percent in 2004 is a good thing. The challenge we face is helping the other 52 percent of Americans enjoy the benefits of investing in stocks—without weakening the core tier of retirement security.

The second risk, associated with defined contribution plans is more troubling—but also completely fixable. Traditional defined benefit plans do not require workers to make many choices. Participation is generally automatic and nearly 100 percent of workers who are eligible for a defined benefit plan participate. In contrast, defined contribution plans shift the burden of decision-making to workers, leaving them in charge of making choices about whether to participate, how much to set aside for retirement, how to manage these funds, and how to roll them over into another retirement vehicle when they leave their job. And the evidence clearly shows that many workers make sub-optimal choices in all these respects. As Brookings economist William Gale says, "You don't have to be a mechanic to drive a car, and you shouldn't need a Ph.D. in financial economics to navigate the pension system."

In essence, while defined contribution plans present a tremendous opportunity for the workers who participate, make smart choices, and invest during strong markets, they also present a substantial risk to workers who fail to participate, make the wrong choices, or invest during weak markets. The Pension Protection Act of 2006 will improve matters for many employees by making it easier for companies to set up an automatic 401(k), but it is only a first step of many that can be taken to help families prepare for retirement.

By far the biggest challenge today's workers face is not being offered any pension plan at all. In 2006, 40 percent of private workers were working for a company that did not have any form of pension coverage. These workers have to save on their own, without the administrative, tax and financial advantages afforded by a company pension plan.

Finally, low- and moderate-income families face unique retirement security challenges. While Social Security benefits are progressive and provide a larger benefit for every dollar contributed by a low-income worker, one feature of particular importance to low-income workers has eroded in recent years: the special minimum benefit. Enacted in 1972, the special minimum benefit was designed to provide a robust floor for people who worked hard and contributed all their lives. Because it is not indexed to wage growth, the benefit has eroded over time and today few workers benefit and within a few years none will.

Another challenge faced by low- and moderate-income workers is that even if they manage to set aside modest retirement savings, they may be forced to deplete these savings before they can get help during times of hardship, such as a temporary period of unemployment or a major illness. Assets tests for Food Stamps, Medicaid, Temporary Assistance for Needy Families (TANF), and Supplemental Security Assistance (SSI) mean that low-income families can face a higher effective tax rate on their saving than high-income families. To make matters worse, many of the assets tests are not indexed for inflation and balances in some defined contribution plans count towards some of the asset tests, even though the defined benefit plans they replaced did not.

Working Americans need new policies for the modern era of retirement planning—policies that make pensions work better for the workers that have them, and policies that ensure more workers, and ideally all workers, have a pension.

The Hamilton Project, as well as the Retirement Security Project, are working to develop such policies. I look forward to discussing some of them in response to your questions.

[1] The views expressed in this testimony are those of the author alone and do not necessarily represent those of the staff, officers, or trustees of The Brookings Institution or the members of the Advisory Council of The Hamilton Project.

Chairman RANGEL. Dr. Goodman, who has been an advisor to many Members of the Congress is author of many books, editorials, is a great speaker. He is commonly seen on television shows, and he received his doctorate from Columbia. He has taught and worked with Stanford, Dartmouth, Southern Methodist, University of Dallas and is a great friend and advisor to Members of Congress. We thank you once again for agreeing to be with us. I think you are the author of this book, Leaving Women Behind, something we really don't want to do. Thank you.

STATEMENT OF JOHN C. GOODMAN, PH.D., PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL CENTER FOR POLICY ANALYSIS, DALLAS, TEXAS

Dr. GOODMAN. Thank you, Mr. Chairman, Members of the Committee.

The most important problems faced by middle-income families today are not caused by the economic system. Instead, they are more likely to be caused by outdated public policies.

Our health care system, our pension system, tax law, labor law, employee benefits law, the basic structure of these institutions was formed 50 or 60 years ago by policymakers who made three interesting assumptions: First, they assumed that workers would have long-term relationships with employers, work for the same employer for their whole lives. Second, they assumed that the male in the household would be the breadwinner, would be a full-time worker, and his wife would be a full-time homemaker, and the two would stay married. Number three, in devising social insurance programs like unemployment insurance and workers compensation, they assumed the individual incentives or market forces could largely be ignored.

These assumptions clearly are not valid for the 21st century.

The traditional defined benefit pension was clearly not designed for a mobile labor market. Workers in these pension systems—in these pension plans lose thousands of dollars of benefits every time they switch jobs. Similarly, the employer-based health insurance system makes less and less sense. A switch of employers today means a switch of health plans. That often means a switch of doctors. That means no continuity of care. It may also mean no continuity of health benefits.

Now, Dr. Hacker says the move to IRAs, 401(k)s, health savings accounts involves a shifting of risk to employees. I think he has it exactly backward. The risk of benefit losses from job switches under the old defined benefit pension plans is greater than the risk of stock market fluctuation to the owner of a 401(k) plan, and the only thing that is portable in a modern health insurance plan is the health savings account part of it.

In a highly mobile labor market, benefits should be personal and portable. They should be owned by employees, and they should travel with those employees as they go from job to job through the labor market.

Portable health accounts and portable savings accounts are not the problem, they are part of the solution. What we should do is build on the institutions that we have created along these lines; and that is what Congress did last summer, by the way, when it adopted some recommendations made by my own organization and the Brookings Institution for how to reform and make better the 401(k) programs. Some of those same ideas could also be used to improve and reform the unemployment insurance system and the workers compensation system and other social insurance programs.

Now to the subject of women. The most important economic and sociological change in the last 50 years has been the movement of women into the labor market, and yet our labor law, employee benefits law, tax law and so forth assumes that this has never happened. So, when a wife leaves the home and enters the labor market, she is in her husband's tax bracket, even if she is only earning the minimum wage. Even if her husband is maxed out on Social Security payments, she starts all over; and she will likely get no additional Social Security benefits in return for the extra taxes that she pays. For a middle-income couple, they are lucky if the wife at the end of the day gets to keep 35 cents of each dollar that she earns.

The employee benefit system is even worse, because it is filled with rigidities. If the wife's husband has her covered under health insurance under another employer, she does not need duplicate coverage. She would probably like to forgo joining the health plan and have higher wages instead, but, in general, employers cannot do this.

On the other hand, if she is not covered at her husband's place of work and she is working part time, she would probably like to take less in wages in order to be able to join the employers' health plan, but, again, the employers are not able to do this.

Labor law also is way too rigid. What couples with children want more than they want higher wages is they want flexibility, they want the ability to have flexibility in their time; and yet the law is very rigid in this area as well. In general, women are more likely than men to move in and out of the labor market, to work part time and to have spells out of the labor market; and whenever they do any of these things the tax law discriminates against them when they buy health insurance, when they save for retirement, when they buy day care and when they do many other things.

So, bottom line, what can we do about all of this? In a single sentence, what we need to do is bring 20th century institutions into the 21st century. At a minimum, that means personal portable benefits, tax fairness and enough flexibility in employee benefits law and labor law to allow employers to help employees meet their needs.

Chairman RANGEL. Thank you, doctor. Your remarks are very well taken.

[The prepared statement of Dr. Goodman follows:]

Statement of John C. Goodman, Ph.D., President and Chief Executive Officer, National Center for Policy Analysis, Dallas, Texas

Mr. Chairman and members of the committee, good afternoon. I am John Goodman, President and CEO of the National Center for Policy Analysis, a nonprofit, nonpartisan public policy research organization dedicated to developing and promoting private alternatives to government regulation and control, solving problems by relying on the strength of the competitive, entrepreneurial private sector.

The most important problems faced by middle-income working families today are not problems that arise from the nature of our economic system. Instead they are problems caused by outdated public policies. The basic structure of tax law, labor law, employee benefits law and a host of other institutions was formulated 50 or 60 years ago by policymakers who made assumptions about how life would be lived. From top to bottom, key public policies were based on the assumption that:

(1) Workers would work for the same employer throughout their work lives.
(2) Men and women would marry and stay married; and throughout their working years the husband would be a full-time worker and the wife would be a full-time homemaker.
(3) Workable social insurance (e.g., for unemployment, disability, illness etc.) could be managed by bureaucratic agencies because the consequences of individual choices are largely irrelevant, regardless of how perverse the incentives are.

Clearly, these assumptions no longer describe the world in which we live. Accordingly, institutions designed for the 20th century are unworkable and inadequate for the 21st century. Among the reforms that are needed: Employee benefits need to be personally owned and portable—traveling with the worker from job to job. In this respect, IRAs, 401(k) plans and Health Savings Accounts (HSAs) are all steps in the right direction.

More needs to be done.

Adjusting to a Mobile Labor Market

One of the remarkable changes in the workforce over the past several decades is the rise in labor force mobility. Today, workers have held an average of 10.5 different jobs by the time they reach age 40.[1] Traditional employee pension and health benefits are ill-suited for this environment.

Mobile Workers, Immobile Retirement Savings. Opportunities to save for retirement are very dependent on where people work—and whether they work.

Defined Benefit Pension Plans. Since World War II, the dominant form of retirement plan provided by employers has been the defined benefit pension. Employees acquire pension benefits based on their wages and years of service to the company. These plans work well for people who stay with the same employer, but they do not work well for employees who switch jobs. The reason: Under typical benefit formulas, workers sacrifice substantial benefits if they switch employers frequently throughout their career, even though they remain fully employed for their entire work lives and fully vested in every plan they enroll in.

Defined Contribution Plans. Unlike defined benefit plans, defined contribution plans such as 401(k)s and 403(b)s promise no specific benefit at retirement. The employee has ownership rights over the assets in a specific account and is entitled to the full accumulation. Unlike defined benefit pensions, these accounts are portable: They follow the worker from job to job.

Some complain that employees are ill-prepared to make the type of investment decisions made under the old system by professional managers. One answer is for workers to copy the investment choices of the defined benefit plans. Another criticism is that 401(k) holders are subject to stock market risk not encountered by defined benefit plan beneficiaries. However, the risk of defined benefit pension losses generated by job changes can be greater than the stock market risk assumed by 401(k) holders.[2]

There are a number of ways to make 401(k) plans work better. These reforms—initially developed and proposed by the National Center for Policy Analysis and the Brookings Institution and passed by Congress in 2006—include automatic enrollment of new employees in 401(k) plans, automatic escalation of contributions and diversified portfolios.[3]

Individual Retirement Accounts. Workers who do not have access to a 401(k) plan may make contributions to an Individual Retirement Account (IRA). However, the contribution limits are lower and there are also income limits. Participants in an employer-sponsored 401(k) plan can contribute up to $15,000, while nonparticipants can contribute only $4,000 ($5,000 if age 50 or older) to a tax-advantaged IRA (both Roth and traditional IRAs).

[1] "Number of Jobs Held, Labor Market Activity, and Earnings Growth among the Youngest Baby Boomers: Results from a Longitudinal Survey Summary," U.S. Department of Labor, Bureau of Labor Statistics, Press Release, August 25, 2006.

[2] James Poterba, Joshua Rauh, Steven Venti and David Wise, "Defined Contribution Plans, Defined Benefit Plans, and the Accumulation of Retirement Wealth," National Bureau of Economic Research, Working Paper No. 12597, October 2006.

[3] For more information, see John C. Goodman and Peter R. Orszag, "Retirement Savings Reforms on which the Left and the Right Can Agree," National Center for Policy Analysis, Brief Analysis No. 495, December 1, 2004.

Mobile Workers, Immobile Health Plans. Like the tax subsidies for retirement saving, tax relief for the purchase of health insurance also depends on where we work and whether we work. The federal government subsidizes employer-provided health insurance through the tax system. The employees avoid federal, state and local income taxes as well as payroll taxes. In some places, the government is effectively paying half the cost of the insurance.

The tax law is far less generous to people who must purchase insurance on their own, however. For this reason, more than 90 percent of people who have private insurance get it though an employer. The downside is that the health plan most of us have is not a plan that we chose; rather, it was selected by our employer. Even if we like our health plan, we could easily lose coverage because of the loss of a job, a change in employment or a decision by our employer.

Problem 1: Lack of Continuity of Insurance. Virtually all employer health insurance contracts last only 12 months. At the end of the year, the employer—in search of ways to reduce costs—may choose a different health plan or cease providing health insurance altogether.

Problem 2: Lack of Continuity of Care. Employees who switch jobs must also switch health plans. All too often that means changing doctors as well, since each health plan tends to have its own network.

Problem 3: Perverse Incentives for Employers and Employees. Some individuals have a family member (often a spouse or child) who has very high health care costs. When these workers compare job opportunities, they are primarily comparing health plans. To protect themselves from such potential hires, employers are increasingly altering their health plans to attract the healthy and avoid the sick.

Problem 4: Younger Spouses of Retirees on Medicare. When a husband retires and enrolls in Medicare, a younger wife may be left without coverage because underage spouses cannot enroll in Medicare. Until the wife qualifies for Medicare at age 65, the couple will have to purchase her insurance with after-tax dollars.

Problem 5: Federal Laws Designed to Encourage Portability Have Actually Outlawed It. Under the current system, employers cannot buy individually-owned insurance for their employees. Specifically, lawyers interpret the Health Insurance Portability and Accountability Act of 1996 (HIPAA) to say that the only employee health insurance employers can purchase with pretax dollars is group insurance.

Exception: Health Savings Accounts (HSAs). An interesting exception to these generalizations is the HSA. These accounts represent individual self-insurance and they are an alternative to third-party insurance. Unlike third-party insurance, HSAs are fully portable, traveling with the employee through the labor market. Moreover, they are a model of how the rest of the insurance arrangement may also become portable.

Solution: Tax Fairness. Health insurance and retirement savings choices have been distorted by a byzantine tax code that has long since lost its rational. In an ideal system, people would receive the same tax relief whether they save at home or at work, and whether they work or do not work.

Solution: Personal and Protable Benefits.[4] Just because employers pay all or most of the premium does not mean health insurance must necessarily be employer-specific. As an alternative, why can't employees enroll in health plans that meet their needs, and then be allowed to stay in those plans as they travel from job to job? Portable health insurance promises a continuing relationship with an insurer and, therefore, a continuing relationship with doctors and health facilities. It also means that people who are in a health plan they like can stay in it, without worrying whether they will be forced out of the plan by an employer's decision or by a change in employment.

Pension benefits should also be personal and portable. While the creation of 401(k)s has been a liberating development in this respect, vesting periods are still too long. Although Congress has made progress on lowering vesting requirements, beyond a nominal period (to accommodate administrative costs) there should be no such thing as unvested, tax-advantaged 401(k) contributions.[5] The principle should be: If there is a tax advantage, the benefit should belong to the worker.

[4] See John C. Goodman, "Employer Sponsored, Personal and Portable Health Insurance," *Health Affairs*, Vol. 25, No. 6, November/December 2006, pages 1,556–66.

[5] The Pension Protect Act of 2006 reduced the vesting period to 3 years for employer contributions to defined contribution plans, down from 5 years before the change.

Adjusting to the Entry of Women Into the Workforce [6]

The most significant economic and social change in the past half-century has been the movement of women into the labor market. Since the 1950s, the labor participation rate of women ages 25 to 55 years has increased more than 75 percent. Today, more than 60 percent of mothers with children under the age of six are working.[7] Families with both spouses in the labor market now constitute almost two-thirds of all married couples.[8] Yet the tax law, pension law, social insurance policies and laws governing employee benefits assume women never left the home.

Income and Payroll Taxes. Income taxes and payroll taxes favor families with a homemaker spouse over families with two working spouses. Consider what happens when a married woman enters the labor market:

- Even if she earns minimum wage, she is taxed at her husband's income tax rate; and even if her husband reaches the cap on Social Security taxes, she must still pay Social Security taxes on every dollar she earns up to the same maximum.
- Since she is entitled to half of her husband's Social Security benefit (and gets 100 percent after his death) whether she works or not, odds are that she will get little if any benefit from the payroll taxes she pays.
- Further, when all taxes and costs are considered (including the cost of child care and other services she was previously providing as a homemaker), a woman in a middle-income family can expect to keep only about 35 cents out of each dollar she earns.[9]

Pensions and Health Care. In contrast to most other developed countries, the United States encourages employers rather than government to provide such benefits as health insurance and pensions. Federal policies also encourage employers to provide life insurance, disability insurance and even day care for children. Not everyone is treated the same, however. The employer-sponsored benefit system has been structured from top to bottom to accommodate the single-earner family with a spouse and dependents at home:

- Because they are more likely to work part time, women are less likely to qualify for employer-provided benefits.
- Because they move from job to job and in and out of the labor market more frequently than men, women are more likely to be burdened by employee benefit programs that penalize job switching (such as lack of vesting in a pension plan).
- And when people acquire health insurance or save for retirement outside the workplace, the tax system is far less generous.

Because of federal policies, this system favors workers over nonworkers, full-time workers over part-time workers and long-term employment over job-switching and intermittent employment.

Child Care. Federal policies have resulted in a patchwork system of child care credits and exemptions that are arbitrary and unfair:

- While the tax law has a credit for child care expenses, the maximum credit for 2006 was only $1,050—well below most families' actual expenses. Further, there is no tax relief for uncompensated care provided by a relative, friend or family member.
- Parents lucky enough to work for an employer who provides a flexible spending account may set aside up to $5,000 of annual pretax wages to purchase child care services.
- Employers can provide an unlimited amount of day care on-site—all tax free; however, if the employer provides additional compensation to the employee to purchase day care services, the benefit is taxable.

Clearly this is not a system designed to accommodate the needs of a 21st century workforce.

---

[6] This section is largely based on Kimberley A. Strassel, Celeste Colgan and John C. Goodman, *Leaving Women Behind: Modern Families. Outdated Laws* (Lanham, MD.: Rowman and Littlefield, 2006).

[7] "Women in the Labor Force: A Databook," U.S. Department of Labor, Bureau of Labor Statistics, Report 985, May 2005, Table 7.

[8] "Women in the Labor Force: A Databook," U.S. Department of Labor, Bureau of Labor Statistics, Report 985, May 2005, Table 23.

[9] Assumes a 25 percent federal income tax, plus a 7.65 percent payroll tax, 7 percent state tax and 25 percent for "replacement services."

Labor Market Rigidities. Our institutions were not only designed for the full-time worker with a stay-at-home spouse, employers and employees find it difficult to make any other arrangement.

- Because of rigid tax laws and employee benefits laws, if both spouses work full time they will likely receive duplicate, unnecessary sets of benefits. The wife will be unable to acquire higher wages in return for forgoing health and pension benefits she acquires through her husband's employer.
- In a free labor market, one would expect to find a wide variety of work arrangements. Not every two-earner couple will want to work 40 hour weeks. Some might opt for 25 to 30 hour weeks so they can spend more time with each other or raising children. But rigid tax and employee benefits laws make such arrangements largely impossible for people who need health insurance, pensions and other benefits.
- Women raising children or caring for an ailing parent have other reasons to want flexibility in working hours. However, rigid labor laws may deny them the opportunity to attend a child's soccer game or take a parent to the doctor one week and make up the hours the following week.

Antiquated Social Insurance. Among its other shortcomings (see below), the unemployment insurance system makes few allowances for women who leave work to have a baby, care for a relative or relocate because of a change in their husband's job. For example, suppose a woman has been working for years, paying taxes into the system, but decides to leave her job to have a baby. In most states, she would receive no benefits during her time away from the workforce and she would also be denied benefits when she searches for a new job. If she does find a job, works for a month and then is laid off, she still won't qualify for benefits because all but nine states ignore the most recent three to six months of work when calculating eligibility for unemployment compensation.[10]

Soutions. Many changes are needed to bring aging institutions into sync with the way people are living their lives in the 21st century. Here are a few suggestions:

- All employee benefits should be personal and portable; they should be individually owned and travel with the worker as he or she moves from job to job.
- There should be a level playing field under the tax law, so that people who save for retirement or purchase health insurance, long-term care insurance, day care, etc., receive just as much tax relief as people who obtain these benefits at work.
- The tax system should not penalize two-earner couples; at a minimum, both spouses should be able to file completely separate tax returns.
- The employee benefit system should be flexible, making it easier for dual-earner couples to obtain higher wages rather than unneeded, duplicate benefits, and for part-time workers to accept lower wages in return for more valuable health and retirement benefits.
- Labor law should be flexible, making it easier for workers (especially parents with young children and caregivers for elderly parents) to choose alternatives to the traditional 40-hour work week.

Making Social Insurance Meet Individual Needs

Social insurance schemes managed by large, impersonal bureaucracies inevitably create perverse incentives for the individual beneficiaries. Sixty years ago there were only a limited number of options open to individuals, even if the incentives were perverse. For example, there were only a limited number of ways to spend health care dollars, even if someone else paid all the bills.

Today we potentially can spend the entire gross domestic product on diagnostic tests alone. As a result, individuals left unchecked to pursue their own interests can bankrupt a health insurance plan. Similar principles apply to the workers' compensation and unemployment insurance systems.

Dysfunctional Workers' Compensation Insurance.[11] State workers' compensation systems do not allow employers and employees to reap the rewards or bear the full financial costs of their individual behavior. Premiums are not fully ad-

[10] "Women, Low-Wage Workers and the Unemployment Compensation System: State Legislative Models for Change," 2003 revised edition, National Employment Law Project, October 1997, pages 3–4, 9.

[11] See N. Michael Helvacian, "Workers' Compensation: RX for Policy Reform," National Center for Policy Analysis, Policy Report No. 287, September 13, 2006.

justed for claims experience, and employers are not allowed to integrate employee health plans and workers' compensation medical coverage.

Most employer-sponsored health plans do not have first-dollar coverage or allow a completely free choice of physicians and facilities. The reason: There are significant savings from other types of plans. For companies that offer health benefits, the health plan presumably reflects the employees' implicit trade-off between wages and health insurance, since employers compete for labor by making their overall compensation package as attractive as possible. There should be no barrier to using the same health plans for workers' compensation claims. The failure to give employers and employees this option forces employees to take too much workers' compensation coverage and too little in wages and other benefits.

Employers should also be allowed to integrate wage-replacement benefits with their regular disability plans. Having the same waiting periods could provide direct financial incentives to workers for safe behavior and impose financial penalties for unsafe behavior. With their premium savings from selecting more limited conventional coverage, employers could establish Workers' Compensation Accounts (WCAs) for employees; individually-owned WCAs would be a form of self-insurance.

As a step in the right direction, employers should also be allowed to "opt out" of the statutory workers' compensation system. In Texas, firms employing almost one-fourth of the state's workers have chosen this option. These firms have fewer injuries, lower treatment costs and fewer sick days.

Dysfunctional Unemployment Insurance.[12] The unemployment insurance system encourages employers to lay off employees and discourages workers from seeking new jobs until their benefits are nearly exhausted. Part-time workers and those who change jobs frequently are taxed, but often are ineligible for benefits. Those who never make a claim receive no benefit in exchange for the taxes they pay.

The system encourages layoffs by shielding employers and workers from the true cost of such layoffs, since the tax rate paid by the employer is not fully adjusted for the cost to the system resulting from layoffs. Furthermore, because benefits for low-wage workers replace 50 percent or more of their previous pay, the loss of benefits upon reemployment acts as a 50 percent tax, acting as a powerful disincentive to find a new job.

The simplest solution is replacing unemployment insurance with personal employment accounts that are individually owned, totally portable and benefit workers even if they are never involuntarily unemployed. A portion of the payroll taxes paid would be put into investment accounts that workers own and control. People could withdraw funds from their accounts during periods of unemployment, and any unused funds would add to their retirement incomes.

Chile has implemented such a personal account system.[13] The accounts are funded by payroll taxes. Workers own their accounts, but prior to retirement they only withdraw funds when they are unemployed. Unlike the U.S. unemployment system, Chileans can draw the funds out even if they quit or were fired from their last jobs. This allows workers more flexibility in changing employment. Any unused funds in their accounts are their own money. Also, employers have incentives to provide steady, year-round employment since seasonal work is not artificially subsidized.

Antiquated Health Insurance for the Poor, Elderly and Disabled. The basic structure of Medicare and Medicaid closely resembles the Blue Cross plan it was modeled on more than 40 years ago. In the years since, private insurance has changed considerably. Our public insurance programs have changed little, or not at all.

Medicare enrollees are the only citizens in our society who must buy a second health plan (medigap) to fill the holes in the first. Many go on to buy a third plan (Medicare Part D) to fill the gaps in the first two. Paying three premiums to three plans is wasteful and inefficient. In fact, Medicare Part D would never have been necessary if Medicare and medigap had been combined efficiently into the type of comprehensive plans available to other Americans.[14] Medicaid is also replete with inefficiencies.[15] Although these programs do not directly affect the middle class, they serve as safety nets in case of loss of earning power, disability or old age.

---

[12] See William B. Conerly, "Unemployment Insurance in a Free Society," National Center for Policy Analysis, Policy Report No. 274, March 29, 2005.

[13] William B. Conerly, "Chile Leads the Way with Individual Unemployment Accounts," National Center for Policy Analysis, Brief Analysis No. 424, November 12, 2002.

[14] Mark E. Litow (Milliman & Robertson, Inc.), "Defined Contributions as an Option in Medicare," National Center for Policy Analysis, February 4, 2000.

[15] John C. Goodman, Michael Bond, Devon M. Herrick and Pamela Villarreal, "Opportunities for State Medicaid Reform," NCPA Policy Report No. 288, September 2006.

These programs are not only inefficient, they are on an unsustainable growth path. If the trend of the past 30 years is continued indefinitely into the future, spending on health care will crowd out every other government program at the federal, state and local level by the time today's college students reach the retirement age.[16]

We cannot get off this unsustainable path unless someone is forced to choose between health care and other uses of money. The only question is: Who will that someone be? Government? Employers? Insurers? Or patients and their families? The system is likely to work better for people if they make their own choices rather than relegating the power to choose to an impersonal bureaucracy. Moreover, if seniors, the poor and the disabled are to have access to the same care as the rest of the country, they must be part of the same health care system.

Chairman RANGEL. Our next panelist is Dr. Diane Rowland. She is the Executive Vice President of the Henry Kaiser Family Foundation and the Executive Director of the Kaiser Commission on Medicaid and the Uninsured.

In addition to other things, she has been at Bloomberg School of Public Health and John Hopkins University and is a noted authority on health policy, Medicare and Medicaid. She holds a bachelor's from Wellesley, a masters from the University of California, a doctorate at John Hopkins. Most importantly, she is a former staffer of the Subcommittee on Health and Environment of the Energy and Commerce Committee in the House of Representatives.

So, that is your outstanding background, and we appreciate your willingness to share your views with us.

STATEMENT OF DIANE ROWLAND, SC.D., EXECUTIVE VICE PRESIDENT, KAISER FAMILY FOUNDATION

Dr. ROWLAND. Thank you very much for having me, Mr. Chairman; and I also appreciate the Committee on Ways and Means, not just the Energy and Commerce Committee. I am pleased to be here today to discuss the impact of health care costs on the financial well-being of America's families.

We all know that health insurance coverage provides a valuable key to gain access to preventive and primary health care services as well as peace of mind and financial security for those facing serious illness. Today most non-elderly Americans depend on employer-sponsored group coverage for their health insurance. Yet for working families, employer-based coverage depends on where they work, the nature of their job, as well as what they earn. You are more likely to have coverage in large firms and firms with unionized workers than in small and low-wage firms. We also know that, unfortunately, the number of firms and the share of workers with employer-sponsored coverage has been declining in recent years.

In the absence of employer coverage, workers have few choices. Most have earnings putting them above the eligibility levels for public programs; and the non-group private market has high deductibles, coverage limits and pre-existing condition exclusions that make that a less than attractive option for many employees without access to employer-based coverage. As a result, millions of America's workers and their families are among our Nation's 46

[16] Laurence Kotlikoff and Christian Hagist, "Health Care Spending: What the Future Will Look Like," National Center for Policy Analysis, Policy Report No. 286, June 2006.

million uninsured. Nearly a quarter of the uninsured are from middle-class families.

When insurance is offered, it is increasingly becoming more unaffordable for low- and moderate-income families. At a cost of $11,500 for a family policy in 2006, the cost of employer-sponsored coverage now exceeds the full year salary of a minimum wage worker. Since 2000, the cumulative increase in health insurance premiums of 87 percent has far outstripped the 20 percent increase in employee wages; and the cost for coverage varies widely across the country, reflecting differences in the cost of medical care as well as the cost of living. Today, in New York City, the typical premium per family coverage in the small group market is now over $15,000 for a health maintenance organization (HMO) and nearly $20,000 for a preferred provider organization (PPO).

It is both the premiums they pay and the coverage they get that determines the financial burdens Americans face for health care. Policies with high deductibles and lower premiums may help from a premium perspective, but, unfortunately, too often shift the dollars saved on premiums to increased out-of-pocket costs for health care services. Many learn through an unexpected injury or serious illness that they are not well protected financially.

Underinsurance, not overinsurance, is a problem in America today, leaving one in six adults with substantial problems paying their medical bills. In 2003, one in four middle-class families had costs for health insurance and medical care that exceeded 10 percent of their disposable aftertax income. Those with chronic illness and those with non-group policies were at greatest risk for financial burden. These increasing health care costs contribute to increased medical debt and are a major cause of bankruptcy today.

To address the growing concern of American families as health care costs take an increasing share of their budget, we should consider ways to first make health insurance more affordable and available by lowering administrative overhead, introducing better information technology to the system, seeking better prices for services in the health care market, and eliminating some of the waste and duplication in our health care system.

We must also consider ways to provide financial assistance or broadened access to public coverage to help low- and middle-class families to obtain affordable coverage; and, finally, we need to promote good health practices and early access to preventive and primary health care services so that we can reduce health care costs by improving the health of American families, rather than shifting greater cost burdens onto them.

Thank you very much.

Chairman RANGEL. Thank you, Doctor.

[The prepared statement of Dr. Rowland follows:]

Statement of Diane Rowland, Sc.D., Executive Vice President, Kaiser Family Foundation

Introduction

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify today on the growing problems of rising health care costs and increasing gaps in health coverage as they affect middle class Americans. I am Diane Rowland, Executive Vice President of the Henry J. Kaiser Family Foundation and Executive Director of the Kaiser Commission on Medicaid and the Uninsured.

Health insurance coverage provides a valuable key to gain access to preventive and primary health care services, and peace of mind and financial security for those facing serious health care problems. Yet, a growing number of Americans—46 million in 2005 and increasing each year—lack health insurance to help them address their health care needs. Our growing uninsured population gets care later, if at all, and ends up sicker than those with coverage. The Institute of Medicine reports that lack of health insurance causes 18,000 unnecessary deaths each year. Leaving 46 million Americans without health coverage not only compromises their health but also puts a growing burden on our health care system and adds additional strain to our economy.

And, even for those with health coverage, rising premium costs, the increasing out-of-pocket costs from more limited coverage, and decreasing availability of employer-based coverage make obtaining and paying for health care an increasing financial burden. For many, health insurance coverage through the workplace now has higher deductibles and more cost-sharing as well as higher premiums. Access to health insurance and medical care that is affordable is becoming out of reach for more and more middle class families and contributing to our growing uninsured population.

My testimony today will focus on health care coverage, the growing burden of health care costs for America's families, and the challenge of making affordable coverage a reality for all Americans.

Health Coverage for Working Americans

While the elderly rely on Medicare for their health insurance coverage, most non-elderly Americans receive their health insurance protection through the workplace. Of the 257 million non-elderly Americans, 156 million (61% of the non-elderly population), are covered by employer-sponsored health insurance (Figure 1). Public coverage through Medicaid and SCHIP provide an important adjunct to employer-based coverage for low-income families, especially children, covering 16 percent of the non-elderly population.

The availability and affordability of employer based coverage varies widely by income, with higher-income families more likely to be covered by employer-based coverage than moderate or low-income families. Nearly 3 out of 4 (71%) of the 74 million middle-class non-elderly individuals—who I will define today as having incomes between 200 and 400 percent of the federal poverty level (about $41,000 to $82,000 for a family of 4 in 2007)—have employer sponsored coverage. Lower-income families (with incomes 100–199% of poverty, some of whom might actually consider themselves part of the middle class) have much lower levels of private coverage—only 39 percent have employer-based coverage—resulting in higher levels of uninsurance (30%) and greater reliance on public coverage (26%).

Lack of employer-based coverage and limited access to public coverage leaves nearly 11 million (14%) middle-income Americans uninsured. They account for nearly a quarter (23%) of the nation's 46 million uninsured although the majority of the uninsured have even lower incomes (Figure 2). In addition, like most of the nation's uninsured, the middle-class uninsured come from working families. In fact, 9 in 10 (91%) come from families with at least one full-time worker, but many of these workers are in jobs that do not offer health insurance coverage or where such coverage is unaffordable.

Availability and Affordability of Coverage

Over time, the availability of employer-sponsored coverage has been declining. From 2000 to 2006, the percentage of firms offering health coverage fell from 69 percent to 61 percent (Figure 3). The size and type of firm where an individual works and the nature of the job make a difference in whether or not health coverage is offered. Sixty percent (60%) of firms with fewer than 200 workers offer health insurance, while almost all large firms (98%) offer health coverage (Figure 4). Between 2000 and 2006, small firms accounted for a substantial share of the decrease in offer rates.

Firms with a high percentage of low-wage and part-time workers are less likely than higher-wage firms to offer health benefits, with only 4 in 10 such firms offering coverage. In addition, the presence of unionized workers increases the likelihood that a business will offer health insurance—87 percent of firms where there are at least some union workers offer coverage, compared to 60 percent of firms where there are no union workers. Certain industries such as agriculture, construction, and the service industry have higher than average rates of uninsured workers, even among the "white-collar" professionals and managers in the industry. For example, about 20% of management workers in the construction and service industries are uninsured.

When insurance is offered, it is becoming increasingly unaffordable for many. From 2000–2006, the cumulative increase in premiums for employer-sponsored insurance was 87 percent compared to a 20 percent increase in wages and 18 percent increase in overall inflation (Figure 5). Since 2000, the cumulative increase in premiums is over 4 times the increase in wages for non-supervisory employees. The average annual family premium reached $11,480 in 2006, and the average family contribution was $2,973 (Figure 6). This means a family earning $40,000 in 2006 would have to pay 7% of their pre-tax income for their share of health insurance premiums. At $11,480 per year, the full cost of family coverage now exceeds the full-year income of a minimum wage worker. In 2006, premiums grew twice as fast as wages and inflation. Even when premium increases have moderated over the last decade, the rise in health care costs and premiums has outpaced the growth in wage earnings, creating a growing gap between worker's income and the cost of health insurance (Figure 7).

Stability of Coverage

The combination of declining employer coverage and rising health costs has placed more and more middle-income families at risk of being uninsured and additional financial burden for health care on those with coverage. In the absence of employer-offered coverage both low- and middle-income workers are at risk of being uninsured, but they have few coverage options given the high cost and limitations in the non-group market and limited access to public coverage.[1] While Medicaid and SCHIP have helped to offset declines in employer-based coverage for low-income children, middle-income adults have not been able to avail themselves of this safety-net. Medicaid and SCHIP do not cover adults without dependent children, and the income levels for eligibility for parents in most states are far below the levels for children. In 24 states, a parent working full-time at minimum wage has an income too high to qualify for Medicaid (Figure 8).

Because public coverage offset employer coverage declines for children, all of the growth in the uninsured between 2000 and 2004 was among adults. Adults under 100 percent of poverty accounted for almost half of the growth in uninsured adults between 2000 and 2004, and over 20 percent of the growth was among near-poor adults (100–199% FPL), who some might classify as the lower middle class. However, middle-income adults contributed about a quarter (24%) of the growth, raising concern that loss of coverage is increasingly becoming a problem for the middle class (Figure 9). From 2004 to 2005, there was no significant change in the number or percentage of uninsured among those with incomes between 2–4 times the poverty level, due in part to the improving economy, but the lower middle class accounted for over three-quarters of the growth in the number of uninsured—comprising 1.0 million of the 1.3 million growth in that year. Unfortunately, 2005 also saw an increase in uninsured children for the first time in a decade as public coverage was unable to offset fully the loss of employer-based dependent coverage.

Employer-based coverage for the middle class is increasingly threatened. Between 2001 and 2005, the share of middle-income employees in firms with employer-based coverage dropped from 82.4 percent to 78.5 percent and, in turn, their uninsured rate grew from 13.4 percent to 16 percent (Figure 10). The decline in employer sponsorship of health benefits explained a quarter (26%) of the drop in job-based coverage; losses in eligibility accounted for 19 percent, and the loss of coverage as a dependent of another worker with job-based insurance explained another 25 percent (Figure 11). About a third (30%) of the decline in employer-sponsored coverage among middle-income employees was attributable to decreased participation by employees in the health plans offered to them. Other research indicates that cost is a large reason why employees decline health insurance—about half (52%) of uninsured employees eligible for their employment-based coverage reported they declined to take up the health benefits because it is too expensive.

The factors leading to decreased availability of employer-sponsored coverage—sponsorship, eligibility and take-up—noticeably affected the lowest-income employees, but are also more common among middle-income employees than those with the highest incomes. Lack of coverage in the workplace for a worker can be offset by a spouse's coverage. However, in 2005 about 13 percent of middle-income employees were not offered health benefits through their own or their spouse's employer, which is more than three times the rate (4%) among higher-income employees (Figure 12).

[1] Yu-Chu Shen and Sharon K. Long, "What's Driving the Downward Trend in Employer-Sponsored Insurance?" *Health Services Research* 41(6):2074–2096, December 2006.

The share of employees declining coverage decreases as income increases; a higher percentage of middle-income workers than higher-income workers declined health insurance benefits offered to them through an employer (8% vs. 4%).

Those without access to employer-sponsored health insurance or public coverage must look to the non-group insurance market for coverage, but unfortunately this market has not proven itself to be an attractive option for many uninsured people. Among those without an offer of coverage through an employer or public coverage, less than a quarter of the middle-income purchase non-group coverage (Figure 13). Some potential purchasers are excluded or charged higher premiums because they have preexisting medical conditions. When available, lower-cost products generally have high deductibles and coverage limitations, especially for maternity care or mental health services. The low percentage of middle-income adults who purchase non-group coverage underscores the limitations of the non-group market.

Scope of Coverage

While the availability of employer-sponsored coverage is declining and the premium costs are rising, the scope of medical care costs covered by insurance is also contributing to growing stress on family budgets. Health insurance policies do not provide complete "100 percent" coverage for health care needs. Depending on their policies, individuals with insurance can have to pay deductibles for physician or hospital services, copayments or cost-sharing for physician visits and other medical services, and pay additional amounts for using providers that are outside a plan's network.

Thus, even people who have insurance can face significant out-of-pocket costs. For example, data from the Kaiser/HRET 2006 Employer Health Benefits Survey shows that 12 percent of workers in PPOs who have deductibles are in plans with a deductible for single coverage of $1,000 or more and that about half of all covered workers are in plans that have cost-sharing in addition to the general deductible for people who are hospitalized. A recent study by Dana Goldman and others at the Rand Corporation looking at health plan data from 15 large employers from 2003 and 2004 found that more than 10 percent of patients with cancer had out-of-pocket expenses over $18,500 and 5 percent had out-of-pocket costs over $35,660, despite having private health coverage through their work.[2]

People's out-of-pocket liability may increase if new consumer directed health care designs gain favor in the market. About 7 percent of employers offering health benefits offered a consumer directed health plan in 2006, covering about 4 percent of all workers with employer-sponsored health insurance (Figure 14). These plans have significantly higher deductibles than traditional insurance arrangements and are more likely to assess coinsurance rather than fixed-dollar copayments for office visits and prescription drugs. In some cases this higher out-of-pocket liability is partially or fully offset by employer-contributions to employee health care savings arrangements, although 37 percent of employers offering HSA-qualified plans do not make contributions to HSA accounts established by their workers.

The movement toward "consumer-driven" health plans restructures insurance toward catastrophic coverage. Consumers face higher deductibles, making them more directly responsible for the purchase of their care and more sensitive to the price of services. The implications of these changes on consumer costs, out-of-pocket spending and access to care are just beginning to be assessed as the participation in these plans is still relatively low.

Medical Debt and the Financial Burden of Health Care

As the availability, affordability, stability and scope of health insurance decrease, far more of the middle class—both insured and uninsured—are now dealing with budget-consuming medical bills and debt. Researchers from AHRQ examined the financial burden of health care relative to family incomes over time. Financial burden was defined as having out-of-pocket expenses for health care services and insurance premiums that exceeded 10 percent of a family's disposable (or after-tax) income. They found that in 2003 almost 20 percent of the total nonelderly population had this level of health cost burden and that the financial burden for health care was heaviest for those with lower incomes (Figure 15). A third (33%) of the poor experienced such financial burden, compared to 10 percent of those in the highest income group (at or above 400% FPL). Nearly a quarter (23%) of middle-income Americans spent more than 10 percent of disposable income on health in 2003.

[2] D.Goldman et al, "Benefit Design and Specialty Drug Use," *Health Affairs* 25(5):1319–1331, Sept/Oct 2006.

The prevalence of high out-of-pocket costs increased significantly from 1996 to 2003, but the increase was particularly steep among the poor and those with middle incomes. In 1996, about 16 percent of the middle class had out-of-pocket health expenses that consumed at least 10 percent of their family income. By 2003, however, 23 percent of middle-income families experienced a financial burden from health care costs that exceeded 10 percent of family income, and about 6 percent had health costs that consumed over one-fifth of the family's disposable income. Essentially, financial burden for the middle class rose, placing them at the same risk for high burden in 2003 as those in the lower-middle class with incomes just above poverty.

The researchers also found that financial burden varied considerably depending on the type of health insurance a person has. Among those covered either by employer-sponsored insurance or public programs, about 19% had out-of-pocket health expenses that consumed at least 10% of their family income. In contrast, 53% of those with private non-group coverage were dealing with this high level of out-of-pocket health costs, and over 20% had even higher health care costs that consumed more than one-fifth of the family's disposable income (Figure 16). The authors note persons with non-group plans are nearly 3 times as likely to bear high total financial burdens for health care as individuals with public insurance or no coverage. Those with non-group coverage are at greater risk of financial burdens as a result of the combination of high premiums plus high out-of-pocket spending.

When the researchers assess how adequately the insurance coverage protects individuals from high out-of-pocket costs relative to income, the difference between employer-sponsored coverage and coverage in the non-group market is again striking. When premium costs are excluded to measure underinsurance, out-of-pocket expenses for medical services consume more than 10 percent of disposable income for 5.5 percent of those with employer-sponsored coverage compared to 12.9 percent of those with private non-group coverage.

Those who bear the greatest burden for health care are most likely to be those with serious illness or chronic conditions. The AHRQ researchers found that forty percent of persons with diabetes had out-of-pocket expenses that consumed more than 10% of their income in 2003, as did 56% of persons who experienced a stroke or other cerebral problem. Those with financial burdens incur high expenses largely due to hospital and prescription drug costs.

Likewise, cancer, the second leading cause of death in the United States, commonly poses financial burdens for families. A November 2006 USA Today/Kaiser/Harvard survey of households affected by cancer surveyed the financial impacts of cancer on families. Even though most (95%) reported being covered by insurance during their cancer treatment, the survey found that nearly half (46%) of people affected by cancer said the costs of care were a burden on their family, including one in six (17%) who said costs were a major burden. A quarter (25%) of all respondents—including those with health insurance—say they used up all or most of their savings as a result of the financial cost of dealing with cancer, and 11 percent were unable to pay for basic necessities like food, heat and housing.

It is clear that for many, health insurance alone is no longer a guarantee of financial protection from the costs of health care and financial stress when illness strikes. Today's higher premiums, deductibles, and copayments can create substantial financial burden for families, and many learn only through an unexpected serious injury or illness that they are not well-protected financially. Based on analysis of the 2003 Kaiser Health Insurance Survey, we found that one in six adults who are privately insured—17.6 million adults—report having substantial problems paying their medical bills.[3] Privately insured adults with medical debt are largely from middle-class families. Two-thirds of the privately-insured who have medical debt have family incomes between $20,000 and $75,000.

An important difference between the privately insured with medical bill problems and those without debt is their health status. Those with medical debt are almost twice as likely to have an ongoing or serious health problem compared to others with private coverage. Unfortunately, the privately-insured who have medical debt are also as likely as the uninsured to postpone care, skip recommended tests and treatments, and not fill drug prescriptions (Figure 17). This can lead to more serious illnesses, which are often more costly to treat than earlier interventions and contribute to more disability and premature death.

[3] Meaning that in the past year, they reported having either great difficulty paying their health care costs, had problems paying their medical bills in the past year, had changed their life significantly in order to pay medical bills, or had been contacted by a collection agency about medical bills.

Some families are turning to their credit cards to pay their medical bills and going into debt to pay for health care as a result. According to a newly released study by Demos and the Access Project, 29 percent of low- and middle-income households with credit card debt spanning at least three months reported that medical expenses contributed to their current level of credit card debt. One-fifth (20%) of those surveyed reported having a *major* medical expense in the past 3 years that contributed to their credit card debt. Households reporting that a recent major medical expense contributed to their debt had an average of $11,623 in unpaid credit card bills, which is almost $4,000 higher than the average amount for other indebted households. These mounting levels of personal indebtedness and the growing role of medical bills in bankruptcy proceedings point to the financial toll rising health care costs and limits on the scope of health insurance protection are taking on America's families.

The Public's Concern about Rising Health Care Costs

The research documents that health costs are becoming increasingly difficult for middle-class families to manage and eroding both health and financial security. Public opinion also bears out the research. Concern over rising health costs has mounted as many watch their health care premiums, deductibles, and copays rise. The increasing costs of health care—both premiums and out-of-pocket payments for health care—create financial insecurity for families. In a September 2006 public opinion poll, we found that 60 percent of adults with health insurance were worried about being able to afford the cost of their health insurance over the next few years, and almost a third (27%) was very worried.

In the same poll, 66 percent of adults with health insurance reported that their health insurance premiums are going up, and nearly a third (31%) felt their premiums were going up a lot. In addition, about half (48%) of adults with health insurance saw their copays and deductibles increasing, adding to their out-of-pocket costs. These findings held true when a subset of middle-income respondents (those with income $30,000-$49,999) was analyzed.

In a recent Kaiser Family Foundation public opinion poll, concerns about health care costs dominated the list of 13 possible issues the public is worried about (Figure 18). Almost half of the public (47%) was very worried about having to pay more for health care or insurance, and 39 percent said they were very worried they would not be able to afford the health care services they needed.

The public is worried about the impact of rising health costs on their family budgets and their lives, and many are looking to Congress for action. Seventy percent (70%) of the public, and a slightly higher percentage of middle-income respondents (75%), felt that health insurance premiums were unreasonably priced and that Congress should *try* to do something about the unreasonable cost of health care. In fact, about two-thirds (64%) of the public believes that health care costs are something Congress not only should—but *can*—do a lot about.

The Challenge Ahead

Health insurance provides families with an important source of financial security when illness strikes and helps to promote access to health care services that can often stave off more serious illness. Although the majority of non-elderly Americans receive health care coverage through their employer today, the availability and affordability of employer-based coverage is declining . . . putting more and more middle- and low-income working families at risk of being uninsured and without coverage for their health needs. For those with coverage, the value of that coverage has begun to erode as limits on the scope of coverage leave more and more insured Americans to face increased out-of-pocket costs when they seek care.

Rising costs for both health care services and insurance coverage are placing a heavy load on family budgets, businesses, and public programs. The financial burden resulting from these growing costs is already squeezing out good health practices, leading many to defer care due to costs and contributing to increases in the uninsured.

As Congress moves forward to address rising health care costs and their impact on America's families, it will be important to address not only the cost of health insurance but also the impact of any changes on reducing the uninsured population and promoting improved access to affordable care for all Americans. Shifting more costs onto consumers could further endanger access to care and financial security. The quality and scope of coverage and the availability of financial assistance to make coverage affordable for low- and middle-income families will determine whether the nation can provide affordable access to preventive and primary care as well as catastrophic health care for all Americans.

I appreciate the opportunity to testify before the committee today and welcome your questions. Thank you.

Chairman RANGEL. Our last witness that we look forward to hearing is Dr. Eugene Steuerle—is that the correct pronunciation?

Dr. STEUERLE. Steuerle.

Chairman RANGEL [continuing]. Who is an outstanding and nationally known tax expert. He has written several books. He has been president of the National Tax Association and, as I said, written special books with international interest and is well-known to this Congress and this Committee. I welcome you once again. I look forward to your testimony.

STATEMENT OF EUGENE STEUERLE, PH.D., SENIOR FELLOW, URBAN INSTITUTE

Dr. STEUERLE. Thank you, Mr. Chairman, Mr. McCrery, and Members of the Committee.

Ever since coming to this town in the mid-70s and appearing with the Treasury Department before the Committee on Ways and Means, I have stood in awe at the prestige and the history of this institution; and I would especially like to thank you, Mr. Chairman and Mr. McCrery, for restoring a longstanding tradition of trying to gather information before we jump in to try to examine policy solutions. I say this especially because at this point in time—I believe we are on the eve of a very different period in our fiscal history. The issues you are raising today are only among those that we face.

In my testimony, I would like to focus on the risks associated with the cost and availability of health insurance. I focus on this issue mainly because past Congresses have decided already how this Committee will meet many of its future economic challenges. In particular, the law now requires that a majority of the increases in revenues that you will receive to be spent on health programs that were designed yesterday. Figure 1 which is up on the monitor, displays this result.

Unfortunately, this precommitment has two major effects. First, it deters Congress and this Committee from doing very much about the new risks facing middle-income families; and, second, some aspects of the current policy are likely adding to risk, including the risk of being uninsured, rather than reducing them. To clarify these two effects, let me lay out very briefly some basic figures and facts.

The total amount spent on health care in the United States in 2006 was around $2.2 trillion. For households, total health spending was around $19,000 per household, with Government providing through direct expenditures and tax subsidies about $11,000 a year already. By about 2010, Government spending and tax subsidies are scheduled to grow by another $2,000 per household, to about $13,000 per household.

These Government benefits are distributed very, very unevenly. In many cases, they do not produce the health outcomes we want, and workers, particularly middle-income families with modest health insurance policies, get very little out of this package. Many of these additional expenditures and tax subsidies—that is, the scheduled increases—are so badly designed that they are likely to lead to an increase in the number of uninsured, largely among working families.

Now most of the data you have and most of the data we researchers have on income security tend to ignore this very large health insurance component of total income, although, if added in—I want to be clear about this—middle-class workers would still not have seen the income gains accrued at the very top of the income distribution.

Finally, among the retired, whom we often ignore when examining these middle-class issues, the typical middle-class couple now receives lifetime retirement and health benefits around 3/4 of a million dollars, growing to over a million dollars soon, but then they are encouraged to spend down these public and private assets long before they reach true old age, which adds to their risk in old age.

Now let me focus very briefly on one Government program, the tax subsidy for employer provided health insurance. This subsidy favors higher income over lower income employees, and it is most valuable to those who buy the most expensive health insurance. Even worse, the subsidy is open ended. Every year billions more are spent without a vote by Congress, and yet the extra subsidies most likely increase—that is right, increase rather than decrease—the number of uninsured people.

The President recently proposed to tackle this issue by proposing what is closer to an equal subsidy for everyone. There are a number of problems with his proposal, but we should agree to try to pursue a more equally distributed subsidy and one more likely to expand health insurance. Why not simply follow the logic of the reform and grant vouchers or tax credits of equal size to every adult and child? In addition, health savings accounts should not be favored—as in his proposal—over other forms of health insurance, and much stronger incentives are needed to deter people from signing up for insurance that is cheaper because it excludes sick people.

In sum, a properly designed voucher is a much better way of getting at so many of these issues than the existing tax exclusion.

In conclusion, meeting tomorrow's economic challenges requires that this Committee have budget flexibility. A very large portion of additional Government spending and tax subsidies is currently designed to go to health programs designed yesterday, squeezing other parts of the budget such as programs for children. In addition, within the health system itself, the additional amount spent on these tax subsidies and direct expenditures is sometimes adding to risk, including the risk of being uninsured, rather than reducing the risk.

Thank you.

Chairman RANGEL. Thank you so much, Doctor.

[The prepared statement of Dr. Steuerle follows:]

Statement of Eugene Steuerle, Ph.D., Senior Fellow, Urban Institute

The views expressed are those of the author and should not be attributed to the Urban Institute, its trustees, or its funders. Portions of this testimony are taken from the author's column, "Economic Perspective," in *Tax Notes* Magazine.

Mr. Chairman and Members of the Committee:

Thank you for the invitation to testify before you today on economic challenges facing middle-class families. I appreciate especially your effort to first gather information in a bipartisan way. Facts—the base on which we start—shouldn't have a political party. I am engaged with the Pew Foundation in a project that includes researchers from the Urban Institute, the Heritage Foundation, the Brookings Institution, and the American Enterprise Institute on a related topic: mapping the status of economic mobility. We will be glad to report those results to you as they become available.

Background on Income Distribution

The subject of this hearing is a difficult one. There are many things we do not understand about what is happening in the economy and, more specifically, to the middle class. It is fairly clear that, beginning in the late 1970s, income distribution has become more unequal, and that income at the very, very top—particularly among executives, the famous, and some professionals—has been growing significantly faster than income at most other income levels. Some explanations relate to the extraordinary economies of scale in fields such as entertainment, prescription drugs, and information technology.

But much else is also occurring. The growth in single-parent families, long correlated with poverty among the young, is changing family structure as we know it; single-adult families are more vulnerable to the whims of the labor market than are two-adult families. Recently, some aspects of life have become more risky and some less. To mention only two, some very recent mortgage-lending practices have put more middle-income families in danger of losing their housing. Yet, unemployment due to recessions has waned over the past three decades relative to most of our history.

In my testimony, I would like to focus on one of the major risks facing American families: the cost and availability of health insurance. Current law schedules Congress to spend more on health care than in any other area. Under Congressional Budget Office projections of current law, moreover, a majority of the increase in federal revenues that would accrue to government in the next 5 years would be spent on additional health expenditures and health tax subsidies (figure 1). Unfortunately, we are likely spending more on health care in a way that increases rather than decreases the number of insured. As a consequence, the way our health budget is evolving has two major effects:

(1) By absorbing most future revenue growth, health policy embedded in current law is deterring Congress from doing very much about the risks facing middle-class families;
(2) Within the health system itself, current policy is likely adding to risks—including the risks of being uninsured—rather than reducing them.

To clarify these two effects, let me lay out some basic figures and facts:

- Health goods and services now comprise one-sixth of the U.S. economy—perhaps soon one-fifth at current rates of growth. The total amount spent in 2006 was about $2.2 trillion, of which government provided about $1.3 trillion (figure 2).
- Per household, total health spending is about $19,000, while government subsidizes health care and health insurance to the tune of about $11,000 per household (figure 3).
- To cover $11,000 of costs per household, government effectively assesses taxes of $11,000 per household, although with deficits, some of those tax liabilities are passed on, with interest, to future generations (figure 3).
- Federal, state, and local governments in the United States spend as large a share of GDP and significantly more in real dollars on health care than most Western European governments with which they are often compared.
- There is little evidence we are getting much better health care for the much larger real dollar expenditures.
- By about 2010, government spending and tax subsidies are scheduled to grow in real terms by another $2,000 per household to about $13,000 or by more than $1/4 trillion when compared to 2006 (figure 4).

- These government benefits are distributed very, very unevenly. Workers, particularly middle-income families with modest health insurance packages, get very little. Benefits tend to go toward the elderly, those in high-cost states, and to higher-income workers with more expensive health plans.
- Many of these *additional* expenditures and tax subsidies—that is, the scheduled increases—are so badly designed that they likely lead to an increase in the number of uninsured, largely among working families.
- Most of the data reported on income security tend to ignore this large portion of total income. For instance, income of workers or retired individuals is often reported net of the value of health insurance policies.
- Even if added in, this additional income would not dispute the fact that, among the working-age population, the middle class has still not seen the income gains accruing at the very top of the income distribution.
- Among the retired, the issue is more complex. If health care is counted, the average household is now retiring with a Social Security and Medicare package that will pay benefits for more than a quarter of a century. If purchased out of a 401(k) account at age 65, the package would be worth more than $3/4 million, rising for retirees in 2030 to well over $1 million in today's dollars (figure 5). Cost-wise, newly retiring middle-class families are getting more and more benefits every year. Because so many benefits are paid to those in late middle age (that is, with significant remaining life expectancy), however, the truly old are often left in much more precarious circumstances.

The Tax Break for Employer-Provided Insurance

Let me now provide more details on the primary subsidy for middle-class families—the exclusion from tax of benefits provided through employer insurance. This tax break raises a number of concerns. The nation spends over $200 billion annually on tax subsidies for health and the number is rising fast. Nonetheless, 47 million people lack coverage. By any standard, we aren't getting our money's worth.

These tax subsidies favor higher-income over lower-income employees—and many poor people get no help at all. Higher-income households sometimes receive as much as $3,000 or more in reduced taxes for buying health insurance, while many moderate-income taxpayers get very little. The existing tax break is also most valuable to those who buy the most expensive insurance: the more one buys, the more subsidy one receives.

Even worse, the subsidy—like many health subsidies—is open-ended. Every year billions more are spent, without a vote by Congress or the public to spend money this way rather than some other way. According to one estimate, from about 2006 to 2010, the cost will grow by an extra $58 billion.

This extra money not only won't buy more insurance coverage, it most likely will increase the number of uninsured. The subsidy encourages insured people to buy more high-cost insurance, which encourages more use of high-cost health care, which helps drive up health costs, which, in turn, leads to a decline in insurance coverage. Many individuals and employers simply decline to pay those high-insurance costs.

Starting from scratch, it seems to me that almost no one would propose *spending more in this extremely regressive manner to increase the number of uninsured* and to encourage the excessive use of health care and health insurance. Yet that is exactly what the current system offers—only it takes place automatically and without a vote by Congress.

None of this suggests that determining how to spend federal dollars on health is easy. One can sometimes hide choices in a socialized bureaucracy so they aren't so apparent to the public, but that doesn't make them any easier. The primary problem is not that choices are hard, it's that automatic growth in health care spending programs prevents some hard choices from being made at all. As for the open-ended tax break for employer-provided health insurance, it is the largest federal tax break and it is also the largest health subsidy in the tax or expenditure systems for the non-elderly and non-disabled. Those facts alone make it worthy of attention.

The president recently proposed to tackle this issue by providing what is closer to an equal subsidy for everyone. At the same time, there would be no additional subsidy if we bought more expensive health insurance. He does this by suggesting a fairly significant tax break simply for buying some minimal policy, but otherwise taking away a tax break—as under current law—that is related to the amount of insurance we buy. I believe we should accept his call to improve both fairness and efficiency of the medical marketplace, but follow the challenge to its logical conclusion.

Once we agree on pursuing a more equally distributed subsidy and one more likely to expand insurance coverage, then we need to figure out how to amend his proposal to best achieve those goals. Yes, his proposal would give everyone the same income tax deduction as long as they purchased health insurance—that's fairer than current law. Social Security tax breaks would certainly be more evenly distributed. But because deductions are worth more the higher one's tax bracket, higher-income people could still get income and Social Security tax subsidies worth over $5,000 while many moderate-income workers could at best get about $2,300 in Social Security tax reduction. Some would do even worse. Thus, while the president's proposals would reduce the disparity in tax subsidies between rich and poor, it would not remove them. Why not simply follow the logic of the reform and grant vouchers or tax credits of equal size for every adult and child?

The efficiency of the subsidy must also be improved. As currently structured, the proposal would turn existing health subsidies upside down by granting an additional tax benefit only to those people who put money into something called Health Saving Accounts or HSAs. Effectively, individuals would be subsidized more if they did NOT join with others in an insurance pool to cover health costs over and above catastrophic amounts. Thus, a person enrolled in a health maintenance organization (HMO) could only get a tax deduction of $15,000. But someone enrolled in an HSA could get $15,000 *plus,* say, $3,000 put into the account—really a double deduction. This would discriminate against certain forms of insurance and favor those who could most easily come up with the cash or afford the risk associated with high deductibles. Whatever one thinks of HSAs, it goes against the original argument of HSA proponents for greater neutrality between expenses paid by an individual and those paid out of an insurance pool.

Much stronger incentives are also needed to deter people from signing up for insurance that is cheaper because it excludes sick people and those with chronic conditions. The Administration is willing to provide states some money to deal with these issues, but it wants to redistribute money that is already earmarked for health spending. It is unclear how much it could buy as a result. We need more work on this front.

A properly designed voucher is a much better vehicle for getting at so many of these issues. It can be extended to people who pay little or no tax, it can be integrated with state Medicaid and related children's insurance for the poor, and, if it were worth the same amount per person, it would be much easier to administer by employers and insurance companies alike.

Medicare and Medicaid

It may seem strange that in a hearing on economic challenges to the middle class, I would raise concerns with the direction of our direct spending programs as well—in particular, Medicare. Analysis of recent Congressional Budget Office data reveals that, under current law, revenues would increase by about $340 billion absent any increase in the cost of health tax subsidies. Because so much built-in growth is contained in health expenditures and tax subsidies, however, these existing programs by themselves would automatically absorb the majority of that growth (figure 1).

This, of course, leaves the Congress—and, in particular, the Ways and Means Committee—little flexibility to determine how to allocate additional revenues to meet the most important needs of the nation, including new risks to the middle class. Existing health policy essentially has put this Committee in a straightjacket. The odds that programs designed years ago would efficiently and fairly meet the needs of tomorrow—before tomorrow has arrived—is slim indeed.

It is not just that there is reduced flexibility to meet non-health needs or to reduce associated risks. The growth in existing health spending programs and tax subsidies consumes resources that might otherwise go to expanding coverage for the uninsured, achieving 100 percent immunization rates, enhancing frail-elderly services, or increasing the budget of the Centers for Disease Control and Prevention. Two or 3 years' worth of Medicare growth could pay for a decent health insurance package for all children, and a few years' worth of growth in the tax subsidies for health insurance, which mainly benefit higher-earning employees, could pay for a modest credit for insurance for households at all income levels.

In addition, the retirement from the workforce of such a large portion of our population significantly reduces revenues to government and puts much additional tax pressure on middle-class families to make up the difference. Meanwhile, since middle-class couples retiring on Social Security and Medicare can now expect benefits for well over two decades, they effectively spend down much of their public and private assets long before they reach old age, as defined by a short remaining life expectancy and larger health needs.

Conclusion

Middle-class families do face many economic challenges. Some risks have been reduced and some increased. An extremely important question is whether past government tax and expenditure policy can be taken off of autopilot and redirected to help meet the needs of today and tomorrow in the fairest and most efficient way possible.

A very large portion of additional government spending and tax subsidies is already destined under current law to go toward the provision of health care. By absorbing so much of future revenue growth, they deter Congress from doing very much about new risks facing middle-class families. In addition, within the health system itself, some of the additional amount spent on these tax subsidies and direct expenditures are likely adding to risks—including the risks of being uninsured—rather than reducing them.

Figure 1: How Future Increases in Revenue Have Already Been Spent on Healthcare

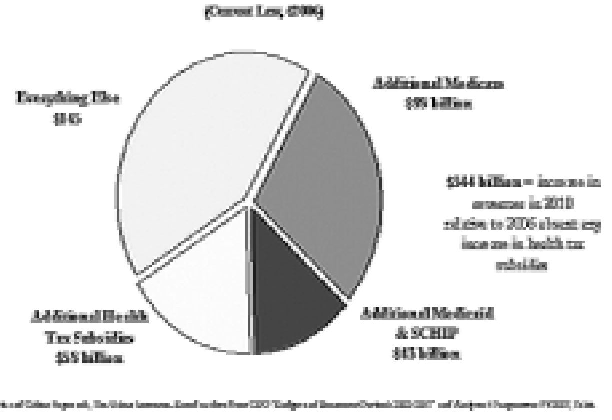


Figure 2: Estimated Sources of Financing for U.S. Health Care Expenditures, Calendar Year 2006
(Total = $2.22 Trillion, Government Sources = $1.28 Trillion)

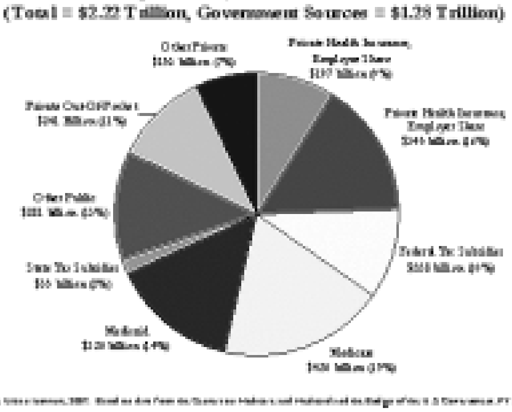


Figure 3: Average Health Care Costs Per Household By Source, 2006
(Total = [illegible]; through Government = [illegible])

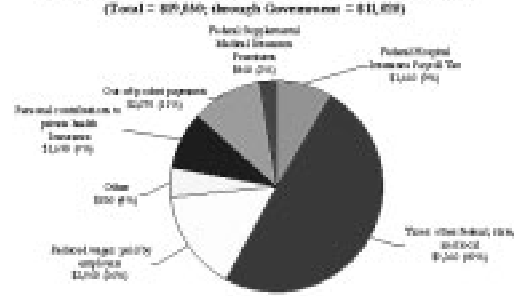


Figure 4: Total Government Expenditures & Tax Subsidies for Health Care, Per Household

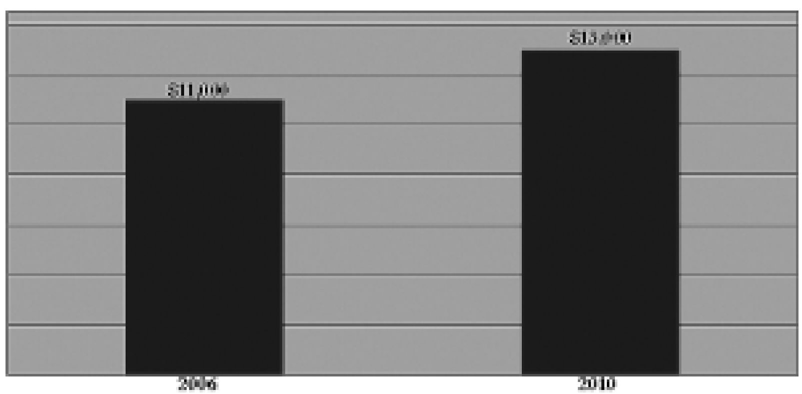
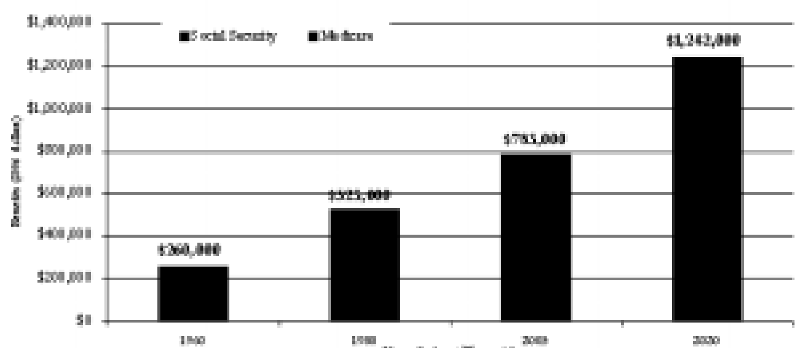


Figure 5: Lifetime Social Security and Medicare Benefits*
-- Average-Wage, Two-Earner Couple ($37.8K each) --



Chairman RANGEL. Let me thank this entire panel. The wisdom that you bring to this issue cannot be fully appreciated in 5 minutes, no matter how much time it took for you to prepare your remarks; and the Ranking Member and I were hoping that you might consider joining with us on these different subject matters in a seminar where we are not talking about 5 minutes.

We are talking about learning, debating, discussing and trying to come up, as a result of you knowing the problems so well, in assisting us in fulfilling our responsibility in a bipartisan way of trying to find solutions to some of these very complicated issues.

To the Executive Director of the CBO, we have had three hearings before this, and it was abundantly clear that ignoring the problems that the poor have and the middle class have ultimately is going to be very costly as it relates to the budget. With the restrictions that we have on our budget in terms of pay-as-you-go (PAYGO) and priorities and the war, how would you suggest that the Congress fulfill its responsibility and, at the same time, finds some way within our budget rules to pay for these things?

It has been reported that we have millions of kids that drop out of high school every year and that this group of people, once they leave the school, they have no alternative, there is no door open to them.

In addition to that, the school system seems destined to be preparing kids for college, but if they don't make college, they don't make anything.

It has been reported that—because of gun violence—that they are very expensive in terms of health care for those that survive, that half of them end up in jail, half of them are ineligible to join the military, and then the long and short of it, forgetting the compassion, they are very, very expensive and costly in terms of economic recovery.

Clearly, it is not perceived to be a priority, but most economists believe that we just cannot ignore that or the price, the costly price that the poor pay by not having access to health care, education, unemployability. While everyone agrees we should do something, what recommendation could you make that this Committee could consider, recognizing the budget constraints we have to work with?

Dr. ORSZAG. Well, obviously, we are very careful not to make recommendations, but we would be happy to provide options. Next month we will be coming out with a budget options volume that will provide potential offsets for new investments that you may want to make.

I would note that there is a variety of work—Mr. Steuerle mentioned one possibility. There are various options for retargeting both the tax incentives and spending programs that already exist. So, Dr. Steuerle mentioned one possibility in terms of the incentive that we provide for health insurance and whether that could be retargeted, in his view, in a more auspicious manner. There are many, many options that exist for taking the investments or the tax incentives that already exist and better targeting them to where you would like, as policymakers, to put them.

Chairman RANGEL. Well, let me thank you. I hope you can get the tax jurisdiction recommendations to us so that, without violating the restrictions that you work against, that we would have a heads-up to how we can organize our hearings to take advantage of some of the options that you may recommend.

I yield to Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

I want to add my thanks to the panel, excellent panel again today. We appreciate very much your taking time to come share with us your knowledge and thoughts on these important subjects.

Dr. Orszag, you mentioned there are ways we could redirect or reallocate current tax expenditures to different recipients that might be more efficacious in terms of getting health insurance in to families that don't have it and so forth. Isn't the President's proposal along that line, the one that he announced in the State of the Union address?

Dr. ORSZAG. I think that the President's proposal has elements of this kind of idea, and I would note that there are parts of it that I think are consistent with what sort of the broad analytical community believes is the right way forward. As Dr. Steuerle mentioned, there are other ways of tweaking it that might make it more effective in terms of the traditional objectives of outside analysts promoting health insurance coverage and fairness and efficiency.

Mr. MCCRERY. I appreciate your answer, because I think some people have a knee-jerk reaction to whatever the President proposes, and I was sorry to hear some say that his idea wouldn't even get a hearing or see the light of day in the Congress. I think that is shortsighted and not conducive to a broad inspection of what we have at our fingertips to deal with to solve this problem.

The President's proposal, I like. I think it is a step in the right direction.

I would go much further along the lines that Dr. Steuerle talked about. If we look at the tax expenditures that we do now in health care, they are not very equally distributed. They are extremely tilted toward people who make very comfortable incomes and don't do a whole lot, in my view, to encourage people of low or moderate income that don't have insurance to purchase insurance. In fact, they do nothing to encourage people to purchase health insurance.

So, in my view, we ought to embrace at least the President's willingness to approach this subject of the reallocation of the tax expenditures and then see how we might all differ in the particulars, but certainly not reject a hearing of that approach.

In terms of the income inequality, income gap that was talked about a lot today, I guess, Dr. Goodman and Dr. Hacker, I would ask you, is it as valuable a tool in examining what is really happening in our population in the United States to look at not only income but consumption data? It is quite different. The gap is considerably less in consumption than it is in income. So, there has got to be some explanation for that, and maybe we should explore the consumption data as well as the income data when we are talking about this gap that exists. Do you have any comments on that, Dr. Hacker?

Dr. HACKER. I will say very briefly that I think they are two very different perspectives on inequality, and I would argue that you shouldn't privilege one over the other. It is indeed the case that inequality of consumption is less dramatic than inequality of income, but it should be noted—and here I am referring to a very nice paper that was done by an economist named Timothy

Smeating called Inequality Through the Prism of Consumption and Income in which he looked at the trends in both consumption and income inequality.

What was interesting is, while consumption inequality is less than income inequality, the trend is surprisingly similar. They both have risen, in other words. The consumption data he points out, too, have some gaps in them that raise questions about their ability to—particularly for hiring very high-income people to look at their consumption pattern. So, I only note that these are really two different perspectives.

I do think it is worth noting that, to the extent that lower—and middle-income people—particularly lower income people—are spending much more than they earn, that does raise concerns about whether people are going into debt to maintain their standard of living. So, I think that it may push our—if we look at the consumption data, it may push our perspective toward asking, how can we provide new kinds of savings instead of new tools for lower—and middle-income people?

Mr. MCCRERY. That is certainly a legitimate point of inquiry.

Dr. Goodman.

Dr. GOODMAN. A very good book by Alan Reynolds I think that just came out last month that went into all different kinds of ways you can compare standards of living and income amongst the different population groups, and worth looking at. One of the things Dr. Reynolds points out is that so many of the comparisons of income growth over time between different population groups ignore transfer payments which means they are ignoring Social Security, they are ignoring income support programs. So, for many, many people, that is a very important source of income.

You are right. There is far more equality of consumption than there is of income, and maybe at the end of the day that is what matters more.

Mr. MCCRERY. Thank you.

Thank you, Mr. Chairman.

Chairman RANGEL. Thank you.

Mr. Stark.

Mr. STARK. Thank you, Mr. Chairman.

I thank the panel for joining us in one of these series of hearings that the Chairman has called which I think are very, very important.

Several of you in your testimony discussed, in reference to the President's proposed tax health care for everybody plan, that there was indeed a certain amount of tax fairness, that having tax-free income or tax-free benefits in the form of health benefits is an advantage that may not be enjoyed by all. I would like to ask the panel if there is anyone who would suggest to me that having equity in a home by virtue of the mortgage interest deduction is more important to the quality of life than having medical care. Would any of you want to take that side of the question?

I assume by the silence of the panel that you all think that perhaps medical care would be more important to our quality of life than building up equity their home. Is that a fair assumption? Anybody want to raise their hand or nod? You can all put your heads on the table. I won't tell.

So, I guess I ask that just to suggest that we put away this argument about the fact that there is a terrible tax inequity that I get my health insurance benefits from the Federal Government as a tax-free benefit. I also get to deduct the interest that I pay on my mortgage, and if we are going to start picking and choosing, I think we can look at the Tax Code as hosting a whole lot of inequities, and I hope we wouldn't just pick on health care for that.

Further, I wanted to suggest that, in the question of consumption, just to add in that it hardly seems to me that the ability through accumulation of assets to fund children's and grandchildren's college education to the tune of $40,000 or $50,000 a year per child or grandchild isn't a grand distinction between people with huge incomes and people with modest incomes. So, that when you start comparing consumption and income I think you have to be careful going down that road. I think there are different ways to——

I wanted to ask Dr. Hacker, who has come up with a brilliant plan for insuring all Americans. I think he calls it the Health Care for America Plan. I wonder if you would describe why you think that plan is the best way to solve our problem for universal health care, aside from the fact that it was supported by Congressman Levin back in 1993 and 1994 when he was instrumental in helping Mrs. Clinton write the bill. Are there other reasons, Dr. Hacker, that you would suggest?

Dr. HACKER. Besides the fact that your own proposal very closely follows the details of this proposal, that would be another piece of argument in favor for what I believe. The Health Care for America Plan, which was recently introduced by me through the Economic Policy Institute's Agenda for Shared Prosperity Project, is an attempt to try to propose a politically feasible, reasonable way of achieving universal coverage and health security in the United States by building on the best aspects of the President's system, namely, employment-based coverage for higher income workers that pools risk broadly and a Medicare Program which has done an admirable job in keeping administrative costs down and restraining cost increases within the program.

It does not simply expand Medicare. It creates a new Health Care for America Plan modeled after Medicare, but it essentially gives employers the choice of either providing coverage on their own that is comparable to this new option or to paying a reasonable—in my proposal's case—payroll-based contribution to enroll their workers in this proposal.

I want to say why I think this has several virtues. One, it really addresses this question and problem of affordability that we have been talking about. The fact is, is that the only way that we have effectively addressed cost increases in the past is through the restraint of price increases within the Medicare Program.

It has—between 1970 and 2002, it grew about 40 percent slower over that period for the same services as private insurance. It has much lower administrative costs, and it is done much better even than that longer track record, which suggests since the mid-eighties—there is no question in my mind if under this proposal you had a substantial share of Americans in the new Medicare-like plan, it would be even more effective in controlling cost, thus being able to guarantee a defined package of benefits, rather than giving people a voucher that might not be able to cover the whole cost of insurance.

Mr. STARK. Did you bring some copies of your book that you might offer to the audience and autograph?

Thank you.

Dr. HACKER. I did not.

Thank you very much.

Chairman RANGEL. The Chair recognizes Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman.

Dr. Goodman, concerning these retirement plans, some have criticized the move from defined benefit to defined contribution because they fear it shifts risk to the employees who are less well suited to bear those risks than the employers. Why do you disagree? I know you have made a comment earlier in your statement. Would you go into that a little bit?

Dr. GOODMAN. Yes. A lot of people don't understand how the defined benefit pensions work, but, basically, they are back-end loaded. What that means is that the last year you work for the employer is worth a lot more for pension benefits than the first year, but if you don't stay with the employer for the whole 4 years—let's say you work for 10 years for an employer, and then you move to another employer with an identical defined benefit pension plan, work another 10 years but get vested in that plan and go to a third and fourth, so you divide your 40-year work life into four employers. You will cut your pension benefits in half, even though you are in an identical plan with all four workers.

So, that is what I meant earlier when I said the job switching costs thousands of dollars of benefits. That is not a good pension plan if you have a mobile labor market.

So, I think we need retirement savings, pension plans that are consistent with a very mobile labor market. That is why I said I think the benefits ought to be personal and portable. The benefits ought to travel with the worker.

Mr. HERGER. We are seeing more of that. Our economy today is more of a dynamic economy that we live in that unlike maybe during the fifties or mid 1900s where people would stay with their job their entire lifetime, we are seeing more of a mobile force that is moving. Is that not correct?

Dr. GOODMAN. I think we are, yes.

Mr. HERGER. Would anyone else like to comment on that?

Dr. HACKER. I would only just say one quick note, which is that these are not either or choices. It is true that defined benefit pensions don't often serve a highly mobile work force and that they also have risks. As Dr. Goodman said, for example, if firms go bankrupt, Congress has of course tried to deal with some of these risks and tried to address some more recently with the pension protection act.

I do want to say, though, that there is a fundamental feature of defined benefit pensions that is very difficult to get in the private market today and it is quite important and that is the ability, the ease with which defined benefit pensions offer a guaranteed benefit in retirement, an annuity if you will. So, one of the fundamental issues with defined contribution plans is it is generally the case that people do not turn that money into a defined benefit for the remainder of their lives. So, one thing to think about is how to make it easier for people to annuitize their benefits because that is a risk that is often not fully recognized by workers.

Mr. HERGER. Thank you. Yes, Doctor.

Dr. STEUERLE. Mr. Herger, if I could respond to you and Mr. Stark, as well, with respect to the pension question. Currently, the tax subsidies for pensions are estimated to be on the order of about $150 billion per year. The personal saving rate in the United States is zero. That means we are spending $150 billion without necessarily getting very much at all in the way of savings. Of course, there are a variety of reasons, one of which is the way these subsidies are designed. We can get the subsidy without doing any saving at all. Most of the people in this room have figured that out because you can borrow with one hand and put money in a pension account with the other and generate huge tax savings without doing additional savings. So, that is among the games that are going on.

There are all sorts of issues like this such as in pensions and other areas where you designed programs decades ago. Mr. Goodman mentioned what is happening with the changing status of the family, but there is also the issue of how to bring older workers into the work force.

The old traditional defined benefit plan had a lot of good features to it, such as annuitization, but for instance, it discriminated enormously against older workers—not just younger workers, but older workers. Why, because you often peaked out on these plans and you started accruing literally negative benefits if you stayed with the plan.

If you don't believe this, go to your local government officials and ask what has happened to teachers and fire persons and other local officials where they accrue negative benefits if they stay on the job.

So, there is a lot of work that we need to do in all these areas. We need to bring the best features of what we had in the past as well as accommodate the needs of the future.

Mr. HERGER. I thank you, and again, Mr. Chairman, I thank you for having this hearing on a very important issue. Thank you.

Chairman RANGEL. Thank you very much. The Chair would like to recognize Mr. Thompson of California.

Mr. THOMPSON. Thank you, Mr. Chairman. I apologize for stepping out. There was a budget meeting I had to attend. I would be interested in hearing from the panel Members their understanding of the impact that this phenomenon—that sandwich generation of folks who are having to care for elderly parents as well as children.

What sort of impact is that going to have both on people's daily living pressures as well as their ability to save and plan for the future?

Dr. GOODMAN. Well, I will comment generally on it. It means that you move out of this traditional idea that you are going to have a full-time place in the work force. People need flexibility to care for children and to care for parents. They might want to combine the care time with a part-time job.

We have an employee benefit system and we have a labor law system that is very unkind to part-time workers. It is all designed around the idea that you will have a full-time relationship with an employer.

So, we need flexibility in employee benefits law and we need for employers to be able to give workers choices between benefits and taxable wages, and we need to have that, or we are not going to be able to accommodate all the many different things that families are going to want to do to deal with those problems.

Dr. ROWLAND. Mr. Thompson, we can't just solve that problem in the workplace. One of the big issues we have is very limited assistance to families who have long-term care needs. We often leave people in the community without any ability to get the kind of in-home assistance they need. We really need to develop a better set of policies that go beyond acute medical care to help with the chronic illness, which is facing more and more of our elderly population.

So, the work force issue is not just an issue for women, it is an issue for whole families where there is no longer any ability to get even the kind of workers in the home that could take care of providing the needs of long-term care services.

Mr. THOMPSON. Is there a way to identify the economic impact that is going to have in a more macro sense?

Dr. ROWLAND. Well, we do surveys of informal care giving and the economic impact of the family having to contribute that without any assistance and we can certainly get back to you with some studies on what the impact is on the overall economy of the family.

Mr. THOMPSON. Anybody else?

Dr. STEUERLE. I testified yesterday before the Senate Budget Committee on a related matter, which was how our particular design of old age programs now work against helping people in old age. To give you an example, in Social Security now, only about 35 percent of benefits are paid to people with less than 10 years of life expectancy. That is, this system has morphed into a middle-age retirement system where benefits are paid to the average couple for 26 years, yet a smaller and smaller share of benefits is available to help them in old age.

So, regardless of the tax rate that this Committee or the Congress may decide it wants to compromise on for some eventual Social Security system, there is still the issue of the ages at which you would want to concentrate the benefits then that this tax rate would support, whether it is a higher rate or lower rate.

I would suggest very strongly we want more of those benefits in older age so we could provide more of the type of protections for the types of risk issues you are talking about today.

I would also mention, by the way, that if we could get people to work longer, it would add revenues to our system. We are going to a system where we are scheduling close to one-third of adults to be on Social Security. When you start subsidizing that many people for that long a period of time and getting them out of the labor force, you lose revenues.

Again, at any tax rate, if we can work on improving the system so that people work longer, we can concentrate not only more benefits in old age, but we can have a higher package of lifetime benefits because there would be more revenues available to the system.

Mr. THOMPSON. I don't have much time left, but I would like to touch on the issue of health care needs quickly, on affordability of health care.

I would like to hear your impression as to how that is going to impact middle class families, and at the same time, what the President's proposal for the tax deduction how that is going to affect or how is it going to impact middle class families and their ability to purchase health care.

Dr. ROWLAND. Well, clearly, we know that the economic burden of health care is growing for families, especially for middle class families. A study just completed by the Federal Agency for Health Research and Quality shows that in 1996, about 16 percent of middle income families faced financial burdens for health care that exceeded 10 percent of their disposable income. By 2003, that had risen to 23 percent of middle class families.

So, we are clearly seeing a growing economic burden not just for health insurance premiums, but for the related out of pocket expenses that families face when they go to use a doctor or when they enter a hospital.

I think that one of the concerns that one might have in looking at the President's proposal is that many of our middle class and lower income families are facing becoming uninsured. Getting insurance is the most important aspect to their having the financial means to obtain health care services and the President's proposal does relatively little to expand the uninsured population into the insured population.

By the Administration's estimates, roughly 3 million people who are uninsured today might gain insurance.

It could also lead in some cases with its incentives toward going to the nongroup market to individuals losing employer-based coverage.

So, for the middle class and the lower income working class, I think we really need to look at making insurance generally more available and more affordable and I don't think we can get as far as we could through tax policy as with other methods.

Mr. THOMPSON. Thank you. My time has expired, but maybe on the second round we can continue on the issue of health care.

Chairman RANGEL. I may have some bad news in terms of the second round, because I have just been advised that the cloakrooms expect three votes and that should take a total with the 15, 5 and 5 of 30 minutes. Then I am also advised that we could possibly expect a series of procedural votes.

Now, we can't ask these witnesses to stay beyond 30 minutes. I was just consulting with the Ranking Member to see whether it would make any sense, since the following—excuse me, panel—since the following procedural votes probably would take 15 minutes apiece.

If we did that, I would like to know how many of the Members that are here would try to make it back and forth within the 15 minutes, and then I would, if there was sufficient number, by putting up your hand.

Now what we would attempt to, with the panel's consent, is to adjourn for a half-hour, and then promise you that we would be coming back. You won't have the full number of people here, but we would do the best we can. I ask your indulgences, but more important than what happens today, it is abundantly clear to all of us that we are going to need you to come and sit with us without the mike, without the 5-minute rule and help us think our way through as to what we can do, because it is abundantly clear that all of us recognize the problem, but your expertise has been clarified, but we need your help as to where we end up, Mr. McCrery.

Okay, Sandy.

Mr. LEVIN. All right, quickly on health, and again, welcome, Dr. Steuerle. In your testimony, you say these tax subsidies favor higher income over lower income employees. It would be helpful if you and others could provide a profile, data, because I do think, it is my guess that the majority of the tax subsidy—and this is going for people who are employed—go for people who would be called in the range of middle income families. I think it is true that those who are under contracts with more comprehensive benefits earn more than low income families, but still, I think they would consider themselves very much middle class families.

[The information follows:]

Table T07-0058
Current Law Tax Benefits for Health Insurance
Distribution of Subsidies by Cash Income Class, 2017[1]
Nondependent Tax Units with Head or Spouse Under 65

Cash Income Class (thousands of 2006 dollars)[2]	Percent with Priv. Health Insurance[3]	Average Premium ($): All Insured Tax Units	Average Premium ($): Tax Units with ESI Only	Average Premium ($): Tax Units with PNG Only	Average Subsidy ($): All Insured Tax Units	Average Subsidy ($): Tax Units with ESI Only	Average Subsidy ($): Tax Units with PNG Only	Subsidy as a Percent of Premium: All Insured Tax Units	Subsidy as a Percent of Premium: Tax Units with ESI Only	Subsidy as a Percent of Premium: Tax Units with PNG Only	Premium as a Percent of Income[4]: All Insured Tax Units	Premium as a Percent of Income[4]: Tax Units with ESI Only	Premium as a Percent of Income[4]: Tax Units with PNG Only	After-Tax Premium as a Percent of Income[5]: All Insured Tax Units	After-Tax Premium as a Percent of Income[5]: Tax Units with ESI Only	After-Tax Premium as a Percent of Income[5]: Tax Units with PNG Only
Less than 10	24.1	7,529	6,832	9,862	555	713	1	7.4	10.4	0.0	70.5	57.6	145.7	65.3	51.6	145.7
10-20	37.4	9,626	9,232	9,754	1,842	2,167	32	19.1	23.4	0.3	37.2	34.3	50.1	30.1	26.2	49.9
20-30	55.7	11,460	11,143	11,757	2,951	3,308	91	25.8	29.7	0.8	28.8	27.3	37.2	21.4	19.2	36.9
30-40	69.5	12,565	12,142	12,455	3,430	3,661	193	27.3	30.2	1.6	23.4	22.3	28.2	17.0	15.6	27.7
40-50	75.5	13,113	12,785	12,604	3,916	4,167	186	29.9	32.6	1.5	19.5	18.8	22.2	13.7	12.7	21.9
50-75	86.1	15,029	14,538	12,440	5,019	5,217	427	33.4	35.9	3.4	16.6	16.8	15.9	11.1	10.2	15.4
75-100	91.9	17,627	17,159	13,912	6,298	6,568	682	35.7	38.3	4.9	14.1	13.7	12.7	9.1	8.4	12.1
100-200	94.5	20,194	19,731	14,924	7,395	7,710	641	36.6	39.1	4.3	10.5	10.3	8.6	6.7	6.2	8.2
200-500	96.2	21,334	20,906	14,825	7,897	8,187	1,684	37.0	39.2	11.4	5.7	5.5	4.8	3.6	3.4	5.6
500-1,000	95.1	19,555	19,260	14,575	7,808	8,099	3,538	39.9	42.0	24.2	2.2	2.2	1.7	1.3	1.3	1.3
More than 1,000	94.6	19,415	19,085	15,790	7,690	7,938	4,158	39.6	41.5	26.3	0.5	0.5	0.5	0.3	0.3	0.4
All	69.8	15,506	15,194	12,199	5,062	5,400	378	32.6	35.5	3.1	11.2	10.7	12.5	7.6	6.9	11.9

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).

(1) Calendar year. Benefits are calculated as the change in tax liability between a baseline of current law modified to include pre-tax employer sponsored health insurance premiums in taxable compensation, to disallow the self-employed health insurance deduction, and to disallow the itemized deduction for medical expenses for all except Medicare beneficiaries, and an alternative consisting of current law. Following convention, the estimates are static and do not incorporate behavioral responses. In particular, they do not account for the gains of those who newly obtain health insurance, the losses of those who lose coverage due to the proposal, or the potential reductions in both premiums and comprehensiveness of health insurance.

(2) Tax units with negative cash income are excluded from the lowest income class but are included in the totals. For a description of cash income, see: http://www.taxpolicycenter.org/TaxModel/income.cfm

(3) Includes both filing and non-filing units. Tax units that are dependents of other taxpayers are excluded from the analysis.

(4) Income used to calculate premiums as a percent of income and after-tax premium as a percent of income is cash income plus the value of pre-tax employer sponsored health insurance premiums.

(5) After-tax premium is the average premium less the average subsidy.

Table T07-0059
Current Law Tax Benefits for Health Insurance
Distribution of Subsidies by Cash Income Percentile, 2017[1]
Nondependent Tax Units with Head or Spouse Under 65

Cash Income Class (thousands of 2006 dollars)[2,3]	Percent with Priv. Health Insurance[4]	Average Premium ($)			Average Subsidy ($)			Subsidy as a Percent of Premium			Premium as a Percent of Income[5]			After-Tax Premium as a Percent of Income[6]		
		All Insured Tax Units	Tax Units with ESI Only	Tax Units with PNG Only	All Insured Tax Units	Tax Units with ESI Only	Tax Units with PNG Only	All Insured Tax Units	Tax Units with ESI Only	Tax Units with PNG Only	All Insured Tax Units	Tax Units with ESI Only	Tax Units with PNG Only	All Insured Tax Units	Tax Units with ESI Only	Tax Units with PNG Only
Lowest Quintile	28.4	8,293	7,771	9,269	1,065	1,316	15	12.8	16.9	0.2	46.9	40.9	77.5	40.9	34.0	77.4
Second Quintile	55.3	11,376	11,040	11,565	2,903	3,245	88	25.5	29.4	0.7	29.8	27.4	37.8	21.6	19.3	37.5
Middle Quintile	74.9	13,189	12,812	12,328	3,885	4,117	238	29.5	32.1	1.9	20.5	19.7	23.3	14.5	13.4	22.9
Fourth Quintile	89.0	16,279	15,788	15,325	5,616	5,847	321	34.5	37.0	3.9	15.2	14.7	14.3	10.0	9.2	13.7
Top Quintile	94.8	20,353	19,887	14,830	7,496	7,805	1,094	36.9	39.2	7.4	6.8	6.6	4.7	4.3	4.0	4.3
All	69.8	15,506	15,194	12,199	5,062	5,408	378	32.6	35.5	3.1	11.2	10.7	12.3	7.6	6.9	11.9
Addendum																
Top 10 Percent	96.1	21,057	20,654	15,212	7,828	8,134	1,564	37.2	39.4	10.3	4.9	4.8	3.2	3.1	2.9	2.9
Top 5 Percent	96.0	21,004	20,612	14,879	7,868	8,168	2,207	37.5	39.6	14.8	3.3	3.3	2.1	2.1	2.0	1.8
Top 1 Percent	95.6	19,408	19,201	14,949	7,762	8,033	3,737	38.8	41.8	25.0	1.1	1.1	0.9	0.7	0.6	0.7
Top 0.5 Percent	94.8	19,519	19,211	15,627	7,787	8,044	4,095	38.9	41.9	26.2	0.7	0.7	0.6	0.4	0.4	0.5
Top 0.1 Percent	93.8	19,451	19,056	16,985	7,535	7,369	4,322	38.8	40.8	25.4	0.3	0.2	0.2	0.2	0.1	0.2

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).

(1) Calendar year. Benefits are calculated as the change in tax liability between a baseline of current law modified to include pre-tax employer sponsored health insurance premiums in taxable compensation, to disallow the self-employed health insurance deduction, and to disallow the itemized deduction for medical expenses for all except Medicare beneficiaries, and an alternative consisting of current law. Following convention, the estimates are static and do not incorporate behavioral responses. In particular, they do not account for the gains of those who newly obtain health insurance, the losses of those who lose coverage due to the proposal, or the potential reductions in both premiums and comprehensiveness of health insurance.

(2) Tax units with negative cash income are excluded from the lowest income class but are included in the totals. For a description of cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm

(3) For the income levels at each quintile and the top income percentiles used in this table, see http://www.taxpolicycenter.org/TaxModel/percentiles.cfm

(4) Includes both filing and non-filing units. Tax units that are dependents of other taxpayers are excluded from the analysis.

(5) Income used to calculate premium as a percent of income and after-tax premium as a percent of income is cash income plus the value of pre-tax employer sponsored health insurance premiums.

(6) After-tax premium is the average premium less the average subsidy.

So, I think it would be useful for us to have data and maybe Dr. Orszag you can also supply it, in terms of consumption, I just urge that we be careful and we not—it is true the consumption differential will be less than the income differential because people have to eat, they have to buy clothes, they have to have a roof over their house.

I still don't think the fact that the consumption gap is less says very much about the income gap.

Let me just, also, suggest in terms of Dr. Orszag's testimony, that you help us, and if there isn't time, and maybe somebody else should join in, to talk about, less volatility, to ask themselves is there less volatility macrowise because we have been so mortgaging the future?

We have piled up so much debt, so much deficit, et cetera that that maybe has somewhat evened out the volatility, but it is essentially raising the risk of much greater volatility when the time comes.

Do you want to comment on that?

Dr. ORSZAG. Sure. I would say the nation's low national saving rate and our for example large external deficit poses some risk, particularly it means we are accumulating less capital and that reduces future income compared to what it would be otherwise.

What I would say about the macro economic volatility is it may be the mirror image, the reduced level of macroeconomic volatility may be the mirror level of a higher level of individual level or household level of volatility, that because workers in households are experiencing more volatility in response to shocks, the macroeconomy is smoother because those households and workers are kind of moving around to respond to fluctuations and demand for goods and services more, and that means the total moves around less. There may be a connection between the two.

Mr. LEVIN. Mr. Chairman. If a Republican could chime in, we have what, 7, 8, minutes? Should we try?

Mr. STARK [presiding]. Well, I had been asked by the Chair to recognize Mr. Camp at the conclusion of your time.

Mr. LEVIN. No, he can.

Mr. STARK. Thank you, and I am pleased to recognize Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman. Dr. Orszag, before we find out whether the middle class is squeezed, who is the middle class? Could you define them for me?

Dr. ORSZAG. I don't think I used that term, and obviously, different people refer to the middle class to apply to different ranges of income. I don't know that—I don't think there is an official definition.

Mr. CAMP. So, there is no definition.

Dr. Goodman, is there a working definition of middle class, or is there at least some way we can define who we are talking about here, to find out whether they are squeezed.

Dr. GOODMAN. Well, it depends on who is making the argument. I didn't say they were squeezed.

Mr. CAMP. That is the title of the hearing, but I am trying to understand, we found this with poverty, there were different levels of describing who is in poverty, some people counted Federal transfer payments when they determined who is in poverty. Some folks did not. The Government doesn't, for example.

Who is middle class? By income level or does owning a home, does that put you in the middle class? What criteria should we, as a Committee, use to define middle class?

Dr. GOODMAN. That I don't know, because that is not the language that I use.

However, I will say this. I don't think that the income is the problem. I think the problem relates to these programs that I think of them as safety net institutions, the pension system, the health care system, the retirement system, that is where the problem is. Those are the institutions that are out-of-date.

Mr. CAMP. Okay, but if some economists have used the middle 20 percent of household income as middle class, and that would be between 25 and $45,000 per year, between the 40th and 60th percentile, is that fair? Are these economists on track or——

Dr. ROWLAND. In terms of the work I looked at with regard to the health services research literature, we define middle class as individuals and families between 200 and 400 percent of the Federal poverty level. That is roughly 41 to 82,000 a year for a family of four.

One can argue that people just below that are still part of the middle class, but that is what we used in our testimony.

Mr. CAMP. Has that number grown in the past? I am sorry, would you like to comment as well?

Dr. STEUERLE. I just wanted to make a couple quick comments here. One of the difficulties with the data is that they often exclude items. For instance, a lot of reporting of what is middle class income excludes income from your housing, it excludes income from your health insurance, it excludes income you might be accruing on your pension plan. So, that is one of the issues. What economists will generally do is present to you the data by percentiles or deciles or the middle 20 percent, so you can decide what you want to define as middle class.

I need to add one other complication as well, which goes back to the consumption-income debate. A lot of households combine together in ways we don't measure very well. There are 2 million people missing even in the Census. That is one of the reasons we get some of these consumption-income differences. Not marrying is the tax shelter of the poor. So, they often combine households in ways that that don't show the data.

Mr. CAMP. Households are combined but yet we don't know——

Dr. STEUERLE. So, all we can do is try to present the data to you honestly in a nonpartisan way.

Mr. CAMP. So, there are double income households potentially, but we don't know that. How many people are, Dr. Rowland, in this category?

Dr. ROWLAND. There are roughly 74 million non elderly people between 200 and 400 percent of poverty, about 92 million above that, and obviously another 90 million below that. So, we are picking the middle range of both people and income.

Mr. CAMP. Is that a static group or do people move in and out of that?

Dr. ROWLAND. People clearly move in and out of these income bands, because as you have heard, income does not stay stable for many people over the course of the year.

So, this is a snapshot view that was taken using the Census current population survey (CPS).

Mr. CAMP. Has that group—our Tax Code has been fairly static for past 50 to 60 years. Has that group grown in the past generation, do you know?

Dr. ROWLAND. Well, during recessionary times, obviously the lower income groups grow resulting in growth in the underpoverty group, and growth in the near poor just below the middle income group. As a result, this group goes back and forth, depending on the state of the economy.

Mr. CAMP. In the last 10 years?

Dr. ROWLAND. In the last 10 years, there has been growth in the middle income group, but there has also been more growth in the near poor group just below it.

Mr. CAMP. Do you count Federal tax benefits when you include the poverty group?

Dr. ROWLAND. This is just using the Census CPS, that does not include Federal tax benefits.

Mr. CAMP. Thank you, Mr. Chairman.

Mr. STARK. We will recess for 30 minutes. Thank you.

[Recess.]

Chairman RANGEL. I you so much for your indulgence, we try to avoid this, but thank you for coming back.

Mr. Blumenauer.

Mr. BLUMENAUER. Thank you, Mr. Chairman and thank you for keeping this going. Not just because I haven't had a chance to have my 2–1/2 minutes, but I truly appreciate what is happening with you and the Ranking Member, laying the foundation, dealing with the issues of poverty, income insecurity, and how to tie these pieces together.

In the course of the hearings that we have been having in a broad range of areas, the things that you are talking about today tie into trade policy and anxiety, manufacturing, health care, we are just seeing across the board you are touching on things under the broad sweep of this Committee, and I think ultimately the things you are talking about are part of the solutions.

I would say, Dr. Furman, you ought not to feel too bad about not having signed up yet for your 401(k) or whatever it is. I am going to find, Mr. Chairman, and enter into the record, I think it was an article in the New York Times last year where they interviewed the winners of Nobel prizes for economics about what they had done with their prize money. There were people who were embarrassed to say I kicked it, it is in a money market, I don't know, it was really telling at a time when some people think that all we need to do is just give more choices to the American public rather than giving them information and guidance, that this study of Nobel Price laureates in economics was quite embarrassing. For them. Not for you, sir, I am sure.

In a world where we now have the studies that show that you sell less jam if you are offering consumers 26 brands rather than 6, the notions of health care, retirement security, how we balance the desire for choice and opportunity, with what we pile on people in a time of insecurity is something that I am deeply concerned with.

I appreciate what has happened in the hearings before this Committee because we started with the 37 million people who were poor. Then we expanded the discussion. Today we are talking about maybe 100 million Americans who are struggling not to be poor, working hard, some of them with two jobs, and then you are talking about the instability and the volatility that there may be another 100 million who are struggling to stay in middle class.

My question—and it probably isn't a lot of time for each of you, I would turn it over to you for observations that you have, but I would welcome any written response you may have to me or the Committee focusing on that 100 million people who are not the poor. They are not the struggling middle class. These are people who are, in many cases, in health care, the only ones that are paying retail. You know they don't have enough for health insurance, but they have to—they have enough that people expect them to pay. They have to put down the credit card. The people who may be steered to subprime loans.

People who are really ensnared in the new bankruptcy laws, there are a series—and these are people who are probably paying more for transportation than for housing. There is a series of things that talk about the stress that these people face.

I wondered, if you had some observations in the things that we were talking about in terms of their income insecurity, the problems they face with health care, probably not having defined pensions and maybe the least likely to have 401(k)s, are there thoughts, prescriptions that you have for these 100 million Americans who are not poor, but certainly aren't rich, not middle class and are really struggling to make ends meet?

[The information follows:]

New York Times
December 5, 1999
Nobel Economics: Spending the Check
By SYLVIA NASAR

On a late October morning, Robert Alexander Mundell sat Buddha-like amid stylish clutter in his Claremont Avenue apartment, two blocks from Columbia University in Manhattan. The magic moment when, amid fairy-tale pomp, he will receive from the King of Sweden the heavy gold medal engraved with Alfred Nobel's stern profile was still weeks away. But life had already changed profoundly for Mr. Mundell, 67, the flamboyant Canadian-born economist whose ideas paved the way for the euro, the European currency.

Since the announcement of the prize 2 weeks earlier, The Wall Street Journal had already described him as more important than Keynes, a television network had filmed a documentary on his life and 3,000 e-mail messages had clogged his "in" box. Invitations were pouring in so fast on this particular morning that his wife, Valerie Natsios, desperate for the last hour to take a shower, couldn't leave the phone: It wouldn't stop ringing.

Mr. Mundell, who "half expected" the prize for some 15 years, had already decided how he would spend the nearly $1 million prize (to complete the renovation of his Tuscan palazzo, once featured in Architectural Digest, and to buy a pony for his 2-year-old son, Nicholas). And he had already decided that he would have the honorarium transferred to his bank account in euros, because he thinks the euro, though sinking of late, is bound to appreciate against the dollar. But one detail appeared to have escaped the man who, during the Reagan presidency, became the intellectual guru of the supply side tax revolution: "You mean . . . " he asked, a tiny frown now evident on the capacious brow, "it's taxed?" The world's great economic thinkers aspire to the Bank of Sweden Prize in Economic Sciences in Memory of Alfred Nobel for some of the same reasons that actors hanker after the Academy Award and athletes hope to enter the Hall of Fame. "People like crowns," said Mr. Mundell, who will receive this year's prize on Friday.

No one has ever refused the economics prize, which was added to the five original Nobel prizes in 1968, although one laureate, Gunnar Myrdal, said publicly that he would have done so had he not been so sleepy when the predawn call came from Stockholm, and another winner seriously considered turning it down because a friend's work had been ignored. The prize, after all, is the only one that can vault a social scientist into the same pantheon as Einstein, Curie and Bohr. William Breit, co-editor of "Lives of the Laureates" (M.I.T. Press), calls the Nobel nothing less than "the maiden's kiss that turns the toad into a daring, dashing fellow."

As its cachet has grown—in step with the awareness of economics' role in public and private life—the prize has had a bigger impact on the laureates. They are tempted with new opportunities—financial, professional and personal—as well as new risks. Research can be disrupted, and, said Milton Friedman, who won in 1976, "the temptation to shoot off your mouth is nearly irresistible." The media hoopla accompanying the announcement may even have hastened the death of William Vickrey, who won in 1996 for his modern auction theory. Three days later, Mr. Vickrey, who was 82, died of cardiac arrest, possibly set off by the unusual stress.

And then there is the money. Woody Allen, that notorious Academy Award absentee, once acknowledged that he would, if called, show up in Stockholm: "Apart from everything else," he said, the prize "carries an interesting amount of cash."

Assar Lindbeck, the Swedish economist who was long the leading force on the five-member prize Committee, put it this way: "People say that the money doesn't matter, but they are just being politically correct."

What makes the money so important isn't the absolute sum. Though it varies, it is never enough to let a laureate quit his day job, as Alfred Nobel might have hoped. Rather, the prize is like a movie deal for a writer or a bundle of stock options for a middle manager: one of those rare windfalls in a middle-class life big enough to make the question "What shall I do with it?" really worth asking.

Interviews with a sampling of economics laureates show that for all their sophistication, they seem no more, nor less, canny about money than mere mortals. Surprisingly few have entrusted their winnings to Wall Street, apparently agreeing with the sentiment of Wassily Leontief, who, upon winning the prize in 1973 for inventing input-output analysis, said: "I like to speculate in ideas. I don't like to speculate in money."

Rather, some laureates have spent their windfalls to take a planeload of family and friends to share the festivities in Stockholm, others to buy real estate——in Mr. Friedman's case, an apartment in San Francisco. A surprising number have given the money to their children or used it to become charitable benefactors. Some have bought time to pursue favorite public causes or—despite the fact that their average age on receiving the prize was 69—have started new research careers.

In part, the variation arises because the laureates haven't all received the same sum. More than one-third of the prizes have been shared with one or two co-winners. The amount, like that of the science prizes, is set each winter and varies with the fortunes of the Nobel Foundation's investment portfolio. The prize became much richer at the end of the eighties thanks to the bull market in stocks and a hugely profitable real estate deal in Stockholm. Mr. Mundell's take will be 7.9 million kronor, or nearly $1 million at current exchange rates. That is about twice the amount, in nominal terms, of awards in the mid-1980s.

Mr. Mundell is lucky. When Paul A. Samuelson won in 1970, the prize amounted to a mere $77,000, less than 40 percent of the purchasing power of the original science prizes in 1901. By 1976, it was $180,000, a sum that hardly bothers the winner, Mr. Friedman, one of the earliest and most vocal proponents of the free market. He argues that, while his prize was delayed for several years by his ideological enemies, they actually did him a favor. Allowing for inflation and tax changes, his has been the biggest prize, before or since. "I know. I calculated it," he said recently.

As Mr. Mundell discovered, the U.S. government has lately become a prime beneficiary of the Nobel Foundation's investment success. Since 1986, when Congress changed tax laws to equalize the treatment of various kinds of income, regardless of source, the prize has been taxed as ordinary income, a little-known fact that, when discovered, has led to an occasional petition to Congress. Starting with Robert M. Solow, who won in 1987, American laureates have had to pay up to 50 percent of their winnings to city, state and Federal Governments.

The timing of the prize introduces its own vagaries, as Robert E. Lucas Jr., the creator of the theory of rational expectations, discovered in 1995. Like Mr. Mundell, Mr. Lucas knew he was in the running. When negotiating their 1989 divorce agreement, his wife, Rita, thought the odds good enough to have her lawyer insert a clause in their agreement stipulating that "wife shall receive 50 percent of any Nobel prize" won prior to Oct. 31, 1995. The prize arrived a few days before, and Mr. Lucas wound up pocketing roughly $300,000 after taxes, instead of the $600,000 or so he would have received if he had won the next year.

"A deal is a deal," Mr. Lucas told reporters afterward, adding that he might have resisted the clause more strenuously had he been more sure of winning so soon. But Mr. Lucas, who teaches at the University of Chicago, is quite philosophical about it now: "She got the whole house," he said recently. "Getting half of the prize was better than nothing."

Mr. Lucas says that he parked his share of the prize money in his retirement account and more or less forgot about it.

At the opposite end of the spectrum is Franco Modigliani, who won in 1985 for his theory of saving and financial markets. Mr. Modigliani, now retired and living in Cambridge, Mass., says he owes his substantial net worth partly to the fact that his tax-free $225,000 prize, mostly invested in stock index funds, has been multiplied many times over by what he calls "the stock market bubble." He declined to say what his bundle is now worth, but said he leaves the day-to-day management of his portfolio to a professional.

Still, he has not relaxed about the future. Before the 1987 market crash and again this year, he acted on his suspicion that the bubble was about to burst. Using a combination of put and call options that allow one to lock in a gain, he bought what is called a "collar." It produces the same effect as if he had sold everything, but without incurring huge capital gains taxes. "The cost is that you freeze yourself out of the market," he said.

There is no way to tell, of course, if he will turn out to be right. But when laureates have followed their own investment instincts, the results have sometimes been less than impressive. Douglass C. North, who won the prize in 1993 for his contribution to economic history and is now teaching at Washington University in St. Louis, delights in the fact that entire countries like Venezuela are asking him to redesign their economies.

But in financial terms, he has not fared as well.

"We got a bad year," recalled Mr. North, who shared the prize with Robert W. Fogel. The prize was worth only $880,000; after dividing it in two and paying taxes (46 percent in his case), "it got to be a manageable sum of money," he said. "We thought the stock market's too high—the Dow was at 2,000—so we put it in tax-exempt municipal bonds, which shows you this economist doesn't know a damn thing about investing." The Dow closed on Friday at 11,286.18.

Laureates have also been caught by sudden swings in the currency markets. In announcing the winners, the news media usually report the prize in dollars, but the amount is actually set in kronor. If the kronor heads south between mid-October and mid-December, when the laureates collect, the dollar value of the prize can be a lot smaller.

Gary S. Becker of the University of Chicago, the 1992 winner for his application of economic theory to a wide range of human behavior, including racial discrimination and crime, now says that he had intended to hedge against a sudden depreciation of the kronor by buying dollars on the forward market. He never got around to it, and 2 weeks after he got his call from Stockholm, a currency crisis erupted in Sweden. His prize, worth about $1.2 million in mid-October, shrank by 25 percent, to about $900,000. "I was too overwhelmed by all the hoopla in the first 2 weeks," Mr. Becker said ruefully. "So I suffered some."

No laureate's life has been as thoroughly transformed by the prize as that of John F. Nash, a co-winner in 1994. The award literally brought the world back to Mr. Nash, now 71, whose life was shattered at 30 by paranoid schizophrenia. Mr. Nash's slim doctoral dissertation, written in 1949 when he was a 21-year-old graduate student, revolutionized the way economists thought about competition, but on the day that the prize was announced, Mr. Nash told reporters that he might now be able to get a credit card. They thought he was joking, but he was not.

When the long-delayed honor finally came, Mr. Nash had been without a job for 35 years, getting by on only a few hundred dollars a month from a trust his mother had established before her death, and avoiding homelessness only because of his former wife's compassion.

After years of grinding poverty, Mr. Nash now has some measure of financial security. The prize, which he shared with John C. Harsanyi and Reinhard Selten, netted him some $200,000, most of which he put first in tax-free municipal bonds and later into a global mutual fund. He even has the luxury to indulge in what was a passion of his youth, dabbling in stocks, mostly making long-shot bets with small amounts of money.

"Without the money, it wouldn't be the same thing," Mr. Nash said of the prize, adding that "the honor is worth more money than the money." After he won the prize, Princeton University offered him a part-time research post that pays about $25,000 a year. And a major Hollywood producer has bought the rights to his life story for a high-six-figure sum.

These days, Mr. Nash looks like his old elegant self. He has paid part of the mortgage on the house he shares with Alicia Nash, his former wife, and shared his good fortune with her and his two sons. Asked what difference the prize had made in his life, he said: "I feel I can go into a coffee place and spend a few dollars. Lots of other academics do that. If I was really poor, I couldn't do that. Previously, I was like that."

Robert C. Merton, while hardly unlucky, was a less fortunate winner. A mere 53 when he won the prize 2 years ago, Mr. Merton had been a superstar since his graduate schooldays at M.I.T. His method for determining the future value of stock options, developed with Fischer Black and Myron S. Scholes, had an impact that few other contributions in economics have matched: they helped hatch a $70 billion market in financial derivatives.

He had long been a professor at the Harvard Business School and was a Member of the National Academy of Sciences. After years of consulting on Wall Street, Mr. Merton had a personal fortune that was sizable even before he became a founding partner in Long Term Capital Management, a hedge fund started by John W. Meriwether, the renowned former Salomon Brothers trader, in 1993.

Mr. Merton netted some $250,000 after splitting the prize with Mr. Scholes and paying taxes; he spent a large chunk of it to take family and friends to Stockholm to share his moment of glory.

It was the fame that proved a bit overwhelming. "This is very different," he said, "no matter how much attention you've gotten before." In his apartment after receiving the news, he hesitated before facing the reporters who had gathered in the lobby. "I realized that if I said something stupid or out of context it would be in every newspaper in the world."

That was the easy part, though. A year later, Long Term Capital imploded and once adulatory headlines like "The Right Option" gave way to ones like "Scrambled Eggheads" and "Teachings of Nobelists Also Proved Their Undoing."

"It was very painful," Mr. Merton recalled—"the extraordinary destruction of value, mostly of the partners, including myself, the effects on reputations."

"For 25 years these ideas were used all over the world—on stock exchanges, asset management firms, banks, insurance companies," said Mr. Merton, his voice still raw from the experience. "If the media had asked, 'Do you still use these models?' the answer would have been yes."

"I'll never really get over what happened to L.T.C.M.," he continued.

Mr. Merton, who never quit his full-time post at Harvard, retired from Long-Term Capital last June. He now has an exclusive consulting relationship with J. P. Morgan.

For Amartya Sen, the first Asian to win the economics Nobel, the 1998 prize had a different significance. Charming and immensely cultured, Mr. Sen has spent a lifetime shuttling with apparent ease between his native India and England and the United States. Married to a Cambridge University economist, Emma Rothschild, he is the first non-Briton to be master of Trinity College, the richest of Cambridge's colleges. He is also a professor emeritus of philosophy and economics at Harvard.

"I've been writing for 40 years about inequality and the terrible neglect of education in India," said Mr. Sen, who was cited by the Nobel Committee for his contributions to the economics of social welfare, including poverty, famines and human rights. "Now I have more of a voice."

Mr. Sen's voice is indeed being heard, particularly in Asia, where he has been greeted as a demigod. Ten thousand people crowded into a Calcutta stadium to celebrate his prize, a generation of babies has been named Amartya (which means immortal) and Asian leaders—including Singapore's Lee Kwan Yew, of whom Mr. Sen has been particularly critical—are eager to meet him. Among other things, his prize prompted the finance minister of West Bengal to commit to building 8,000 new primary schools.

In keeping with his lifelong desire to make a difference to the world's poor, Mr. Sen, who witnessed the 1949 Bengal famine, used $400,000 of his $940,000 prize to set up two trusts—one in India, the other in Bangladesh. He said the trusts, named Pratichi after his boyhood home, would "work toward the removal of illiteracy and ignorance, the lack of basic health care, and the special disadvantages from which women, particularly young girls, suffer."

Mr. Sen, who has an American green card although he remains an Indian citizen, will be able to keep roughly $250,000 after paying United States taxes. "I don't think I will invest it," he said. "I'll use it for useful purposes." That means, first, paying for his three grown children's air fares for regular trips to India so that they can maintain their ties to family and culture. "It's nice to have money," Mr. Sen said. "But now I don't see that life would be that much better if I had more money. If I were to get another big cash prize, I'd give it all to the trusts."

Like Mr. Sen, Tjalling C. Koopmans, the quiet Yale professor who won in 1975, gave away a large portion of his prize. Mr. Koopmans, who won for his contribution to the theory of optimum allocation of resources, was upset that George B. Dantzig, the inventor of linear programming, was not included, so he called another laureate, Kenneth J. Arrow, to ask him whether he should refuse the prize. Mr. Arrow recalled: "I'm sure he was glad when I said, 'Go ahead, take it. You deserve it.' "

Mr. Koopmans took the advice but couldn't quell his conscience after splitting the $240,000 prize with his co-winner, Leonid V. Kantorovich. So he donated $40,000 to the International Institute for Applied Systems Analysis, a research organization in Vienna with which he and Mr. Dantzig were affiliated. The donation reduced his personal gain to $80,000, the amount he would have received had Mr. Dantzig shared the prize. An explicit condition of the gift was that it be kept secret, though a friend has since told Mr. Dantzig about it and published an account after the death of Mr. Koopmans in 1985.

Ronald H. Coase, who was 81 when he won the 1991 prize for his work on transaction costs and property rights, is intent on parlaying his award into more influence. He netted about $700,000 after taxes, partly by getting the Nobel Foundation to push part of his payment into the following January, by which time the kronor had appreciated. That sum has grown to $2.4 million in a Merrill Lynch mutual fund.

Mr. Coase, who retired from the University of Chicago Law School, now regards the economics profession with a jaundiced eye. And he would like to use his new fortune to establish a program to encourage more empirical research. But finding the time has been difficult. "I'm fully engaged now, engaged and overwhelmed," he said from his home in Chicago. Besides, as he has learned, he said, "it's very hard to give money away" to good effect.

The prize has tugged a different laureate back into economic research. By the time William F. Sharpe won the prize in 1990 for his theory of capital asset pricing, he had already retired from the Stanford Business School and was a principal in a company that advised pension funds. He shared the prize, $380,000 before taxes, with two co-winners so it "wasn't huge," he said. Once, when a fellow laureate, Merton H. Miller, was asked how he spent his share, he joked, "Well, I took my family to dinner in Stockholm."

Mr. Sharpe did the same, taking "my full extended family—stepmother, mother, children, stepchildren" along.

The prize inspired him, then 56, to return to his old position at Stanford. "I was in a commercial phase of a my life, but I wanted to go back to writing and research," he said. A burst of publications has followed. "I've published a lot of what I've done on my Web site, including a book I've had under construction since I went back," he said.

Mr. Sharpe has since retired a second time and joined an online investment advisory firm, but this time strictly in a research capacity. "You really feel increasingly that what you do should really add to knowledge or welfare in some important way," he said.

Even when the prize amount is small, the Nobel creates money-making opportunities—five-figure speaking fees, fat consulting contracts and post-retirement job offers, not to mention glamorous opportunities like opening-night tickets to La Scala and first-class travel around the world. For those who consult, join financial firms or hire themselves out as expert witnesses in court cases, the payoff can be huge.

But perhaps true to their lifelong devotion to scholarship, some laureates do not find such opportunities all that seductive. At first, for example, Mr. Lucas reveled in the invitations. But after five or six trips, he realized that he wasn't having that much fun. "I'm still excited by mathematical economics," he said. "The other stuff is just a diversion. It doesn't advance any ambitions I have." Mr. Lucas, 62, finds that the higher profile the Nobel has given him in the economics profession is "extremely stimulating." His recent work on growth theory may make him the first economics laureate to win the prize twice, as the award is given for specific, not lifetime, achievements.

Mr. Mundell, meanwhile, is thinking of calling his Nobel lecture "Reconsideration of the 20th century." For him, like most other laureates, it is the intellectual contribution—and the stamp it leaves on the world—that counts far more than the money.

Harriet Zuckerman, the author of a classic study of the science Nobel Prizes and the stepmother of Mr. Merton, said: "Posterity is the ultimate gold ring. The prize has a way, if not of insuring one's place in history, of giving one a better chance of being included."

Chairman RANGEL. You will have a full minute to respond, and I do hope you take advantage of the invitation of Mr. Blumenauer, for all of you to prepare something to send to us, because we all want answers to that question. Someone wanted to volunteer? Dr. Furman.

Dr. FURMAN. Sure. I think part of that answer is that you are not going to change the volatility, and a lot of it is people going to better jobs and moving to new and better industries. What you can change are the really bad consequence that that volatility has for people so that you won't lose your health insurance when you lose your job. You won't lose your pension plan when you lose your job. You won't lose your income when you lose your job.

So, stopping the unemployment insurance system from eroding and making it work better in a work force where people are unemployed for longer is something that the Hamilton project has proposals on, along with making it easier for families to save.

We are working on, and will be coming back to later in year, proposals in the health care area that would, again, take away one of the biggest risks you can face in a volatile economy.

Chairman RANGEL. Please share with us, the Hamilton proposals as well as all of you because we will use this at our reunion when we get together and try to resolve some of these issues. Mr. Pascrell.

Mr. PASCRELL. Thank you, Mr. Chairman, Mr. Ranking Member.

Mr. Goodman, I read your testimony as well as the other testimonies, and thank you all for making yourselves available to us and we need to do more of this, this is what the Chairman wants. This is what we are going to have. This is so refreshing.

I think this is, we need to air so that we can come to resolve and compromise. I think that is what a democracy is supposed to be all about.

You said in your testimony that the most important problems faced by middle income working families today are not problems that arise from the nature of our economic system. Instead, they are problems caused by outdated public policies.

I like the first part of the statement.

I like the second part of the statement. I don't agree with you on the third part of the statement, because when I look at the issues of the cost of debt, trade policies, health situations in this country, college tuition, utility costs, many of these policies, many of the things that Government has involved itself in deals with public policy. Does effect.

There has been a huge—and I want your opinion of this, your thoughts about this, they are important to me. There has been a huge redistribution of income in this country, the result of changes over the last 30 years, particularly in the Tax Code. The Government interceded to effect economic factors.

If you look at what we tax now in terms of income and assets, it is certainly the reverse of what we were doing 30 years ago, 40 years ago. There is more emphasis on taxing income than it is assets. I know many more people own assets today in sharing of the economy. You would have to admit that in taxing more of an income that I think that has more than anything else has lead to a squeeze of these people who are working poor, those people that we would consider come to some agreement on, what is the middle class, somebody asked before.

What is your take on that?

Dr. GOODMAN. Well, first, I agree with what Dr. Furman said a minute ago that we are not going to change the economy, and we shouldn't want to change the economy, and that a growing economy is one in which there is going to be volatility, and so the things we should pay most attention to are the safety net institutions, health insurance, pensions, unemployment insurance, workers' comp insurance. That is where the reforms need to go.

Mr. PASCRELL. You do mention that in your testimony. When you talk about 401(k)s and Individual Retirement Arrangements (IRAs), but you do mention also health savings account, there is where we may have this question and we may have to iron some things out and come to some compromise. I interrupted you. I am sorry.

Dr. GOODMAN. I have not spent a lot of time personally with the income redistribution statistics. It is my impression, however——

Mr. PASCRELL. Not my interpretation, believe me.

Dr. GOODMAN. Every tax cut we have had in the last 30 years I think has made the Tax Code more progressive. So, on the tax side we are not—it is not as though we are letting rich people off the hook. They are bearing a larger share of the load than they did 30 years ago.

Mr. PASCRELL. Well, their incomes are increasing proportionately, but Dr. Orszag, I am very interested in this question about distribution and redistribution of wealth in this society. I believe in capitalism. I don't want to sound like a socialist, but there has been in terms of what the emphasis is on taxing and people are hurting out there, you talked about the volatility within individual incomes rather than the general economy has calmed down. This is good. We need a stable economy, but local—individuals this has not happened. Could you address that and try to, not get to a debate but just give us your reaction to what I am trying to get at here?

Dr. ORSZAG. If I could focus in on the tax system for a moment, the tax system could play a role in cushioning the volatility in after-tax income, in particular, progressive tax system can take any given level of variability in before tax income and squeeze it down so that it is not as large on an after tax basis. I think this is potentially a quite important role of a progressive tax system, so changes in the tax system that alter the progressivity of the overall tax burden will have implications for after-tax income volatility as well.

Mr. PASCRELL. Dr. Furman, I may be comparing apples and oranges, but we know what happened before 1934 when individuals certainly didn't save in this country and were put in a precarious station where we had 60 to 65 percent of the poor living in poverty, and we know what happened after the, not only some programs, but particularly Social Security was implemented.

We have a situation, is the debate between whether we should go back to that, at least philosophically? Or to strengthen, to strengthen some programs that came out of these last 70 years? Is that where the debate is going? People—it is a question that they had the option to decide where they are going to put all their money. They didn't have the money to begin with. A lot of older people were hurt, suffered, died, because they couldn't make it. It just wasn't there. It wasn't simply because of the depression. Those things were happening before 1930 as well when older people were living in poverty as well.

Now, how do you address that?

Dr. FURMAN. As I tried to discuss a little bit, if you look at your retirement portfolio, anyone would want a diversified retirement portfolio. Some of it invested in the market, some of it risk free, market risk free, rock-solid guarantee. That part of the portfolio was represented in the past by Social Security benefits and defined benefits pension plans.

With defined benefits going down, that is, if anything, an argument for a more robust Social Security system, which, again, market risk free, offers a guaranteed benefit, I think several of the witnesses have said an annuity, a real annuity that lasts as long as your life so that, if anything, it plays a more important role than it did before.

Mr. PASCRELL. Thank you all very much for doing such a great job.

Chairman RANGEL. Mr. Pomeroy.

Mr. POMEROY. Thank you, Mr. Chairman. I appreciate it very much, the testimony right across the panel, and particularly I like the work of some of the panel participants.

I think the issue of economic insecurity, particularly as discussed in Dr. Hacker's book, is, right front and center, and presents an opportunity for bipartisan action on this Congress.

For the last several months, we have been having exhortations from those that view the economic, macroeconomic data as wonderful news, country is doing great, and it just hasn't resonated at all.

In fact, last week we had the curious anomaly of the highest stock market ever, and 71 percent polled by ABC polled saying the Nation is on the wrong track.

What I think the disconnect is, is that macroeconomic data is different than the aggregate of microeconomic fact, household to household, and at the household level, people are not feeling this gain, because of the disconnect between productivity and wages, but it is also even more, I think, much more deeply spread than that through this insecurity business.

What do you think we ought to focus on as we try to address the insecurity issues? Do we revisit the pension bill and try and extend the transition period on the stepped up funding requirement so that we try to mitigate something that wasn't considered by either party last year. I might add, try to mitigate the funding shock that is going to hit pensions, they are going to cause, I think, an untenable amount of freezing, the defined benefit plans that remain.

There still are 20 million people covered by the defined benefit plans. These are still big deals out there.

Do we look at health care? Do we invest in broad-based education programs?

Dr. Hacker, because you have the most recent significant published work in this area, I would like you to kick this off.

What should we do to address this worker insecurity issue?

Dr. HACKER. I think the first step is exactly the step that has been taken by the Committee today, which is to discuss among people who are expert in these areas some of the key challenges that Americans are facing. I think you are absolutely right, as Peter, Dr. Orszag's testimony suggested, that part of this disconnect has to do with the fact that the broad macroeconomic indicators don't capture some of the insecurity and instability that workers are feeling.

I do think that, as you suggested, that it is not just the squeeze that workers are facing in recent years as the cost of many valuable items like health care and college tuition have gone up, but that wages have not, but they also have concerns about their future. Some people who are active in the financial service sector who sell products for financial services such as MetLife have emphasized this as well with what they see as the financial burden shift in the sense that workers, they have to have a personal safety net.

So, I think the focus should be in the core areas that we talk about today, that is pensions, health insurance coverage, thinking about job security and the work-family balance more broadly, and finally some of the key concerns about wealth and savings that have been discussed.

Obviously I can't offer proposals in each of those areas. My book has a discussion of them. What I do think is that we can keep some principles front and center.

The first principle is, I think we should try insofar as possible is to emphasize broad risk pooling, that social insurance in the form of particular programs may have problems sometimes dealing with the present era——

Mr. POMEROY. Is it your sense that as we look at risk pooling that the employment relationship can still play a part in trying to help people affect risk pooling?

Dr. HACKER. I do believe it can still play a part, but I don't believe it can continue to play the dominant role it has played——

Mr. POMEROY. The Administration is a very different mindset they have obviously put tremendous pressure on pensions trying to shift them to defined contribution plans capping the risk of the employer. They are now trying to do the same thing on health insurance. It seems to me that they are very much more sensitive to the risk burdens of the corporations than ultimately the employees that are getting the risks shoveled off on them.

Dr. HACKER. What we have here is one area where there is a fundamental ideological debate. There are lots of areas of agreement about the tax treatment of health insurance, for example, that there are many people who believe in broad risk pooling, who believe the current tax treatment has problems, where I think there is a broad ideological debate is about risk pooling, whether or not individuals should be purchasing these benefits on their own and being within individualized benefit options, or whether we could try to encourage new forms of broad risk pooled benefits, whether they are provided by employers or not.

I think that the terrain that we have not yet covered in terms of broad thinking is how could we construct broad risk pools that wouldn't necessarily be tied to an individual employer.

Mr. POMEROY. I would just observe, in closing, no further comments from the panel, Mr. Chairman, I believe the ownership society is not at all inconsistent with risk management. Ownership society doesn't mean you need to own all your own risk. Still applied risk management, owner opportunity, share the risk and I really am hopeful we might find some bipartisan areas of agreement on that one. Thank you, Mr. Chairman and Ranking Member.

Chairman RANGEL. Thank you. Mr. Becerra.

Mr. BECERRA. Thank you, Mr. Chairman, and to the panel, thank you for your patience in staying with us. I would like to get into something that my colleague, Mr. Pomeroy, got into a little bit because I think it is interesting to note that while Wall Street may think that we are going in the right direction, Main Street, by an overwhelming number, thinks we are going in the wrong direction. People back home think something is wrong, and it is palpable that them they feel something is wrong.

I would like to just explore something, because to me it helps explain why so many people are saying to us today even though the stock market is hitting all time highs, that we may be heading in the wrong direction.

Mr. Orszag let me check some facts here. What have the Bush tax cuts cost us in lost revenue to date?

Dr. ORSZAG. We could get back to you with the official revenue score for the 2001, 2003 tax legislation. For this year, that number amounts to a little bit over $200 billion.

Mr. BECERRA. That is for this year alone?

Dr. ORSZAG. For 2007.

Mr. BECERRA. Cumulatively, roughly. Roughly.

Dr. ORSZAG. Roughly speaking, it would be over a trillion dollars.

Mr. BECERRA. Over a trillion. If we were to extend them out say another 5 years because some are set to expire over the next 4, 5, years, if we were to extend them out, how much more revenue over that 5-year period would we lose?

Dr. ORSZAG. There would be another significant revenue effect of extending the tax provisions past their scheduled sunset.

Mr. BECERRA. So, if we were to key those tax cuts in place over the next 5 years, how much would that cost us, roughly? I am not going to keep you on this number.

Dr. ORSZAG. It depends on what happens to the alternative minimum tax, but it is the range, it is more than a trillion dollars, and depends on what exactly what you assume by the alternative minimum.

Mr. BECERRA. Let's assume roughly a trillion so far that we have lost in revenue from the Bush tax cuts, roughly another trillion dollars or so over just the next 5 years if these tax cuts remain in place.

Dr. ORSZAG. Let me make clear the extensions would begin, the tax provision sunset in 2010, so there is after, so if a 5-year period that you are discussing——

Mr. BECERRA. My understanding is that to date, we spent something between 350 to upward of $450 billion on the war in Iraq, we have lost over 3,000 men and women in Iraq, and I suspect that most of the men and women who have perished as a result of the war in Iraq or Afghanistan would have qualified for very few benefits from those Bush tax cuts.

Dr. ORSZAG. We haven't done an analysis of the tax legislation with regard to particular service Members.

Mr. BECERRA. Other than perhaps the child tax credit and a few things that are focused on family, not on income, I suspect most of the men and women who are in uniform today don't make enough income to benefit dramatically from the Bush tax cuts. Is that a fair statement?

Dr. ORSZAG. Again, we haven't done an analysis of particular service men.

Mr. BECERRA. Let me ask this: What percentage of the tax cuts would you say went to the one-third wealthiest Americans in this country?

Dr. ORSZAG. You are, again, asking me to do a distribution analysis that we have not done.

Mr. BECERRA. Do you have a sense that most of the tax cuts go to those who are wealthier than not?

Dr. ORSZAG. The distributional consequences of the tax changes are to make larger percentage changes in after tax income in higher income households than lower income households.

Mr. BECERRA. Once we get the data will probably show that the wealthiest Americans have benefited most from these tax cuts. So, while we have men and women sacrificing their lives in Iraq and men and women back home or middle income or modest income making sacrifices, because we have these massive deficits, we can't figure out ways to resolve our health care crisis, we are not educating our kids well because our public schools are deteriorating, we have given tax cuts to very wealthy individuals.

Can you think of a time in our history where this the Federal Government, the U.S. government has pushed forward tax cuts that benefit the wealthiest Americans at a time when we are at war?

Dr. ORSZAG. I had gotten some indication that there would be a question about tax changes during times of war and I did ask the CBO staff for their historical analysis and got this response, which I will just read to you. The United States declared war on Mexico on May 13, 1846 although Mexico didn't formally return the favor until July 7th. A major tariff, effectively the country's only source of taxes, was reduced on July 30th, 1846 and became effective on December 1st, 1846. The war ended February 2, 1848. So, that is your example.

Mr. BECERRA. Is that the only time when you can—when your staff would find that the U.S. government decreased a tax or tariff on the American public?

Dr. ORSZAG. During a time of war. Apparently so.

Mr. BECERRA. My understanding, then I will conclude with this, because I know my time has expired, the Spanish American War, at the end of the 1800s, actually saw us institute what we now consider the inheritance tax, which was a tax principally on the wealthiest Americans to try to help finance the cost of the Spanish American War. Since you didn't mention anything during World War I and World War II, Vietnam, Korea, I am assuming that at no time during those conflicts did we ever decrease the tax burden for the wealthiest Americans while we are asking for an increased commitment on the part of America's men and women serving in uniform. So, with that, I appreciate whatever response you were able to give, and Mr. Chairman, I yield back the balance of my time.

Chairman RANGEL. It is not directly relevant but do you have any information as to whether or not the causes given by the president of that war were validated?

Dr. ORSZAG. You don't really expect me to answer that question, do you?

Chairman RANGEL. I didn't really expect you to give the answer you gave here. I would like to yield to Mr. Porter and thank him for his patience and thank him for coming back. The panel has been very kind to us and we appreciate the fact that you came back.

Mr. PORTER. Thank you, Mr. Chairman, and thank you to the panel. A couple things, I guess, in comment. Dr. Hacker, I wouldn't disagree that there certainly is some financial insecurity, certainly, in lots of different parts of the country. I would wish that in your next book you had a couple more chapters. I think directly related to insecurity isn't just finances. There is personal insecurity, there are people worried about killer bees, killer birds, hurricanes. They are worried about homeland security. They are worried about their personal security in traveling. They turn on cable television for 24 hours a day, they see what is happening around the world.

So, there is a whole other sense of what is happening in the American people community. It is not just financial, and I think it is directly related to our direction as a Congress in that this insecurity isn't just financial because as was mentioned by my colleagues, the financial aspects of the country are coming back strong. I just, again, appreciate the one piece of the insecurity, but part of it is because of their mental attitudes in these other areas. I, again, appreciate what you said.

To Dr. Rowland, I do have a couple of questions. You mentioned throughout your report about employer-sponsored coverage is declining, premium costs are rising, scope of medical care costs covered by insurance contributed to growing stress. You also mentioned that employer-based coverage for the middle class is increasingly threatened.

This Congress has had opportunities to provide for small businesses the same opportunities that big business has in pooling their medical insurance.

The same advantages that labor unions have, but this Congress has chosen time and time again to vote against the ability for small businesses to band together.

Don't you think that small businesses should have the same tools as big business to pool together to make sure they get proper, adequate, and coverage of choice that large businesses have?

Dr. ROWLAND. I think it is very important for small businesses to have adequate entry into the group market. Many States have moved to try and open up the group market. New York, for example, has a small group market that they allow small businesses into with some subsidies from the State government. I think one of the issues is across State lines; what are the rules and how to deal with the fact that our economy often doesn't operate within a single State, and how to get through some of the constraints on State offers of insurance in terms of the mandates that some States have put on to make sure that there is at least a minimum policy.

I think one of the things one might look at is how the State of Massachusetts is now trying to move forward to create a purchasing pool where they can pool risks to let small businesses and individuals come into that pooled risk.

So, I think the real goal ought to be to broaden the risk pools that people can buy into both for small businesses and for individuals who are outside of the employer market.

Mr. PORTER. Again, Federal Employees Health Plan is probably the biggest associated health plan in the country with close to 9 million participants, and we have found a way to make it work for Federal employees to have benefits that small businesses can't have.

Don't you think there is a way we can work with the States to come up with a program—not unlike the large businesses do nationwide, not unlike labor unions do nationwide, that small businesses could do the same and look at that as an advantage for the small businesses?

Dr. ROWLAND. Certainly I think that is one way to look at it, and the Federal Employees Health Benefits system has been one that many have proposed as a vehicle that could provide a more national across-State-line way of dealing with health care.

So, I think there are lots of models that can be used. I think enabling individuals and those in small businesses to be able to purchase in a group purchasing pool, really would be very important because we know that the nongroup market has a lot of limitations and can have a lot of experience rating, that really makes it very difficult for people with health problems to gain affordable access.

Mr. PORTER. One last, not difficult question. Is the foundation part of the Kaiser health organization nationwide?

Dr. ROWLAND. No, actually the Kaiser Family Foundation was founded by Henry J. Kaiser, and it is his foundation. He also started the Kaiser Permanente Health Plan.

Mr. PORTER. Which, by the way, is a model.

Dr. ROWLAND. No longer related, although they have a common name and a common founder.

Mr. PORTER. Thank you, we appreciate you all being here.

Chairman RANGEL. I guess most of you know the worst thing about this hearing has been the frustration of the Members of not being able to really have the time to ask you questions and to get the benefit of your knowledge.

So, I do hope you can consider seriously—I have talked with the Ranking Member and we do want a round table, no camera, no mike, type of setting, perhaps with a configuration where we are not talking about Members and witnesses, but genuine effort. I've never seen this Committee in session where nobody was looking for a headline or no one wanted to make a point, but was actually seeking an opportunity to learn.

You have made a great contribution. We have a long way to go, and I especially want to thank you for your patience and understanding on our voting procedure. Thank you so much.

The record will be held open for 2 days—5 days—it's great being Chairman—for those who want to include items in the record. Thank you so much.

[Whereupon, at 4:34 p.m., the hearing was adjourned.]

[Submissions for the Record follow:]

Statement of Americans for Fair Taxation, Conyers, Georgia

As a member of the tail end of the Baby Boomers, we are experiencing exactly the conditions described by this hearing's focus. We are still at an income level that we had attained back in the mid 80's. Moreover, retirement and the uncertainty of Social Security benefits being able to sustain our retirement is viewed by many of us to be our future reality.

The main reason we are in the predicament that we are in is due to the absence of a steady job market and the mind-set today's employers have to keep the workforce dynamic. This single attitude has caused downsizing, elimination of positions because some streamliner suggested to rethink business processes (only to have those positions reopen a year or two later), and the monetary risk an employer tends to avoid by laying off older workers.

Many of these problems have caused the current condition within the middle class, but the cure for them is a twofold process. First, there must be an incentive for businesses to keep their core business processes and staff. The only way this will happen is if there is competition for market share within the U.S. boundaries. Secondly, the tax system of keeping families from passing on their lifetime's accumulated wealth to their children must be done away with. Inheritance tax, estate tax, and taxes on retirement income must be eliminated if family structures are going to be allowed to pass on wealth and value and set the stage for a better life for their children.

I strongly recommend that the Fair Tax, H.R. 25 be seriously considered for its life-changing value it can instill in America. Full funding of Social Security, increased American manufacturing (and hence, more competition for market share), and the ability to pass on accumulated wealth to our children without the tax man taking most of it. That is why the Fair Tax is endorsed by many Farm Bureau organizations, because they believe that this is the only way that the family farm can stay within the family.

DONALD WILLIAMSON

Letter from Council, John M., Council Tool Company

Council Tool Company
February 2, 2007

Committee on Ways and Means
The United States House of Representatives
1102 Longworth H.O.B.
Washington, D.C. 20515

Dear Sir/Madam:

On behalf of The Council Tool Company, Inc., we hereby respond to the January 31, 2007 Advisory from the Committee on Ways and Means soliciting comments, by February 7, 2007, on the Commerce Department's proposed modification to its calculation of weighted-average dumping margins in antidumping investigations. Congress should vigorously oppose the Commerce Department's decision to end its long-standing practice of "zeroing," which will eviscerate the principal tool available to U.S. manufactures and producers to combat unfair trade practices.

The Commerce Department, on December 27, 2006, notified Congress that it would implement the World Trade Organization's Appellate Body ruling banning Commerce's practice of "zeroing." The Commerce Department stated that it would, effective February 22, 2007, begin to offset positive dumping margins (sales that were not dumped) against sales with negative dumping margins (sales that were dumped), when calculating the weighted-average dumping margin in antidumping investigations. In other words, Commerce will no longer set positive dumping margins to "zero" when calculating overall margins of dumping. The effect of this change to U.S. law will be to reduce generally and/or eliminate margins of dumping in investigations, and to mask or eliminate dumped sales by foreign exporters.

Congress must oppose the Commerce's Department's inappropriate concession on this issue. First, Congress has given the Administration explicit instructions in the context of the Doha Round of trade negotiations to defend the practice of zeroing; those negotiations are ongoing. Second, Congress, not Commerce, is the proper body for making laws. For many years, the Commerce Department argued before the Courts that it was statutorily required to zero in investigations. While the Courts have stated that Commerce has some discretion in this matter, Commerce changed its view only when it became apparent that the WTO intended to ban improperly the practice of zeroing. The Department should not alter course because of an adverse WTO ruling that fails to address significant evidentiary findings by the lower panel, relies on novel findings by reference to evidence not before the Appellate Body, and that exceeds the Appellate Body's authority.

Additionally, in May 9, 2006 comments filed at the WTO, the Administration noted "disturbing" aspects of the WTO ruling, including that (1) it would be "extraordinary" for Members to have negotiated specific language in the Antidumping Agreement now rendered superfluous by the Appellate Body ruling; (2) the Appellate Body's finding that dumping should be measured for "the product as a whole" reverses 47 years of WTO jurisprudence finding that dumping should be measured "in respect of each single importation of the product;" and (3) that the ruling banning the practice of zeroing was never agreed to by Member States in the Uruguay Round or previous trade agreement negotiations.

Congress is empowered to make U.S. laws, not the WTO. Commerce's reversal of its long-standing practice of zeroing is tantamount to yielding that authority to others. As such, Congress should require the Commerce Department to continue its zeroing practice when calculating antidumping duty margins in investigations.

Sincerely,

John M. Council, III
President

Statement of Employee Benefit Research Institute

"Research on Economic Security Issues: Retirement, Health Coverage, Employment-Based Benefits, and the Growing Debt of the Elderly"

The Employee Benefit Research Institute (EBRI) is a nonprofit, nonpartisan research organization that has focused on health, retirement, and economic security issues since 1978. EBRI does not take policy positions and does not lobby. www.ebri.org

EBRI has conducted very extensive and in-depth research on many of the issues related to the Ways and Means Committee's Jan. 31 hearing on Economic Challenges Facing Middle Class Families. For this submission for the record, EBRI is included short, summary material, with links to the more detailed analysis. Specifically, this includes:

RETIREMENT/PENSIONS:

- "EBRI Benefit FAQ: Pension Trends, *EBRI Benefit FAQs*, http://ebri.org/publications/benfaq/index.cfm?fa=retfaq14
- "Traditional Pension Assets Lost Dominance a Decade Ago, IRAs and 401(k)s Have Long Been Dominant," *Fast Facts from EBRI*, Feb. 3, 2006.

HEALTH CARE:

- Key Determinants of Health Care Coverage and the Uninsured, *EBRI press release*, October 3, 2006 #749.

EMPLOYMENT-BASED BENEFITS:

- "The $7 Trillion Question: How Do Employers Spend That Amount on Worker Wages, Salaries, and Benefits?" *Fast Facts from EBRI*, Jan. 3, 2007.

GROWING DEBT OF THE AMERICAN ELDERLY:

- "How Debt Has Increased for Older American Families," *Fast Facts from EBRI*, Oct. 17, 2006.
- "A Breakdown of Debt for Older Families," *Fast Facts from EBRI*, Nov. 14, 2006.

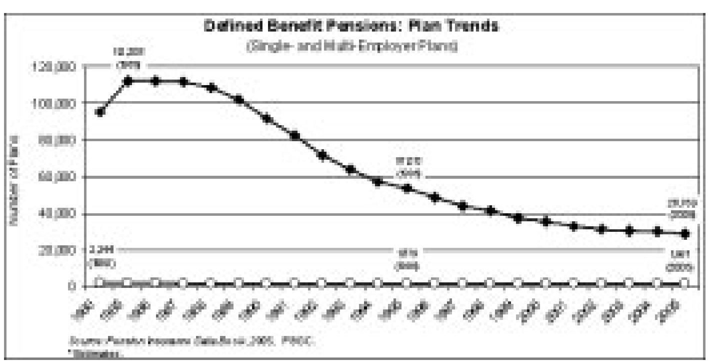
ADDITIONAL LINKS TO ERBI ECONOMIC SECURITY RESEARCH:

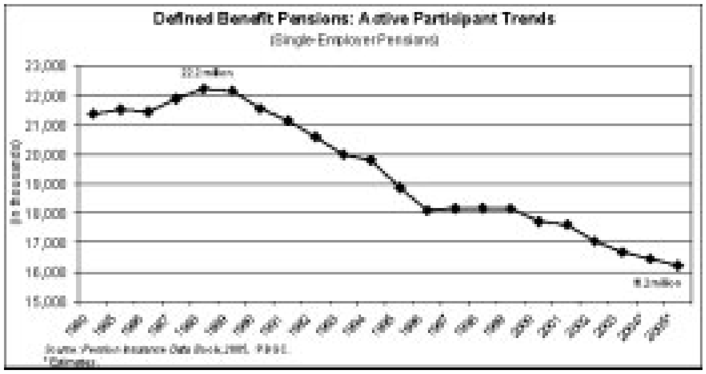
- "Measuring Retirement Income Adequacy: Calculating Realistic Income Replacement Rates," *EBRI Issue Brief*, September 2006, http://ebri.org/publications/ib/index.cfm?fa=ibDisp&content__id=3745
- "Defined Benefit Plan Freezes: Who's Affected, How Much, and Replacing Lost Accruals," *EBRI Issue Brief*, March 2006, http://ebri.org/publications/ib/index.cfm?fa=ibDisp&content__id=3628
- "The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement," *EBRI Issue Brief*, July 2005, http://ebri.org/publications/ib/index.cfm?fa=ibDisp&content__id=3565
- "ERISA at 30: The Decline of Private-Sector Defined Benefit Promises and Annuity Payments? What Will It Mean?" *EBRI Issue Brief*, May 2004, http://ebri.org/publications/ib/index.cfm?fa=ibDisp&content__id=3500
- "Can America Afford Tomorrow's Retirees: Results From the EBRI–ERF Retirement Security Projection Model," *EBRI Issue Brief*, November 2003, http://ebri.org/publications/ib/index.cfm?fa=ibDisp&content__id=182

EBRI FREQUENTLY ASKED QUESTIONS: PENSION TRENDS

See http://ebri.org/publications/benfaq/index.cfm?fa=retfaq14

The number of defined benefit plans in the private sector has been shrinking, as small—and mid-sized employers have either dropped their pension plans or shifted to defined contribution retirement plans (such as the 401(k) plan). In addition, the number of active participants in pension plans has been declining since the late 1980s (historically, the number of *total*—including inactive—participants has increased slightly, since pension plans typically pay benefits for the life of the retiree). In the public sector, defined benefit plans have remained the predominant type of retirement plan.



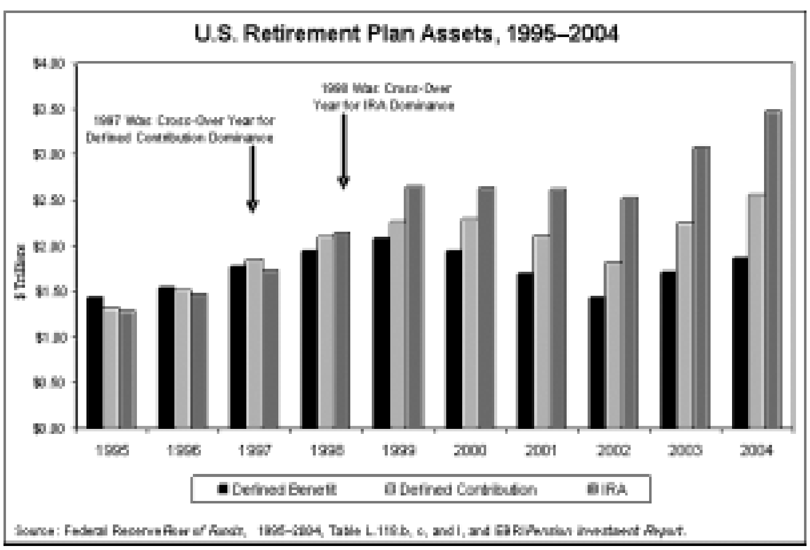


"Traditional" Pension Assets Lost Dominance a Decade Ago, IRAs and 401(k)s Have Long Been Dominant

WASHINGTON—Where are bulk of private-sector retirement assets held in the United States? By a substantial margin—and for many years—individual retirement accounts (IRAs) have held more funds than any other financial vehicle, followed by defined contribution plans (primarily 401(k) plans).

So-called "traditional" defined benefit pension plans were displaced a decade ago by defined contribution plans in terms of assets held. The most recent data from the nonpartisan Employee Benefit Research Institute (EBRI) show that about 58% of private-sector retirement assets currently are held in defined contribution (DC) plans, compared with 42% in "traditional" defined benefit (DB) pensions. In fact, as data from EBRI show, assets held in DC plans first surpassed DB pension assets in 1997—almost 10 years ago. Data from the Federal Reserve and EBRI show that IRAs became dominant in 1998.

As research by EBRI and others has documented, the forces behind these trends involve a move away from defined benefit pensions by employers and a corresponding shift to defined contribution plans (principally the 401(k) plan). The sharp growth in IRAs has been driven by the rollover of assets by workers and retirees from other tax-qualified plans (such as pensions and 401(k)s) to IRAs upon job change or retirement.



EBRI first reported in 2001 that private-sector pensions had lost their asset dominance to DC plans (*EBRI Notes,* January 2001, "IRA Assets Continue to Grow," http://ebri.org/publications/notes/index.cfm?fa=notesDisp&content—id=3226) and most recently updated this trend in its January 2006 *EBRI Notes* ("IRA and Keogh Assets and Contributions," http://ebri.org/publications/notes/index.cfm?fa=notes Disp&content__id=3614)

FOR IMMEDIATE RELEASE: Oct. 3, 2006

New Research from EBRI: **Study Details Key Determinants of Health Care Coverage: Work Status, Income, Age, Gender, Firm Size, and Others**

WASHINGTON—Do you have a job? What is your income? How old are you? What is your occupation? How large is the firm where you work?

The answers to these questions—and a few others—go a long way to determining whether U.S. residents are likely to have health insurance, according to a study published today by the nonpartisan Employee Benefit Research Institute (EBRI). The study appears in the October *EBRI Issue Brief,* "Sources of Health Insurance and Characteristics of the Uninsured: Analysis of the March 2006 Current Population Survey," available at www.ebri.org

"Work status and income play a dominant role in determining an individual's likelihood of having health insurance," writes Paul Fronstin, director of the EBRI health research and education program and author of the study. In addition, age, gender, firm size, hours of work, industry, and location are all important determinants of an individual's likelihood of having coverage—as are race and ethnicity, Fronstin says.

As the study notes, the impact of these indicators varies widely. Here is some of what the study says about each of the indicators for U.S. residents under age 65 in 2005:

- **Work status:** Workers are more likely to have insurance than nonworkers. Nearly 71 percent of workers had employment-based health benefits, compared with nearly 37.7 percent of nonworkers.
- **Income:** Workers with low earnings are much less likely to be insured than those with high earnings. One-third of workers with earnings of less than $20,000 were uninsured, compared with 5.4 percent of workers with earnings of $75,000 or more.
- **Age and gender:** Younger adults are more likely than older adults to be uninsured. Nearly 40 percent of men ages 21–24 and 30.6 percent of women ages 21–24 were uninsured. This compares with 15.8 percent of men ages 45–54 and 14.8 percent of women ages 45–54 who were uninsured.
- **Hours worked:** Part-time and seasonal workers are less likely to have employment-based health benefits than full-time, full-year workers. Part-time or part-year workers accounted for 30.2 percent of the employed population, but accounted for 41.4 percent of uninsured workers.
- **Industry:** Workers employed in agriculture, forestry, fishing, mining, and construction are disproportionately more likely to be uninsured, with 36.9 percent uninsured. This compares with 14.6 percent uninsured among workers in the manufacturing sector, 18.5 percent in wholesale and retail trade, and 22.1 percent in the service sector.
- **Firm size:** Nearly 63 percent of all uninsured workers are either self-employed or working in private-sector firms with fewer than 100 employees. Nearly 27 percent of self-employed workers are uninsured, compared with 18.8 percent of all workers. More than 35 percent of workers in private-sector firms with fewer than 10 employees are uninsured, compared with 13.4 percent of workers in private-sector firms with 1,000 or more employees.
- **Location:** The proportion of the population with and without health insurance varies by location. In 12 states—generally in the south-central United States—the uninsured averaged close to 20 percent of the population during 2003–2005. States with a relatively low percentage of uninsured individuals include Minnesota, Hawaii, Wisconsin, Iowa, and New Hampshire.
- **Race and ethnic origin:** While 64.7 percent of the population under age 65 is white, whites comprise 47.6 percent of the uninsured. Individuals of Hispanic origin are more likely to be uninsured than other groups (34.3 percent).

The study discusses each or these factors in detail and provides more than 25 charts that provide a full statistical picture of those who have health insurance (along with the sources of coverage) and those who do not.

As the study notes, the proportion of uninsured working-age Americans rose slightly to 17.9 percent in 2005, and the overall percentage of the population under age 65 with health insurance declined in 2005 to a post-1994 low of 82.1 percent. Declines in health insurance coverage have been recorded in all but 3 years since 1994.

The study also reports that the segment of the U.S. population under age 65 with employment-based health insurance dropped from 64.4 percent in 1994 to 62 percent in 2005, the latest year for which statistics are available. The change was small from 2004 to 2005 (0.4 percentage points), but share of the population under age 65 with employment-based health insurance has declined significantly since 2000, when the number was 66.8 percent. Even after the drop in coverage, employment-based health benefits remain by far the most common source of coverage in the United States.

EBRI is a private, nonprofit research institute based in Washington, DC, that focuses on health, savings, retirement, and economic security issues. EBRI does not lobby and does not take policy positions. www.ebri.org

PR #749

The $7 Trillion Question: How Do Employers Spend That Amount on Worker Wages, Salaries, and Benefits

WASHINGTON—Employers in the United States are spending at least $7 trillion a year on total worker compensation, including wages, salaries, and benefits. Where does the money go?

An article in the December 2006 *EBRI Notes*, published by the nonpartisan Employee Benefit Research Institute (EBRI), provides this breakdown for all employers, based on 2005 Commerce Department data:

- Wages and salaries: 80.6 percent
- All benefits: 19.4 percent

The article, available at www.ebri.org, shows these additional details:

- **Wages and salaries:** This sector accounted for about $5.7 trillion of total employer spending for worker compensation in 2005, up from $4.8 trillion in 2000. In 1960, wages and salaries accounted for about 92 percent of employer spending for total compensation, but that share has slipped over time.
- **Retirement benefits:** Employer spending was $628.4 billion for retirement benefits in 2005, up from $458.8 billion in 2000. Retirement benefits have long been the largest single sector for benefits expenditures, but have been declining as a share of the whole. In 1960, retirement benefits accounted for nearly 60 percent of total benefits spending, but by 2005 that number had declined to 46 percent of the total.
- **Health benefits:** In 2005, employers spent $596.5 billion on health benefits, up from $399.6 billion in 2000. Health benefits, which are taking an ever-increasing share of employers' benefits spending, accounted for 44 percent of employer spending on benefits in 2005, up from 42 percent in 2000 and just 14 percent in 1960.
- **Other benefits:** Employer spending on other benefits, such as unemployment insurance, life insurance, and workers' compensation, was $138.3 billion in 2005, up from $94.2 billion in 2000. Other benefits accounted for just over 10 percent of employers' spending for benefits in 2005, compared with just under 10 percent in 2000. Over the long term, other benefits have been a shrinking share of employer spending on benefits, down from nearly 26 percent in 1960.

The *EBRI Notes* article provides a detailed breakdown of employer spending for total compensation and benefits for selected years from 1960 to 2005. The article also contains a breakdown of spending for total benefits by the federal, state, and local governments.

EBRI is a private, nonprofit research institute based in Washington, DC, that focuses on health, savings, retirement, and economic security issues. EBRI does not lobby and does not take policy positions. www.ebri.org Fast Facts from EBRI is issued occasionally to highlight benefits information that may be of current interest.

How Debt Has Increased for Older American Families

WASHINGTON—How much debt do older American families have? How has it changed over time? What does it mean?

A study by the nonpartisan Employee Benefit Research Institute (EBRI) shows that nearly 61 percent of American families with family heads age 55 and older had debt in 2004, almost 5 percentage points higher than in 2001 and about 7 percentage points higher than in 1992.

Further, the debt of families with family heads over age 75 has increased over time as well. An article in the September 2006 *EBRI Notes*, which contains these numbers, says that the increasing debt levels could have serious implications for the future retirement security of older Americans, as their debt levels are rising at a time when their earning ability is declining. The *EBRI Notes* article is available at www.ebri.org

Here is a look at the recent rise of debt among families with a family head age 55 or older and age 75 or older:

	1992	2001	2004
Families With Debt			
Family head age 55 or older	54%	56%	61%
Family head age 75 or older	32%	29%	40%
Average Family Debt			
Family head age 55 or older	$29,309	$41,294	$51,791
Family head age 75 or older	$7,769	$9,549	$20,234
Median Family Debt (midpoint, half above, half below)			
Family head age 55 or older	$14,498*	$24,497*	$32,000*
Family dead age 75 or older	$4,218*	$5,326*	$14,800*

Source: *EBRI Notes*, September 2006.
* For families with debt.

Fast Facts from EBRI is issued occasionally by the nonpartisan Employee Benefit Research Institute to highlight benefits information that may be of current interest. EBRI is a private, nonprofit research institute based in Washington, DC, that focuses on health, savings, retirement, and economic security issues. EBRI does not lobby and does not take policy positions. www.ebri.org

FFE #35, Nov 14, 2006

A Breakdown of Debt for Older Families

WASHINGTON—What percentage of older American families' total income goes for debt payments? What percentage of older families had debt payments of more than 40 percent of family income? How do housing and credit card debt fit into the picture?

A study in the September 2006 *EBRI Notes* has the answers to these questions. Overall, the study found that total debt payments increased for families with a family head age 55 or older from 2001 to 2004 and that housing debt and credit card debt were both factors in the increase. The study is available at *www.ebri.org*

Here are some details of the study for families with a family head age 55 or older, showing the recent increase in their debt levels:

Families With a Family Head Age 55 or Older	1992	1995	2001	2004
Total debt payments as a percentage of family income	9.2%	8.5%	8.8%	10.3%
Percentage of families with debt payments more than 40 percent of income	5.8%	5.6%	7.2%	7.3%
Percentage of families with housing debt	24%	27%	32%	36%
(median amount: half above, half below)	($36,904)	($34,471)	($53,255)	($60,000)
Percentage of families with credit card debt	31%	31%	31%	34%
(median amount)	($1,147)	($1,231)	(1,353)	($2,000)

Source: *EBRI Notes*, September 2006. (All debt values are in 2004 dollars.)

Fast Facts from EBRI is issued occasionally by the nonpartisan Employee Benefit Research Institute to highlight benefits information that may be of current interest.

EBRI is a private, nonprofit research institute based in Washington, DC, that focuses on health, savings, retirement, and economic security issues. EBRI does not lobby and does not take policy positions. *www.ebri.org*

Statement of Ivar Rydstrom

Summary of Statement Issues Covered:

State of the Economy: American Dream of Homeownership, Its Solutions & Direct Relationship with the Economy & Retirement/Homeownership as Key Economic Wealth Builder/80% Homeownership Subprime Success Rate/Can We Expand Homeownership?/Should We Expand Homeownership?

Problems & Solutions Concerning The 20%—Subprime Homeowner Defaults, Foreclosures

Immediate Solutions: We can help stop defaults and foreclosures——Interim Loan Measures (“ILM”)

Long Term Solutions:

Secret or Silent Risks/Overburdened Borrowers/Naked Lenders and Naked Government Backed Securities “RAhD” (randomly activated hidden debt)/“RAhC” (randomly activated hidden contingencies)

Failed Disclosures to Government Sponsored Entities (GSEs) or Investors

Failed Disclosures to the Borrowers

“Truly Intelligent Disclosures” (“TID”)—New proposed lender disclosures—“Borrower’s Consent on Suitability”

Failed Historic Bargaining Positions of Market Participants—New proposed risk-price allocations

RISK MITIGATION TECHNIQUES

“Safe Harbor Intelligent Loan Options” (“SHILO”)—New proposed “Contractual” default type solutions

RISK MITIGATION DEVICES

Mortgage Insurance (Funds) (“MI”) New MI Products: Cash Affordability, Shared Costs-Shared Benefits

TID, SHILO & MI Integration:

Foreclosure Mortgage Insurance (“FMI”)—New proposed mortgage insurance solutions:

Default Mortgage Insurance (“DMI”)

Investors Mortgage Insurance (“IMI”)

Key Risk Benefit Pricing & Tax Reallocations—New proposed Tax Law Changes

Conclusion—You’re As Sick as Your Secrets/Sustainable Homeownership

Ultimate Questions Not Yet Answered by Comprehensive Policy:

1. *The question is simple. Do we want to expand the American Dream of Homeownership and grow the Economy at the same time, or not?*
2. *Ultimately our children and grandchildren will sit back and ask, why did they punish the weak, and reward the strong—when they could have strengthened the weak and strengthened the strong at the same time?*

Mr. Chairman, Members of the Committee: I am pleased on behalf of Economic Justice & Policy Center to witness and submit this statement for the record of the House Ways and Means Committee on the “Challenges Facing Middle Class Families” limited to the problems and solutions concerning *homeownership* and its *direct relationship to the economy* and retirement. We think it is critical to take a market neutral approach without allegiance to any group or interest and present all sides: Homeowners, Lenders, Bankers, Investors, GSEs, Immigrants, Baby Boomers, Retirees, Builders, Brokers, etc.

State of the Economy: American Dream of Homeownership, Solutions & Its Direct Relationship with the Economy & Retirement/Homeownership as Key Economic Wealth Builder/80% Homeownership Subprime Success Rate

Can We Expand Homeownership? Yes we can. Look at the statistics. If "one in five (20%) subprime loans ("made in the last 2 years") result in foreclosure" (*Ron Nixon, New York Times, Center for Responsible Lending*), then 80% of that revenue stream was a good risk after all. If 80% of subprime loans are performing, expanding homeownership through weaker buyers has worked. Homeownership adds a significant tax revenue base and equity wealth to borrowers, local towns and strengthens the national economy as a whole. To achieve a better success rate, we must support policy that:

(1) Expands homeownership across the board, and
(2) Fashions incentives or controls necessary to lower the 20% subprime foreclosure rate by refining the market risk-pricing structure, and adding intelligent refinements and risk mitigation devices and techniques to the bargain.

Should We Expand Homeownership? Yes we should. The argument against such expansion includes the idea that not all Americans can afford homeownership, and we are entering a period of continued deficits and mounting baby boomer entitlement costs that preclude America from engaging in such growth. Both arguments fail. The former because the 80% subprime success rate proves it can work, but is in want of refinements as discussed in this report. The later because the authoritative study quoted by Chairman Bernanke (COB *Budget Outlook 2005)* testifying at the Committee on the Budget, U.S. Senate January 18, 2007, concerning the risk of weakness in the U.S. economy over the next decade or two, fails to take into account "new immigrant and increased subprime homeownership"—and its positive effect on the economy. Frankly, the study hypothetical dealing with the relationship of both increasing immigration from 1 million to 2 million (per year) and entitlement costs, must be revisited with offsetting economics from both *homeownership from new and existing immigrant family members, and increased subprime homeownership*. Housing creates jobs and tax revenues. We must remember that about *20% of GDP* is related to housing. In 1998, some 50% of all homeowners held 50% of their net worth in home equity. (The State of the Nation's Housing, Harvard "JtCtr" 2002) Every 1000 homes built create 2,448 jobs and $79.4 million in wages and $42.5 million in federal, state and local tax revenues and fees. (JtCtr citing National Association of Home Builders 2002 (NAHB)) Twenty percent (20%) of all consumer spending is linked to household wealth. Every $1,000 gain realized from a home sale boosts spending by some $150; $30–50 from stocks. (JtCtr citing Federal Reserve Board). We can add 15.61 million homeowners over the next 14 years (approx. 1.2 million per year). Demand may require 1.7 million new homes and apartments per year (JtCtr) which could pour billions into the tax and wage base. Homeownership creates a backbone of wealth throughout America like no other financial product to date. "The American Dream" begets hope, confidence and success. Greater homeownership can help balance the budget. On January 20, 2001, President Bush indicated that poverty was unworthy of our citizens, and that we all have a duty to help eradicate it. Now let's work on lowering that 20% figure.

Problems & Solutions Concerning The 20%—Subprime Homeowner Defaults, Foreclosures

Although the general economic indicators appear positive, the economy may not be stable if the mortgage banking industry experiences significant defaults or foreclosures from homeownership. Residential real estate is losing power (Grubb & Ellis Multi Housing Report 2007, *www.grubb-ellis.com*). Wages have not caught up to home prices. Home inventories are growing and prices are falling but prices are still historically high (CVBT reporting PMI 1/24/07). However, if Chairman Bernanke returns to fighting inflation with interest rate hikes during periods of declining home values, homeowners will become locked-in with no way out, creating a bigger foreclosure industry and additional social problems. Worse, if Congress, the government or industry simply implement solutions that tighten markets and eligibility, growth in homeownership and the economy will stall. Homeownership will continue to play the most significant role in wealth creation for the middle class American (family) than any other financial vehicle. The effective "saving" of money for a down payment is *not* a realistic policy for a newly defined middle class thrown into a new American economy mixed with historically inflated home prices and lagging wages. Demographics prove that the current and future middle class will not be the same as it was after WWII. This new middle class homeowner will be largely new immigrants, non-family or singles, and women (JtCtr). *"Affordability" and "eligibility" of homeownership will become more important to the national economy, if not critical.* We must also realize that expanding the dream of homeownership in the near and long-term, will strengthen a soon to be vulnerable economy under unique pressure from the aging baby boomers, growing entitlement demands, deficits and changing demographics.

We now see over 100,000 home-foreclosures per month (for the last 5 months) (RealtyTrack 1/07). On January 24, 2007 the Central Valley Business Times (CVBT) reported on the latest PMI Group study entitled Economic & Real Estate Trends (Milner, Henry), saying: "There's a greater risk of price declines in 34 of the nation's 50 largest metro areas, PMI says. That translates into a 34.2 percent chance that home prices will decline in 2 years, according to PMI's formulas. Nineteen MSAs face a greater than 50 percent chance that home prices will decline, up from 18 last quarter, it adds. While year-over-year appreciation remained in the double digits in 14 of the 50 largest MSAs, the rate of appreciation slowed in 43. The risk of price declines continues to be concentrated in California and along the eastern seaboard. Of the 19 MSAs facing a greater than 50 percent chance of a price decline, eight are located in California, eight are in the Northeast, and two are in Florida." In high-price areas such as California, "foreclosures were up nearly seven-fold in the fourth quarter of 2006 and the number of notices of default, the first step in the foreclosure process, were *up 145 percent* compared to the figures from a year earlier, according to real estate information company DataQuick Information Systems of La Jolla." Recent reports of increases in loan applications don't necessarily show a healthy homeownership market, but reveal possible panic to replace adjusting Option A.R.M.S. as values and appraisals fall. Millions of homeowners are about to lose their homes from default or foreclosure over the next few years in waves, as adjustable loans and HELOCs reset. One of five subprime mortgages over the last 2 years will end in foreclosure, *nearly double the projected rate* from 2002. When distressed prepayments are added in, *total "failure rate" approaches 25 percent.* Of the subprime loans, over 50% went to African-Americans, and 40% to Hispanics. (*Center Responsible Lending 12/2006*) The foreclosure sub-culture is now gearing up (for the kill) and growing rapidly. Foreclosures are here and about to break the dam with dramatic numbers each and every year over the next few years corresponding to the reset dates of adjusting mortgages. Homeowners are already becoming locked-in with no way out. The negative consequences to the economy will be devastating when compounded by the strain of changing demographics.

Immediate Solutions: We can help stop defaults and foreclosures now—with what I call Interim Loan Measures ("ILM")?

We must help keep people in their homes, and offer immediate remedial measures and relief from default or foreclosures; but we must pay for such risk with mortgage insurance type devices or risk mitigation techniques. The conceptual solutions are also found in the long-term solutions recommended below, but applied in the short-term by law, policy and incentives. Lender and investor Loss Mitigation departments must be *more receptive* to quick and orderly loan workouts with borrower relief from certain negative credit damage, costs, (refinance) deficiency judgments and tax debt or tax uncertainties. Recall most loan workouts leave the borrower with negative credit and more burdensome terms; and most foreclosure market workouts leave the borrower with "nothing"—*not even "relocation expenses"*! The foreclosure industry attempts to give the borrower relocation expenses (against Bank policy or law) under the guise of a separate transaction by purchasing the borrower's personal property. Since an old picture or stove will not truly be worth $15,000, the legal or banking prohibitions on giving the borrower any money whatsoever create yet another quagmire in the system for helping a person in need. *The current system helps create a growing foreclosure market, and the current system helps restrict or preclude helping the unfortunate who find themselves in the system*. Meanwhile we need to help the people now. We need education and real joint venture assistance with business, media and homeowner groups (like NeighborWorks, National Urban League, GM, GE, Bank of America, WFB, Washington Mutual, Countrywide, Lilly Endowment, Gates Foundation, Goldman Sachs, Merrill Lynch, CitiGroup, CUNA (CU360), etc.).

Long Term Solutions: Additionally, in a comprehensive fashion, we must also expand the homeownership market for the betterment of that social public policy and for the national economy. We must do this by adding risk mitigation devices and techniques to our mortgage banking system. We need to add more affordable and flexible *shared-costs and shared-benefits* mortgage insurance devices (and funds) along with our newly created refinements such as:

"Truly Intelligent Disclosures" ("TID")

"Safe Harbor Intelligent Loan Options" ("SHILO")

"Shared Mortgage Insurance" (Government, Borrower, Lender, Investor, Insurance Company) ("SMI")

"Foreclosure Mortgage Insurance" ("FMI") ("GFMI")

"Default Mortgage Insurance" ("DMI")("GDMI")

"Investment Mortgage Insurance" ("IMI"))("GIMI")

The Stage is Set for Change: The stage is uniquely set (in 2007) for positive change for increasing the Dream of American Homeownership as starting in 2007 mortgage insurance will be *tax deductible*, and *F.H.A. is offering new no or low down loan programs*. We need to expand creative loan programs by using risk absorption devices, make mortgage insurance a permanent tax break, and add tax relief from "forgiveness of debt" with simple clarifications to such tax laws. The present tax laws breed uncertainty in a time which requires certainty and confidence. We must not tease mother-economy any longer. Moreover, Congress, the Administration, Industry and the American public must consider a reallocation of the risk-pricing formula in the mortgage banking loan industry. Inherent in this relationship is what I call "RAhD" (*randomly activated hidden debt*) and "RAhC" (randomly activated hidden contingencies). We must mitigate RAhD and RAhC in our long term solution to homeownership and the current mortgage banking foreclosure challenges. Although foreseeable to some extent, its quantification is uncertain, but some price must be paid for such risk mitigation. Such is the market price of confidence.

As such, Congress must consider the growing economic strain from mounting baby boomer entitlement programs, and the looming deficit. If legislation causes the shrinkage of eligibility and homeownership, its effect will help spoil the economy, especially if we are entering into a period of new uncertainty and inherent weakness due to changing demographics. Chairman Bernanke testifying at the Committee on the Budget, U.S. Senate, January 18, 2007, warned us that the near future is riddled with economic uncertainty or weakness (RAhD and RAhC), stating: "Although the retirement of the baby boomers will be an important milestone in the demographic transition—the oldest baby boomers will be eligible for Social Security benefits starting next year (2008)—the change in the nation's demographic structure is not just a temporary phenomenon related to the large relative size of the baby-boom generation." He went on to say: "Unfortunately, we are experiencing what seems likely to be the calm before the storm." The Federal Reserve Chairman made clear that: "The only time in U.S. history that the debt-to-GDP ratio has been in the neighborhood of 100 percent was during World War II. In contrast, under the scenario I have been discussing, the debt-to-GDP ratio would rise far into the future at an accelerating rate. Ultimately, this expansion of debt would spark a fiscal crisis, which could be addressed only by very sharp spending cuts or tax increases, or both."[6] *However, another solution* would be to add new and growing homeownership to the economy from new and existing (or even from an increased rate of) immigrants and the ever-changing family structure. Homeownership will be a positive offset to mounting entitlement and budget deficits. Chairman Bernanke also warns us to act comprehensively. He stated: "[However], the unified budget deficit does not fully capture the fiscal situation and its effect on the economy, for at least two reasons. First, the budget deficit by itself does not measure the quantity of resources that the government is taking from the private sector. An economy in which the government budget is balanced but in which government spending equals 20 percent of GDP is very different from one in which the government's budget is balanced but its spending is 40 percent of GDP, as the latter economy has both higher tax rates and a greater role for the government. Second, the annual budget deficit reflects only near-term financing needs and does not capture long-term fiscal imbalances. To summarize, because of demographic changes and rising medical costs, federal expenditures for entitlement programs are projected to rise sharply over the next few decades. However, if early and meaningful action is not taken, the U.S. economy could be seriously weakened, with future generations bearing much of the cost." If we are to be true to our social public policy of bringing the American Dream of homeownership to the masses and if expanding homeownership can help secure the national economy over this historically unique and vulnerable upcoming decade, then we must expand opportunity, not restrict it to only "prime" or quasi-prime borrowers. The solution is in the problem. Let's refine it now before it's too late.

Secret or Silent Risks/Overburdened Borrowers/Naked Lenders and Naked Government Backed Securities/"RAhD" (randomly activated hidden debt)/"RAhC" (randomly activated hidden contingencies)

RAhD is (*randomly activated hidden debt*). RAhC is (*randomly activated hidden contingencies*). RAhD and RAhC are a part of risk. They are risk contingencies, and as such they are a critical part of the risk-pricing bargain. They are like free radicals. They are a foreseeable contingency with unknown ramifications, unknown activation date(s), or an unknown contingency with unknown ramifications—all due to insufficient disclosures or failed market bargains. I first coined the phrases RAhD and RAhC on my review of the Enron debacle. Enron had numerous special purpose entities (or "SPEs") holding debt or contingency type commitments hidden "off-balance sheet" and not disclosed or understood on the public financials used by investors. When random or inevitable events caused Enron to make good on such debts, the world became aware the true state of its financial sickness. If you're as sick as your secrets, and unknown, over-priced, mis-priced, or unmitigated RAhD and RAhC are the secret, the economy will become sick. We must fairly reallocate risk-price mitigation. Micro RAhD and micro RAhC are also contained in the risk-pricing of each market participant's deal. If disclosures are insufficient whether to the borrower or government sponsored entities (GSEs) or investors, then risk is not accurately defined or mitigated. The market "bargain" between price, risk and return is then corrupted. Thus the risk pricing paradigm is faulty. True market risk-pricing has failed. This discrepancy in market risk-pricing becomes a contingency in itself infused into the market in unknown proportions with untold consequences. This is the threat of RAhD/RAhC. This is where we are in history concerning our homeowner mortgage banking system. RAhD and RAhC are infused into the risk-price bargain *inherently*, *but unnecessarily* because of three forces:

(1) failed disclosures to or risk pricing by government sponsored entities (GSEs) or investors
(2) failed disclosures to the borrowers
(3) failed historical bargaining positions of market participants

(1) Failed Disclosures to Government Sponsored Entities (GSEs) or Investors

So called "exotic" loans are not so exotic at all. They are purpose driven. They fulfill specific market needs. They are however the 2007 Congressional tell-tale of a pending unmet need of the borrower. Of course, in the wrong hands a misused loan product or a misinformed borrower can result in devastation. What I think is exotic is the possible infusion of unnecessary **"RAhD" and "RAhC"** into the mortgage banking market system. The sad truth is we may have *naked lenders* and *naked government backed securities*. Ginnie Maes are guaranteed against principal loss by the full faith and credit of the federal government, but Fannie Mae and Freddie Mac are not. Fannie Mae and Freddie Mac have to absorb the foreclosure fall out if borrower's default. These mortgage pools are not rated. Are the triple-A corporate sponsor bonds able to support the risk? We have a large volume of high loan to value loans (with a high risk of default) that will reset to even higher rates compounded by a period of lowering property values, without mortgage insurance. This is critical because the lowering property values will create borrowers with no exit capabilities. These factors have the potential to feed upon itself and create broad economic trouble and loss of market liquidity. Lenders created and brokers sold non-insured loans (especially high ratio piggyback first liens with high variable rate revolving home equity line of credit ("HELOC") second liens) to meet the market demand and rapid growth of homeownership. But did the government sponsored entities or GSEs (such as *Fannie Mae and Freddie Mac*) understand the risk of a first "conforming" (80%) lien *without mortgage insurance*; tied to the same borrower who had a piggyback *overpriced* 20% silent or secret second *without mortgage insurance*? Did the market properly price this risk? Did investors overcharge borrowers for this risk by overloading the borrower's monthly cash burden? Worse yet, many of these secret seconds are not closed ended seconds, but revolving credit (card) type HELOCs. The GSE regulatory reporting guidelines were developed before the avalanche of piggybacks (*The Hidden Risks of Piggyback Lending, C.A. Calhoun, PhD*). Whether the market truly understands these risks or not, the risk therein must be truly mitigated by mortgage insurance type products that are shared in costs *and* benefits by all market participants, including the borrower.

(2) Failed Disclosures to the Borrowers

We know any loan may go into default or foreclosure due to known or unknown reasons. A borrower may lose a job, get sick, become disabled, die, get divorced, lose a lawsuit, incur an underinsured or uninsured event from a hurricane, tornado, water damage, auto accident, environmental and mold burden, etc. Creative or adjustable loans have added another layer of risk (RAhD, RAhC) to the borrower especially if the borrower didn't understand or can't afford the risk of paying the monthly burden as loans adjust or reset. These loans may in fact hold the answer, but we need better disclosures.

a. "Truly Intelligent Disclosures" ("TID"). Creative or exotic loan products and easy credit are not the problem per se, but in fact may be part of the answer per se. However, in any case, a truly uninformed borrower or misinformed borrower is truly a problem. If the system of fulfilling the American Dream includes a broker gatekeeper who holds all of the cards by virtue of the borrower's non existent relationship with the "unknown lender" who is motivated to keep costs, fees, and more shockingly interest rates, higher (*Losing Ground: Foreclosure Sub-prime Market/ Cost to Homeowners*, citing Jackson, Berry, *Kickbacks or Compensation: Yield Spread Premiums, Harvard* (Jan. 8, 2002)), then the borrower has little chance to obtain the most effective or "suitable" loan package for his/her needs. Effectively, market competition may not have fully prevailed in this round of mortgage lending. In such event, we all suffer. We must refine the relationship, and better share risk and price. We should expand, not limit creative loans and available credit. However, creative loan products should require what I call: "truly intelligent disclosures" ("TID"). *However, we do not need more disclosures for disclosures sake. We truly have enough paper for paper's sake. Maybe we need less of that*. We need (1) more accurate, meaningful and easy to understand disclosures, and (2) additional borrower disclosures with intelligent "underwriting business type analytics" (of the borrowers' risks and analytical probabilities in changing and projected conditions such as the effect of declining property values on this particular loan especially with rising interest rates). Those risks need to be clearly disclosed to the borrower in a ***summary format***. Over the last 10 years numerous third party computer information services have gathered and computerized relevant information needed to supply the borrower with an intelligent short summary form disclosure (in real time) sufficient to enhance real issue warnings and "suitability" concerns (First American, **Experian**, Equifax, TransUnion, PMI Group, CUNA Mutual/CMG, Mortgage Bankers Association, DataQuick, DataTree, RealtyTrack, DataPlace, Risk Profiler, GAO, FDIC, CRL, HUD, Fannie Mae (GSEs), MassHousing, BankRate.Com, HSH, etc.) If Congress or the industry mandated truly intelligent numeric summary disclosure formats (TID), I would estimate that the industry could be ready to operate with same within 18 months or so. The partial (summary) list below is a list of disclosures that were commonly insufficient in the last lending cycle (also couched as TIDs), in addition to newly suggested TIDs:

1. Lack of TID re accurate (or industry consistent) calculations of loan characteristics such as ANNUAL PERCENTAGE RATE (APR), and relevant instruction or examples on how to use or evaluate such information.
2. Lack of TID of CLEARLY LABELED FEES AND COSTS including *broker yield interest rate spread compensation and junk or inflated loan costs including points or buy downs*. These figures should be shown alongside applicable *industry norms or legally permissible charges* so the borrower can make intelligent decisions concerning the cost/benefit bargain of the loan offer.
3. Lack of TID re the lender's ACCEPTABLE MINIMUM INTEREST RATE REQUIREMENT PER APPLICABLE CREDIT SCORE for this particular loan. This would allow the borrower to know and negotiate to avoid (abusive) interest rates hikes caused by *broker yield-rate spread compensation*. This is not a suggestion to totally eliminate such compensation, but such compensation must be justified, the effect on the borrower must be disclosed, and it must be subject to the borrower's rejection of those terms (or the loan offer based on those terms).
4. Lack of TID re *BORROWER'S CONSENT ON SUITABILITY* based on a *numeric summary sheet disclosure* including the EFFECT ON THE BORROWER AND PROPOSED LOAN PROGRAM(S) WHEN THE MARKET AND PROPERTY VALUATIONS CHANGE (i.e.: decline) as related to INTEREST RATE CHANGES (i.e.: rise), including but not limited to the change in monthly payment amounts, potential (non)eligibility of alternative loan payment options, loan modifications or common market loan programs, all indicating applicable Loan to Value (LTV, CLTV)

and Income to Debt ratios, prepayment penalty burdens, negative amortization loans, the effect on other key eligibility barometers and LACK OF (EXIT, SALE or REFINANCE) OPTIONS over a projected 1, 3, 5 and 15 year period. Many borrowers may have a perfectly good reason to choose a negative amortization loan, interest only loan, option arm loan or other variation of them, and may in fact realize true financial and related benefits therefrom. But the borrower needs to understand them to make a proper suitability decision. *Lenders and brokers must have a duty to disclose and obtain the borrower's consent on suitability*.

CRITICAL; Loan Comparison Summary Sheet Disclosure With All Common Or Applicable Loan Programs, With Mortgage Insurance & Tax Analysis: *The TID re "BORROWER'S CONSENT ON SUITABILITY*" must include a COMPARISON OF ELIGIBLE LOAN PROGRAMS WITH AND WITHOUT MORTGAGE INSURANCE including a COSTS/BENEFITS/LOSS analysis with PRE-TAX and AFTER-TAX EXAMPLES (showing legally deductible amounts based on tax assumptions developed by the actual numbers reported to underwriting of the borrower. For example the borrower should be able to quickly look at a summary sheet and see the estimated total loss to borrower and lender due to limited default and foreclosure, MI coverage and projected payout amounts, lender exposure and other projected Need-To-Know and What-If relationships. More importantly the borrower would be able to confirm or object to the broker's representation that a Piggyback (80/20) loan is less expensive than a single loan with MI. Now these loan programs and concepts can truly compete because the borrower will have intelligent summary comparisons to use in making his/her decisions. **Note—**PMI GROUP has a computerized disclosure model that I have tested. Other mortgage insurance companies may as well. It does much of what I am concerned with, not all however. Also we need a more advanced version for professionals and a simple summary version for consumers to enhance understandability and allow a meaningful decision to be made by the borrower on "suitability".

5. Lack of TID to the borrower concerning the HISTORY OR DESIRABILITY OF THE LOAN SERVICER.
6. Lack of TID on the truth that certain GOOD FAITH ESTIMATES may not at all be accurate and the reasons why. The industry must move to more comprehensive and automated information system with accurate estimated TIME TABLES in the loan processing itself and related parties must respond with info (payoff demands, etc.) within short legal deadlines.
7. HUD AMENDMENTS: Lack of TID on the HUD–1 disclosure forms reflecting and incorporating the above TIDs. The GOOD FAITH ESTIMATES and the HUD–1 disclosure should be amended to include the appropriate TIDs or appropriate summary material therefrom.

3. Failed Historic Bargaining Positions of Market Participants

Borrower's Risk Pricing: The borrower is carrying too much risk and paying too high a price for such risk. The borrower's monthly cash burden is too high. The borrower's RAhD and RAhC are much too high. The risks of failed exit options for the borrower are too high. The market participants have attempted to mitigate this risk by simply charging the borrower, but the borrower simply cannot afford the price. We are at a time in history where the price for risk has been proven to be too high for the borrower—if we want to continue the public policy of increasing homeownership. Risk must have a price and someone or something must pay for that risk. *Who or what pays for the risk and how it is paid for are the key questions etched in the fabric of the solution*. Answer them and you will have a refined solution.

Risk can be paid for with **risk mitigation devices and risk mitigation techniques**. The solution will require an integrated combination of both.

A. RISK MITIGATION TECHNIQUES

"Safe Harbor Intelligent Loan Options" ("SHILO"). We can and should foresee delinquency, default and foreclosure contingencies and handle them *in the loan agreements at origination*. Why wait for the effect of costly defaults and foreclosures until we handle the solution? We are creating a sub-industry based on failed attempts at the American Dream which cause further economic market uncertainty, economic ruin, and human disgrace. Is that what we want? If not, why not build-in some contractual remedies to enhance certainty in the marketplace and help save people at the same time? I recommend that we consider *contractual risk mitigation techniques in the loan agreements at origination. I call this concept*:

Safe Harbor Intelligent Loan Options or "SHILO"

"SHILO" is a minimum set of borrower (lender, insurer, or government) loan option rights concerning issues of payment, default, and foreclosure including forbearance or deferment options, loan modification or conversion rights, refinance rights, short refinance rights, short sale rights, and/or exit options contained in the loan agreements that may or must be used in the event of pre-default or foreclosures circumstances. The Lender and the Borrower may also negotiate for additional SHILO. These provisions directly benefit the borrower, but on many levels also directly and indirectly benefit the lender, the local State and Federal Governments, investors, and the economy. **Presently the borrower in trouble has a lack of exit options available. This causes "liquidation type forced sales" and creates a feeding frenzy in the foreclosure markets.** This often causes great loss to the borrower, lender, local State and Federal Government, investors, and the economy. When a borrower is in trouble and in need for loan modifications, he is generally experiencing financial, medical or market distress, or has a specific economic or other reason for wanting same. We need contractual remedies that offer relief from the foreseeable financial and personal problems that we know will occur and unforeseeable contingencies as well. Obviously persons in financial trouble will not be able to qualify for many of the current extra-contractual options. It creates another set of problems. The current loan agreements create RAhD and RAhC risk. Substituting predefined contractual solutions (SHILO) for those unknown and known potential problems would reduce the size of the foreclosure marketplace and help stabilize the risk benefit pricing structure. SHILO would cause real estate markets to experience or realize less extreme risks. This would reduce the risk, costs and losses to all participants in the marketplace. The SHILO solutions are the current concepts used by the foreclosure industry including but not limited to:

(1) Forebearance with Reinstatement or Repayment Plan Agreement, (2) Loan Modification, (3) Short Refinance, (4) Short Sale, (5) Market Sale, (6) Investor Sale, (7) Investor Sale and Lease Back, (8) Deed in Lieu of Foreclosure (9) Reverse Mortgage, (10) Bankruptcy, (11) Hand in Keys & Walk Away Clean, (12) Walk Away Dirty, (13) FHA Partial Claim (14) Gift Equity Transfer, Etc. The key is to allow a borrower when in financial trouble to access prescribed contractual payment or exit solutions without requiring good credit standards. We must stop kidding ourselves; we all know that the borrower who is in trouble will not have good credit or feasible foreclosure market solutions. We may see $164 billion in equity loss over the next few years. In an optimal or evolving economic society, we must refine this market inefficiency with non-cash substitutes or equivalent risk-pricing ("ERP") with MI.

B. RISK MITIGATION DEVICES

There must be a price paid for risk absorption, but it doesn't have to be "cash upfront", nor paid for by the borrower. The problem to solve now for the future, is can we mitigate risk inherent in the middleclass or subprime rated borrower without creating unrealistic "cash" carrying burdens? We can and must by using risk mitigation devices such as mortgage insurance or funds, with TID and SHILO.

Mortgage Insurance (Funds) ("MI") Type Products: The costs of avoiding MI may be too high for market stability. The default and foreclosure rates prove that it is too high for the middle class, subprime borrowers and borrowers in high-priced market areas like California and the eastern seaboard. Is the investor and lending industry taking too much in fees without mitigating risk in the market especially on non-conforming second liens? Should all market participants pay for risk mitigation or MI type products? The "concept" of private mortgage insurance or "MI" ("PMI") is a good one from a market standpoint because it insures and shares risk. Insuring or sharing risk is what makes markets work. It protects the mortgage holder (lender) from complete loss in the event of default. It hedges some risk inherent in the financial mortgage vehicle. Borrowers generally have a negative opinion about MI. They view it as too cash-expensive. Now that President Bush in late December 2006 signed into law allowing *tax deductions for mortgage insurance* the comparison of using MI or using piggyback loans without MI will change. Borrowers must always remember that piggybacks with adjustable high rate HELOCs can be deadly. Piggybacks and non-piggybacks are in need of MI type risk mitigation, and an overhaul or intelligent refinement that takes into account the *borrower's affordability*. High rate second liens overload the borrower's carrying burden. MI should insure such second liens, or better facilitate one-loan programs. The GSEs will have to change policies to meet this need as well.

TID, SHILO & MI Integration: We must integrate TID and the SHILO solutions with the new and existing MI solutions. This will allow for more price risk alignment and enhanced stability in loan products. Joseph Thomas of Retirement Networks (Florida), and the author suggest the following risk mitigation conceptual examples at a no or low cash cost basis to the borrower:

Foreclosure Mortgage Insurance™ ("FMI")—FMI under certain conditions may cover certain cost burdens as well as return *FRESH START money, credit or opportunities to the borrower*. Remember, the wealthier the borrower, the less risk is introduced into the markets.

Default Mortgage Insurance™ ("DMI")—DMI under certain conditions, may cover missed payments; up to12 months or more.

Investors Mortgage Insurance™ ("IMI")—Second liens have been over priced from the borrower's perspective; especially certain adjustable rate piggybacks with high rate seconds (HELOC). If piggybacks are to continue, the cumulative risks inherent must be mitigated without simply charging the borrower more cash-burdened money. Investors in such loans must be offered risk mitigation insurance benefits as a "substitute" or "equivalent" for increased price burdens on the borrower. The borrower alone can not afford to pay the price for this risk.

Key Risk Benefit Pricing & Tax Reallocations. To effectuate a solution, risk and cost of risk mitigation must be shared more equally by all of the parties to the bargain. A comprehensive solution would also require:

New Tax Laws: *Congress must extend and make permanent (beyond 2007) the new (2007) tax deduction for borrower paid MI. Congress must allow the borrower to deduct same if the cost of the MI was effectively transferred or absorbed by the borrower whether or not paid in cash by that party. New tax laws must allow borrowers to avoid forgiveness of debt on certain loan workouts, and the "uncertainty" of such taxes. Bulk rate MI should be implemented on a grand scale with shared tax deductions. Risk absorption should yield a tax deduction whether it's cash based or not. These tax breaks are paid for by the taxes and liquidity concomitant in increased market wealth through new homeownership.*

Conclusion: You're As Sick as Your Secrets/Sustainable Homeownership—Increasing "penalties" or shrinking the market will not prevent abusive lending or foreclosures. But if you preempt the transaction itself which is subject to foreclosure abuse by allowing the parties to the relationship to invoke prescribed contractual solutions, you will remove the opportunity for others to violate the weaker party to that relationship, which is invariably the borrower. We must correct by refinement our "secret" market defects to achieve less sickness. If 80% of subprime loans have been successful, TID, SHILO, and *new cash-affordable MI products* will reduce defaults and foreclosures in the 20% high risk group, and by definition enhance "sustainable homeownership". Nothing will be 100%, and it shouldn't be. This risk of loss and risk of success create market opportunities—as long as price is fairly set with risk mitigation. Expanding homeownership will create more wealth and better local, national and international economies. Let's stop knee-jerk non comprehensive rules and laws; let's refine, expand and enjoy the ever changing new America, and the first historic period of American retirement—supported by homeownership wealth.

Statement of Lawrence Stahl, American Prepaid Legal Services Institute

I am Lawrence Stahl, President of the American Prepaid Legal Services Institute. The American Prepaid Legal Services Institute (API) is a professional trade organization representing the legal services plan industry. Headquartered in Chicago, API is affiliated with the American Bar Association. Our membership includes the administrators, sponsors and provider attorneys for the largest and most developed legal services plans in the nation. The API is looked upon nationally as the primary voice for the legal services plan industry.

The hearing today deals with the economic challenges facing middle class families. Committee Chairman Rangel noted in calling the hearing that "Many American families are finding it harder and harder to hold on to the American dream. We need to take a deeper look at what is driving these concerns so we can build and maintain an economy that works for all Americans."

One of the economic challenges facing working families is surviving in an increasingly complex financial environment. Currently working families are in an extremely precarious economic position. A perfect storm of adjustable rate mortgage increases, credit card interest rate increases, layoffs and cutbacks have put many families on the edge of economic collapse. A single event, such as a divorce or illness that interrupts cash flow is enough to trigger defaults on mortgages, evictions or collection lawsuits. Now is the time when working families need access to the legal system, through employer-provided legal plans, to save their homes, deal with debt collectors and keep the family intact.

I offer this written testimony in support of employer-paid group legal services for working families. Employer-paid group legal services provide a vital safety net for middle-income families. However, this safety net has been compromised ever since the tax-preferred status of the group legal services benefit fell out of the Code.

Since the loss of the tax-preferred status in 1992, existing plans have been forced to cut back and few new plans have been added. Congress has the opportunity to reinstate Section 120 of the Internal Revenue Code of 1986 and restore the exclusion from gross income for amounts received under qualified group legal services plans. This will provide an incentive for existing plans and tax relief for working families and businesses.

Bills have been offered in the past several Congresses, most recently as H.R. 897, introduced by Representative Camp and Chairman Rangel and co-sponsored by 29 members, including 16 members of this committee.

Section 120 was originally enacted in 1976 and extended on seven separate occasions between 1981 and 1991. The provision encourages legal services benefits for employees and their families by excluding from income and social security taxes employer contributions towards qualified group legal services plans. Unfortunately, when this exclusion expired, it triggered a tax increase for millions of working Americans whose employers contribute to such plans. Currently employees and retirees are taxed on the employer's contribution, whether or not they use the benefit.

These plans are important to working Americans. With the growing complexity of today's world, ordinary citizens need access to preventive legal advice. Access to the legal system is especially important for so many middle income families who are living paycheck to paycheck with very little cushion in the event of illness or injury Group legal plans provide employees with low cost basic legal services, including assistance with the purchase of a home, the preparation of a will, probate, and domestic relations issues, such as child support collection. Many plans also offer assistance with elder care issues and the growing problem of identity theft. Plans do not allow for suits against the employer, class actions or fee generating cases.

More than 2 million working families are now covered by legal plans. They are offered by such national companies as Caterpillar, DaimlerChrysler, J.I.Case, Mack Truck, John Deere, Ford Motor Company, General Motors, and thousands of small businesses.

Many people do not realize that Group Legal plans cover not only active workers but also cover retirees, surviving spouses and dependents. Much of the legal work done by legal plan attorneys is designed either to prepare workers for retirement or to handle issues that arise after retirement. This is part of the American Dream that Chairman Rangel focused on in calling this hearing.

Retirement is a complex task today. Those individuals anticipating retirement must consider how to:

- Protect their spouses and children in the event of death.
- Anticipate the need for long term care, as well as Medicare and Medicaid issues.
- Instruct medical professionals on how they want to be treated in the event of a serious illness or a life threatening accident.
- Instruct family members on how they want their property handled in the event of incapacitating illness or accident.
- Address financial management and investment issues in the face of a decreased income.

Legal plans provide the advice and legal documents to accomplish these tasks including wills and trusts, powers of attorney, living wills/medical directives, guardianship and conservatorships, nursing home contract review, Medicare and Medicaid appeals and home refinancing document review. These important legal services provide retirement security.

Legal plans also provide a significant educational benefit on a multitude of issues important to working and retired Americans and are a vital component of any retirement education plan. By learning how to protect their savings, middle class citizens can achieve their dream of retirement.

Legal plans:

Educate consumers about budgeting and debt problems.

Present seminars on preparing for retirement covering estate planning, social security and review of IRAs, including such issues as what to do with the IRA when the first spouse dies.

Educate clients on how to avoid identity theft and what steps to take if a client is a victim of this crime.

While qualified employer-paid plans have proven to be highly efficient, there is still a cost to the employer for providing this aspect of retirement security. Employers must pay an additional 7.65 percent of every dollar devoted to a legal plan as part of its payroll tax, whether for an active employee or a retiree. Employees pay the payroll tax plus income tax on the cost of the benefit whether they use it or not in any given year.

As employers seek to reduce or eliminate benefits in general, targeting benefits that are not tax preferred are high on employers' lists. Recently this trend toward reducing benefits has taken a toll on existing group legal plans. Large employers such as Rouge Steel, Delphi and Visteon have either dropped the benefit entirely or created a two-tier benefit system that eliminates group legal for their newest employees. The lack of a tax preference for group legal plans makes the benefit vulnerable for reduction or elimination by employers.

Benefit to retirees and the value of the legal services far exceeds the cost of the plan. Many retirees have commented that without a legal plan they would not have the money to hire an attorney to solve their legal problem, which could be as serious as defending against a wrongful foreclosure. Our most vulnerable middle class citizens, our retirees, are at risk of losing the dream they worked so hard to achieve.

Still employers can provide a substantial legal service benefit to participants at a fraction of what medical and other benefit plans cost. For an average employer contribution of less than 100 annually, employees and retirees are able to take advantage of a wide range of legal services often worth hundreds and even thousands of dollars, which otherwise would be well beyond their means.

Reinstating Section 120 would repeal this tax increase, restore equity to the tax treatment of this benefit and ease the administrative burden on employers. Reinstatement also grants access to the legal system for millions of middle class families who might otherwise be priced out of justice. Restoring the tax-preferred status will also demonstrate to millions of hardworking low- and middle-income workers, not only that this Congress supports them, but that the tax code can be beneficial for them.

Respectfully,

Lawrence Stahl
President, API