BERKELEY CENTER ON HEALTH, ECONOMIC & FAMILY SECURITY

Shared Responsibility, Shared Risk:

Government, Markets and Social Policy in the Twenty First Century

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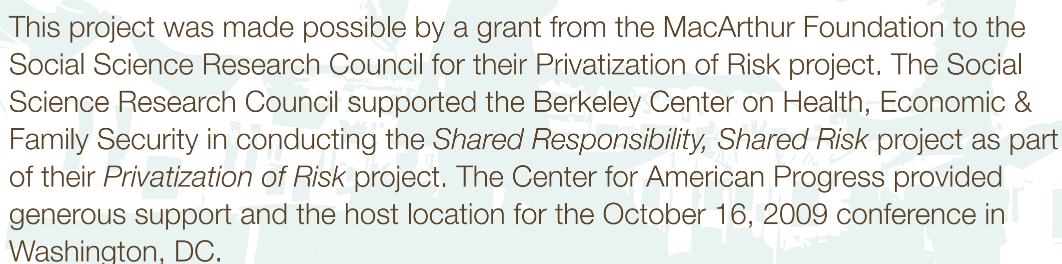
Social Science Research Council (SSRC)
Center for American Progress (CAP)

BerkeleyLaw
UNIVERSITY OF CALIFORNIA

SHARED RESPONSIBILITY, SHARED RISK: GOVERNMENT, MARKETS AND SOCIAL POLICY IN THE TWENTY FIRST CENTURY

"Across the globe, rich democracies are facing grave economic challenges. In the United States, this immediate crisis has been greatly exacerbated by a long-term decline in the economic security of workers and their families that I call the "Great Risk Shift."

— **Jacob S. Hacker**
Author of "The Great Risk Shift: The New Economic Insecurity and the Decline of the American Dream"



This project was made possible by a grant from the MacArthur Foundation to the Social Science Research Council for their Privatization of Risk project. The Social Science Research Council supported the Berkeley Center on Health, Economic & Family Security in conducting the *Shared Responsibility, Shared Risk* project as part of their *Privatization of Risk* project. The Center for American Progress provided generous support and the host location for the October 16, 2009 conference in Washington, DC.

PROJECT OVERVIEW

The privatization of risk has become all the more stark in the past year with the collapse of the financial market, the rise in short-term and long-term unemployment, a record number of home foreclosures, continually rising health care costs and shrinking retirement funds. In each case, protections against risks previously shared by the government or employers are severely limited and, in fact, in many instances are no longer available to help the vast majority of American workers and their families. Whether it is the result of the decrease in access to defined benefit retirement plans backed up by the government, the unwillingness of the government to regulate the mortgage market before it collapsed, or the sharp decline in access to unemployment insurance when a worker is involuntarily out of a job, Americans are increasingly being asked to bear the risks of a bad economy and an unstable market with a very limited safety net in place.

The *Shared Responsibility, Shared Risk: Government, Markets, and Social Policy in the Twenty-First Century* project seeks to undertake an in-depth exploration of proposed solutions to reverse the privatization of risk in order to help protect the American worker and reinvigorate the economy.

Berkeley CHEFS has commissioned this series of papers to offer rigorous and creative solutions on how to improve economic security by rethinking the role the government, employers and individuals should play in managing risks created by the market, an increasingly globalized economy, changing family structures and responsibilities, and a government that provides less and less protection against such risks. This project encourages thinking that offers unified and integrated approaches to the way our society structures risk with a focus on addressing risks caused by health care costs, lack of job leave or income insurance, fewer flexible and secure jobs, risky pension and retirement plans, and lack of incentives for family debt relief and family asset building.

SPONSORING ORGANIZATIONS

Berkeley Center on Health, Economic and Family Security
UC Berkeley School of Law
The mission of the Berkeley Center on Health, Economic & Family Security (Berkeley CHEFS) is to address the increasing insecurity faced by American workers and families through the development of integrated and interdisciplinary policy solutions.

The economic security of American families is a growing national concern, but policy proposals to address the needs of working families with regard to health security, economic security, and work-family balance are too often advanced separately. With faculty experts in law, social welfare, public health, political science, public policy, medicine, and economics, Berkeley CHEFS initiates robust dialogue and research aimed at developing policy recommendations to assist the engineering of legislative, institutional, and regulatory reforms.

Berkeley CHEFS is the only center of its kind at any of the top 50 law schools, and the only university-based think tank that focuses specifically on developing and promoting integrated policy solutions to address problems stemming from the rising insecurity of American workers and families. Berkeley CHEFS' legal

expertise allows the center to craft its proposals to withstand potential court challenges. Its interdisciplinary approach makes the center a rich resource for researchers, policy leaders and students alike.

The Social Science Research Council

The Social Science Research Council (SSRC) was founded in 1923 with a mandate to reach across disciplinary and institutional boundaries and bring the best social researchers together to address problems of public concern. Its initial funder, the Laura Spellman Rockefeller Trust, sought to advance scientific knowledge in order to inform social reform, public policy, and practical action.

The SSRC leads innovation, builds interdisciplinary and international networks, and focuses research on important public issues. Independent and not-for-profit, the SSRC is guided by the belief that justice, prosperity and democracy all require better understanding of complex social, cultural, economic and political processes. They work with practitioners, policymakers, and academic researchers in all the social sciences, related professions, and the humanities and natural sciences. With partners around the world, they mobilize existing knowledge for new problems, link research to practice and policy, strengthen individual and institutional capacities for learning, and enhance public access to information. They bring necessary knowledge to public action.

http://www.ssrc.org

Center for American Progress

The Center for American Progress (CAP), founded in 2003, is a think tank dedicated to improving the lives of Americans through ideas and action. They combine bold policy prescriptions with a modern communications platform to help shape the national debate, and challenge the media to cover the issues that truly matter.

CAP's work builds upon progressive ideals put forth by such leaders as Teddy Roosevelt, FDR, JFK, and Martin Luther King. They draw from the great social movements of the 20th century—from labor rights and worker safety, to civil rights and women's suffrage. They translate those values into new ideas and action firmly rooted in the economic and political realities of the 21st century.

http://www.americanprogress.org

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The full edited volume will also include pieces from Elizabeth Warren, Harvard Law School; Heather Boushey, Center for American Progress; Goodwin Liu, UC Berkeley School of Law; and Martha Minow, Harvard Law School.

The New Economic Insecurity and What Can Be Done About It

Jacob S. Hacker

Across the globe, rich democracies are facing grave economic challenges. In the United States, this immediate crisis has been greatly exacerbated by a long-term decline in the economic security of workers and their families that I call the "Great Risk Shift."[1]

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 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 far more on *private* workplace benefits, such as health-care and retirement pensions.[2] 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.

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 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, America's strained system of unemployment insurance has eroded as a source of support and recovery for Americans out of work.

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 are becoming fewer and harder.

America's 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. The new world of work and family has ushered in a new crop of highly leveraged investors—middle-class families.

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[1] Jacob S. Hacker, *The Great Risk Shift: The New Economic Insecurity and the Decline of the American Dream*, rev. and exp. ed. (New York: Oxford University Press, 2008).

[2] 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).

Consider just a few of the alarming facts:

- The instability of family incomes has risen substantially over the last three decades. While less educated and poorer Americans have the least stable family incomes, the increase in income volatility affects all major demographic and economic groups.[3]
- Personal bankruptcy has gone from a rare occurrence to a relatively common one. Over the last generation, moreover, 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.
- Americans are also losing their homes at record rates. Even before the housing market collapsed in 2008, there had been a fivefold increase since the 1970s in the share of households that fall into foreclosure.
- American families are drowning in debt, with the personal savings rate plummeting and debt levels skyrocketing. According to a recent analysis of families with incomes between two and six times the federal poverty level and headed by working-age adults, more than half of middle-class families have no net financial assets (excluding home equity), and nearly four in five middle-class families do not have sufficient assets to cover three quarters of essential living expenses for even three months should their income disappear.[4]

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.

Little surprise, then, that polling over the last decade—and especially the last few years—shows extremely high levels of economic anxiety among all but the richest Americans. In April 2009, for example, two in three adults said "today's economy presents [me] with more risks than my parents confronted"—six times as many who said they faced fewer risks.[5]

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[3] See Jacob S. Hacker and Elisabeth Jacobs. 2008. "The Rising Instability of American Family Incomes, 1969-2004: Evidence from the Panel Study of Income Dynamics." EPI Briefing Paper #213. Washington, DC: Economic Policy Institute.

[4] Jennifer Wheary, Thomas A. Shapiro, and Tamara Draut. *By a Thread: The New Experience of American Families*. Waltham, MA: Institute on Assets and Social Policy, 2007. Available online at **http://heller.brandeis.edu/news/releases/pdfs/byathread_web.pdf**

[5] Ronald Brownstein, "Financial Risk Cuts Deeper, Poll Finds," *National Journal*, April 25, 2009, available online at **http://www.nationaljournal.com/njmagazine/cs_20090425_8127.php**

Looking forward

The United States badly needs 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. Three areas of risk in particular cry out for attention: employment risks, retirement income risks, and health care risks. But it would be a mistake to only design economic protections narrowly around specific economic concerns. Another priority is to create new and flexible policies for dealing with economic risks of all kinds, such as a proposal I call "Universal Insurance" to provide stop-loss protection for all American workers and their families against grave income loss from a wide range of causes, as well as catastrophic health costs.

The American Challenge in Cross-National Perspective

Neil Gilbert

This paper surveys three broad trends—welfare demand, privatization and active labor market policies—that characterized the social policy context of modern welfare states immediately prior to the 2008 onset of the economic downturn. The paper examines the implications of these trends for the U.S. in comparison to other advanced industrial countries in the face of our current economic climate.

Increasing Social Welfare Demands in a Growing Economy

Over the two decades from 1960 to the 1980s, the average public spending on social welfare in the member countries of the Organization for Economic Co-operation and Development (OECD), which had 21 members at that time, nearly doubled as a proportion of the Gross Domestic Product (GDP).[1] After that period, sometimes referred to as the "golden era" of modern welfare states, the average rate of growth among the OECD countries slowed, increasing from an average of 16 percent in 1980 to 20.4 percent in 1993.[2] From 1993 to 2005, however, Figure 1 shows that the level of social spending relative to GDP remained almost flat, fluctuating by less than 1 percent a year and ending up in 2005 at 20.5 percent—virtually the same level as in 1993. The U.S. experienced a similar pattern of an increase between 1980 and 1993, followed by a leveling off of social spending as a percent of GDP, though at a rate considerably below the OECD average.[3]

This trend, of course, does not signify that the absolute level of social spending remained constant. To the contrary, since the total real growth of GDP for the OECD countries increased by an average of 2.6 percent annually from 1994 to 2007, the actual amount of social expenditures continued to rise rather substantially—as seen when the measure of spending shifts from the percent of GDP to per capita expenditures controlled for purchasing power parties (PPPs).[4] Under this metric social spending not only continues to rise, but the US emerges with the highest level of public social spending (as seen in Figure 1).

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[1] OECD. "The Future of Social Protection." (Paris: OECD, 1988)

[2] The OECD membership was growing over this period and eventually had climbed to 30 by 2009.

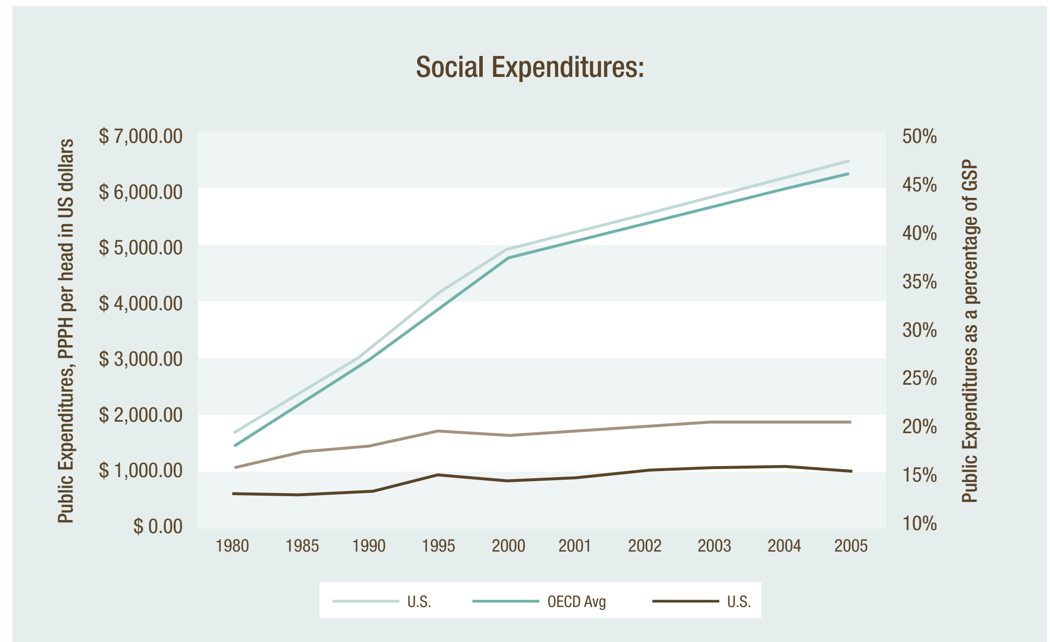
[3] It is well recognized that these levels of spending change when the "gross public social expenditure" measure is adjusted for taxes, tax expenditures, mandate and voluntary private benefits. A critical assessment of these measures is offered in Neil Gilbert, "Comparative Analysis of Stateness and State Action: What Can We Learn from Patterns of Expenditure?" in Jens Alber and Neil Gilbert (eds.) "United in Diversity? Comparing Social Models in Europe and America" (New York: Oxford University Press, forthcoming).

[4] The OECD total growth rates are averages for the individual countries weighted by size and converted to dollars using PPP. OECD, "The OECD Factbook, 2009" (Paris: OECD, 2009)

continued:

THE AMERICAN CHALLENGE IN CROSS-NATIONAL PERSPECTIVE

Figure 1



Spending climbed despite the facts that unemployment was declining and that the proportion of the working age population entering the labor force was on the rise. This is because, even with falling unemployment, increasing demands for social welfare provisions were being generated by demographic changes, particularly the aging of the populations, which loomed as an immense source of fiscal pressure on health, social care, and pension provisions. In addition, the proliferation of two-income households, as well as lone-parent families have reduced the modern family's capacity to provide in-person care for children, elderly, and other infirm relatives, which creates additional demands for the state to supply child care, financial assistance, and other supportive services. Increased demand for spending was being met, not by increased taxes, which had leveled off (reaching what some considered a ceiling) but by economic growth generated by an apparently health economy. And over this period, social expenditures in the U.S. and Europe followed the same trajectory.

High levels of unemployment accompanying the economic downturn have accelerated the already increasing demands for social welfare. The implications of greater demand are relatively straightforward. Since the shrinking economies cannot rely on GDP growth to finance higher levels of social expenditure required to meet the mounting needs—as they have over the past decade—governments are left with the options of increasing taxes, borrowing against the future, and reducing spending on social welfare benefits. These options are not mutually exclusive.

Increasing Privatization of Health and Pension Provisions

Reliance on private initiatives for health and pensions has been increasing among most of the OECD countries. The U.S. social welfare system is distinguished by a level of privatization in these areas that is much higher than the OECD average, particularly in regard to health care coverage and private pension benefits. Expenditures on private pensions in the US represent a significantly higher proportion of the total public/private pension expenditures than the average level of private expenditure for the OECD. In 2001, for example, private benefits amounted to about 38 percent of the total public/private pension expenditures

in the US, which was two-and-a- half times the OECD (23 country) average of 14 percent.[5] Overall, the private share of health care spending in the OECD countries accounted for slightly less than one-third of the total public/private health expenditure. In comparison, private health care spending in the U.S. amounted to more than 50 percent of the public/private total.[6]

During sustained periods of high unemployment U.S. citizens are more vulnerable to the shock of increased risk and insecurities than citizens in many of the other OECD countries. In a deep recession the relatively high degree of privatization of social protection in the U.S. welfare state, particularly in the realms of health insurance and pensions, leaves unemployed workers without health care coverage; at the same time those in retirement who rely heavily upon company stocks and IRA accounts to supplement their standard of living experience a significant reduction in their retirement portfolios.

Active Labor Policies Were Widely Adopted

These policies involved work-oriented reforms that tightened eligibility and replaced the provision of unconditional cash benefits to unemployed, disabled, and elderly people with measures designed to stimulate employment and personal responsibility. The U.S. emphasis on the "work-first" approach offers fewer social benefits and places less weight on building human capital through training programs and education than most of the other OECD countries.

The work-first approach functions best when there is work to be had—quick entry to a job stalls when work is scarce. Even when jobs are in short supply some people find employment. But as the percent of unemployment reaches double-digits, policy adjustments are called for that soften the consequences of extended unemployment. In many of the OECD countries, active labor market policies are padded by well-cushioned social safety nets. These policies often referred to as "flexicurity," have been widely promoted at European Union summits. They seek to balance a high degree of flexibility in the labor market (rules that make it easier to lay-off employees) with a strong element of security for workers, which involves unemployment benefits that replace a high percent of the lost wages for relatively long periods, health care, and retraining. Recent U.S. policies signal a softening of the "work-first" strategy through the extension of unemployment benefits, health care subsidies, and federal funding to help meet the increasing costs of public assistance.

Finally, it is observed that within the U.S. the increased risks and insecurities generated during sustained periods of high unemployment are not distributed equally. The economic downturn of 2008 has exacerbated the growing level of risk experienced by the working-and-middle-classes over three decades since the early 1970s. Poor people live daily with a heightened degree of risk and insecurity – while they may suffer additional hardships, they do not have all that much to lose in a recession. The people hit most sharply are those who have wages and employee health benefits to lose and retirees in the upper income brackets who depend heavily on private pension assets to maintain their standard of living.

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[5] Calculated from data in Chart 2, Willem Adema and Maxime Ladiaque, "Net Social Expenditures 2005 Edition: More Comprehensive Measures of Social Support," OECD Social, Employment, and Migration Working papers #29 (Paris: OECD, 2005), p. 14.

[6] OECD, The OECD Factbook 2009 (Paris: OECD, 2009).

The Arms of Democracy: The Legacy of Economic Security Policy on the National Security State

Mariano-Florentino Cuellar and Connor Raso

These measures have all had only one supreme purpose – to make democracy work – to strengthen the arms of democracy in peace or war and to ensure the solid blessings of free government to our people in increasing measure.

— President Franklin D. Roosevelt, 1939,
upon signing a bill to create the Federal Security Agency[1]

This chapter discusses how economic security policy profoundly affects the national security of an advanced industrialized democracy such as the United States. Though often considered as separate, the domains of economic security and national security operate in close relationship, exerting powerful effects on each other within a given nation's legal, political, and economic framework. To advance current thinking, we focus particular attention on some of the most-often neglected aspects of that relationship, involving the concept of "economic security."

Economic security policies can be understood as measures designed to balance economic prosperity with limits on the risk of sharp discontinuities in social welfare. We analyze the impact of economic security thus understood on national security, which is conventionally defined to encompass the management of geostrategic and terrorism-related threats.

Our analysis trains particular attention on four legacies of economic security policy. First, economic security policy affects the availability of scarse national resources, impacting the fiscal environment in ways that affect both short-term and long-term national security. For instance, spending on fundamental aspects of economic security such as health care have profound implications for the resources available for national defense. Federal spending on the Medicare and Medicaid programs alone is projected to explode to 20 percent of gross domestic product by 2050, the same share of the economy as the entire 2007 federal budget consumed.[2] Such growth in health spending clearly threatens to reduce the level of federal resources available for national security. Policy reforms to reduce the growth rate of health care spending are therefore likely to have an important impact on future national security spending. Similarly, vulnerable infrastructure threatens national ability to provide both economic and national security.

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[1] Franklin D. Roosevelt, Reorganization Plan No. 1 of 1939, 5 U.S.C. – Appendix.

[2] Peter Orszag. "CBO Testimony Before the United States Senate Budget Committee." June 21, 2007. Page 2.

Second, decisions about economic security shape a nation's social capital, which has important implications for a nation's ability to defend itself. A nation that neglects to invest in economic security will struggle to build and maintain a healthy and vigorous army. The capacity of military recruits to thrive depends on their nutrition and their access to health care before joining the armed forces. Education is similarly vital to national security, as a nation without educated citizens will struggle to produce soldiers who can use cutting-edge military technology. The U.S. military has struggled to recruit well-qualified soldiers. A report analyzing military recruitment in Pennsylvania found that 25 percent of young adults from ages 17-24 were ineligible to serve because they lacked a high school diploma.[3] Even students who graduate from high school frequently lack basic academic skills. One survey showed that 36 percent of Pennsylvania students lacked basic reading skills and 38 percent lacked basic math skills. This educational failure has affected the quality of recruits available to the U.S. armed forces. In a plea for better soldiers, a senior official of the U.S. armed forces recently highlighted the role of human capital: "The best aircraft, ships, and satellite-guided weapon systems are only as effective as the personnel the military can recruit to operate them."[4] This comment underscores that a nation that fails to invest in social capital will see its relative military standing erode.

Third, economic security affects the total stock of a nation's institutional capacity, which in turn influences a nation's ability to impact its geostrategic environment. Since the rise of the nation-state, governments have built institutions to control their territory and provide vital services to their populations. A nation may use its institutions to provide both economic and national security. For instance, the U.S. Social Security Administration played a vital role in World War II mobilization. Similarly, federal highways serve both civilian and defense purposes.

Fourth, the long-term viability of a nation-state – depending to some extent on citizens' loyalty and the capacity of interested parties to support coalitions that are consistent with a continued role for the state – is almost undeniably bound up to some extent with decisions about how to handle economic security. Put simply, a nation that neglects its economic security will face a populace unwilling to defend it. Examples such as efforts by European countries to bolster economic security in the wake of the Cold War illustrate that nations recognize this threat. Such nations will inevitably struggle to sustain themselves in the face of threats.

This relationship between economic and national security holds important implications for law and policy. Judges will inevitably struggle to establish viable legal limits on the scope of national security. Famous Supreme Court decisions such as *Youngstown Sheet & Tube v. Sawyer*—in which President Harry S. Truman's Executive Order seizing certain steel mills in the interest of national and economic security was overturned by the Supreme Court—exemplify this relationship. National security cases stemming from the September 11 attacks show that this connection persists today. Legal practitioners and scholars must therefore account for the relationship between these realms.

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THE ARMS OF DEMOCRACY: THE LEGACY OF ECONOMIC SECURITY POLICY ON THE NATIONAL SECURITY STATE

[3] Military Readiness: Military Leaders for Kids. "Ready, Willing, and Unable to Serve." 2009. Page 1.

[4] Id. at 6.

continued:

THE ARMS OF DEMOCRACY: THE LEGACY OF ECONOMIC SECURITY POLICY ON THE NATIONAL SECURITY STATE

Policymakers will similarly struggle with this ambiguous boundary between economic and national security. Thorny policy areas such as trade, immigration, natural disaster mitigation, and the environment all serve as a testament to the entanglement between domestic policy, foreign affairs, and defense. We offer a detailed analysis of this entanglement in the context of trade policy, which holds important implications for economic growth and therefore for national ability to provide economic security. At the same time, trade restrictions and limits on export of sensitive technologies with military applications are frequently used to pursue national security objectives.

Similarly, politicians may be sorely tempted to use the close relationship between national and economic security strategically. This dynamic has a critical effect on the formulation of policy in both realms. We outline examples of such strategic behavior, including the Roosevelt administration's creation of the Federal Security Agency (FSA). The FSA encompassed increasingly-popular national security initiatives as well as health and economic security programs that would have otherwise faced potentially severe cuts as the nation prepared for war.

We conclude that the relationship between economic and national security underscores the practical and organizational difficulties of segregating policymaking into separate domains. This interconnection raises deep questions about a self-contained, narrow vision of geostrategic security.

Public Policy Options to Build Wealth for America's Middle Class

Christian Weller and Amy Helburn

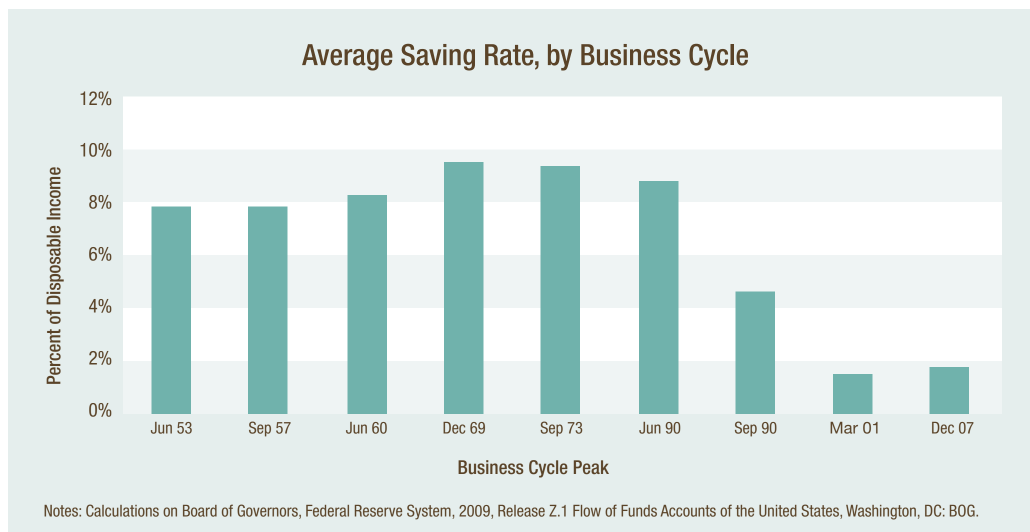
The current financial crisis has taken a toll on family wealth as it included the sharpest drop in total wealth since the Federal Reserve started to collect these data in 1952. This loss of household wealth deserves public policy attention. Wealth serves critical economic security functions in an economy that relies heavily on individual initiative, such as the United States. It is a store of future income, in the case of retirement, unemployment, illness or injury and thus allows families to smooth consumption over their lifetime, even when incomes and expenses change. The worst financial crisis since the Great Depression has substantially frayed this economic security blanket and contributed to a sharp rise in household economic distress.

Policymakers should pursue three goals to help families build stable and sustainable wealth: greater savings rates, lower costs of building wealth, and less risk exposure. In this chapter, we highlight examples of policy solutions in each of these categories.

The data indicate that moderate-income to middle-income families were the group that likely lost the most in terms of economic security during the recent crisis. Many of the policy proposals that we discuss are thus intended to help moderate and middle-income families build wealth, but will likely have a strong impact on low-income families' ability to build stable, sustainable wealth.

Rising Economic Insecurity – Historically Low Savings Combined with a Debt Boom

One important contributing factor to the erosion in middle class economic security was the historically low saving rate. A significant obstacle to raising the saving rate is the U.S. tax code. The primary saving incentive under the U.S. tax code is the deductibility of contributions to tax advantaged savings vehicles, which provides few or no incentives to low-income and moderate-income families to save more money. Another explanation for the low personal saving rate may be the so-called

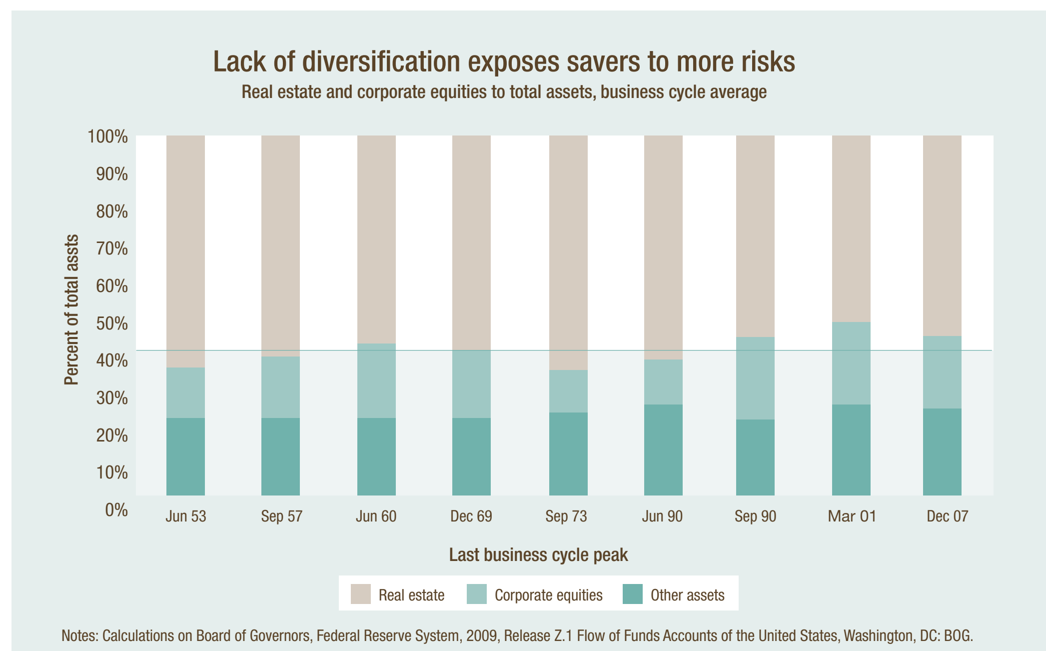


Notes: Calculations on Board of Governors, Federal Reserve System, 2009, Release Z.1 Flow of Funds Accounts of the United States, Washington, DC: BOG.

wealth effect, whereby families save less because they feel wealthier due to unexpected increases in asset prices.

The companion to the low saving rate was a debt boom. In 2007, over 77 percent of families owed some type of debt. A number of factors contributed to rising household debt, but this debt boom was largely fueled by a growth in debt secured by private homes. Increasing personal saving rates should reduce the need for families to borrow money to acquire assets as well as pay for basic goods and services since they will have more of a financial buffer despite stagnating and declining income levels.

The risk exposure of families is further exacerbated – beyond high leverage – by the lack of asset diversification. Families held an increasing share of their wealth in homes and stocks.



Notes: Calculations on Board of Governors, Federal Reserve System, 2009, Release Z.1 Flow of Funds Accounts of the United States, Washington, DC: BOG.

Finally, savings and borrowing are associated with substantial fees. Fees could be lower and rates of return on household wealth could be higher if financial markets were more transparent and less segmented. Public policy can help achieve these goals by requiring more and better disclosure and encouraging more financial competition.

Policy Solutions to Aid Families in Wealth Building

Helping families build wealth is a large-scale policy undertaking. We offer six principles that could guide the policy discussion. These include:

- *Turn tax deductions into credits.* Existing saving incentives in the form of tax deductions are skewed towards higher-income earners. Redesigning such incentives as refundable tax credits, which treat each dollar saved equally and do not depend upon income tax liabilities would offer the largest increase in incentives to the lowest-income earners, thereby increasing aggregate personal saving.

continued:

PUBLIC POLICY OPTIONS TO BUILD WEALTH FOR AMERICA'S MIDDLE CLASS

- *Streamline saving incentives.* Incentives for people to save and build wealth should be streamlined to promote efficiency and enable greater choice for savers. Rather than create government incentives for a whole host of assets, families should be encouraged to save for their current needs such as near term issues as education, business formation, and housing, while saving separately for future needs such as retirement savings.
- *Automated savings and investment decisions to make it easier to save.* Behavioral economics has taught us that public policy can use people's inherent inertia to build wealth, rather than impede wealth creation, as is currently the case. A number of policy proposals would expand so-called "auto solutions" to workers saving for retirement through employer-based vehicles, as well as those not currently working for an employer who offers a retirement savings plan. Additional steps could include universal employer and employee contributions and additional incentives for families to contribute to their savings accounts.
- *Increased transparency for savings and credit products.* Comprehensive, concise and comparable information on the costs and risks of different forms of wealth needs to be available to all consumers. Increased transparency of financial products will help consumers to make better informed choices and thus presumably generate more competition in the market for financial products. This should lower the costs associated with asset management and borrowing and in turn, increase the potential to build wealth. This increase in information flow may be achieved through oversight, legislation and incentives.
- *Increased credit market competition.* Improved information flow alone will likely not be sufficient and policymakers could take additional steps to encourage more financial market competition. Financial market regulation could encourage elimination of segmented markets to promote access to more affordable credit and investments. This would foster more stable wealth creation as families could borrow on more advantageous terms. Moreover, an expansion in the scope of services offered by Industrial Loan Companies and Credit Unions could improve access to lower-cost financial services among underserved communities.
- *Public support for underdeveloped credit markets.* Some credit markets do not exist or involve large costs, such as markets for new technologies, affordable student loans, infrastructure financing, among others. Thus, policymakers need to consider policy tools available to address these problems, such as loan guarantees by the public in the event of borrower default, direct loans underwritten by the public and lending requirements for private sector lenders to extend credit to particular types of projects and borrowers. Existing initiatives, such as the Community Reinvestment Act, and innovative proposals, such as the National Infrastructure Bank, offer a foundation upon which to site such public support.

Wealth plays an increasingly critical role in the United States economy as responsibility for accessing education, health care, and retirement security has been shifted onto individuals. Public policy should thus intervene to help families build stable and sustainable wealth. The principles for guiding policy are based on well-established economic theory and research; therefore policies based on them have the potential to make a real difference in people's lives.

Risk Allocation in Homeownership: Reviewing the Role of Mortgage Contract Terms

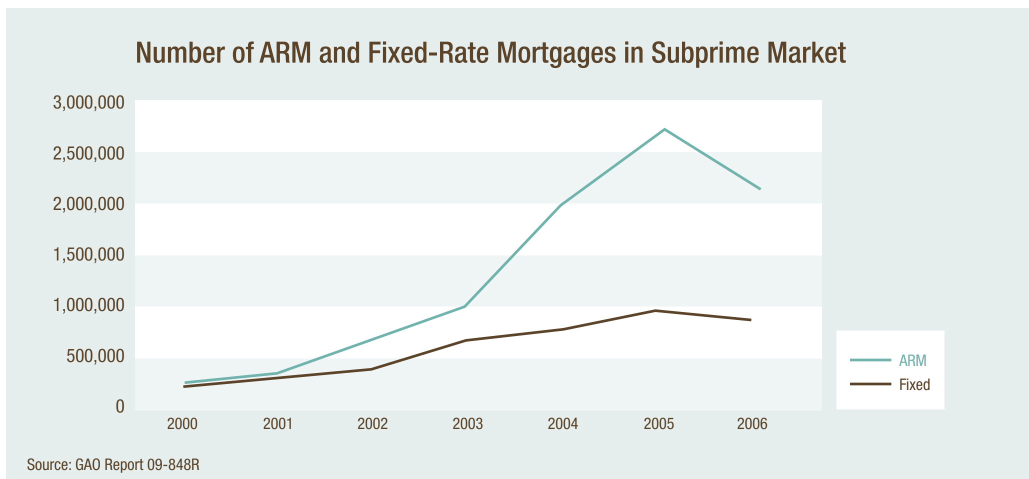
Katherine Porter and Tara Twomey

The American institution of homeownership is in crisis. In the twentieth century, homeownership was touted as the American Dream. In the twenty-first century, homeownership is proving for millions of families to be the American Nightmare. The current foreclosure crisis has wiped out increases in the homeownership rate achieved over the last 8 years. The rate is expected to fall further with millions of families already facing foreclosure and millions more struggling with delinquent loans. Today, more than one in four homeowners owes more on their mortgages than their homes are worth. The plight of these families, and the reverberating effects on neighborhoods, governments and the economy, are a powerful reminder of the risks that accompany homeownership.

The government is trying to contain the damage with acronymic programs that fail to offer forward-looking strategies for homeownership. We argue that mortgage loan terms are key elements in controlling and allocating the risks of homeownership. Loan features that became common in the last decade increased the number of market factors that could trigger default and allocated more risk to consumers. Government has the power to manage the risks of homeownership through substantive regulation of mortgage contract terms. We offer principles to guide policymakers in such efforts.

Evolution of Risky Home Mortgage Loans

History shows how adjusting mortgage terms can alter homeownership risk. After the Great Depression, the government facilitated the development of a long-term, fixed-rate loan. This loan dramatically reduced borrowers' risk in financing a home purchase, and for nearly fifty years this "plain-vanilla" mortgage was the dominant residential real estate loan. In the 1980s, however, the residential mortgage market went through dramatic deregulation, including the preemption of state laws that had prohibited variable interest rates, balloon payments, and negative amortization. Lenders could now issue adjustable-rate mortgages (ARMs) that included many more terms for consumers to evaluate. Compared to fixed-rate loans, ARMs also shift risk to consumers. At their core, such loans require borrowers to make a guess, educated or otherwise, about the direction of market interest-rate change. Over time, lenders began to layer other contract terms on to the basic ARM such as prepayment penalties, low introductory rates, interest-only payments, negative amortization, or combinations of these features. The result was not only to shift risk to borrowers, but also to compound the risk of default. To manage these greater risks, lenders and borrowers relied almost exclusively on the ability to refinance these loans. Reliance on refinancing, however, exposed the parties to risks related to housing value and credit availability, ultimately with disastrous consequences for millions of homeowners and the global economy.



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RISK ALLOCATION IN HOMEOWNERSHIP: REVIEWING THE ROLE OF MORTGAGE CONTRACT TERMS

Economists hailed many of these innovative mortgage products. From their perspective the one-size-fits-all approach to mortgages represented by the thirty-year fixed-rate mortgage misallocates resources. Alan Greenspan captured this sentiment when he praised the virtues of adjustable-rate mortgages and noted that fixed-rate mortgages "effectively charge homeowners high fees for protection against rising interest rates and for the right to refinance."[1] In the economists' view, the savings from lower payments on adjustable-rate mortgages could be put to more productive use. But economic models are too frequently constructed in a theoretical world and based on perfectly rational consumers. Increasingly behavioral economics research undermines the rational actor model that undergirds these theories and shows that consumer appetite for high-risk mortgage contract terms may reflect behavioral biases such as myopia and optimism bias. Such cognitive effects are particularly powerful when products are complex.

Government Inactivity in Regulating the Mortgage Market

As mortgages transformed from plain-vanilla products to exotic ones, government failed to expand its regulatory focus to measure consumer risk. The result was massive underestimation of the amount of total risk generated by mortgage product innovations, and crucially, a lack of knowledge of where such risks lay. Policymakers were quick to pronounce that subprime lending was the problem. The data suggest that is too broad of a target. Default rates on thirty-year fixed-rate subprime loans are actually quite closer to ARM loans made to prime borrowers. Yet prime borrowers with ARM loans are three times more likely to be delinquent than if their mortgage has a fixed-rate. The default rates on pay-option ARMs, which were made primarily to borrowers with good credit scores, stand at nearly 37 percent and are climbing. These data signal the importance of loan features in risk management. To date in the current crisis, the terms of the loan have been a crucial determinant of default, notwithstanding the general creditworthiness of the borrower.

[1] Alan Greenspan, Chairman, Fed. Res. Bd., Remarks at the Credit Union National Association 2004 Governmental Affairs Conference: Understanding Household Debt Obligations (Feb. 23, 2004) (transcript available online at **http://www.federalreserve.gov/boarddocs/speeches/2004/20040223/**).

Principles for Regulating the Mortgage Market

Product terms are crucial levers in curbing default risk and in allocating risk between lenders and borrowers. Existing government agencies or the proposed Financial Product Safety Commission could regulate mortgage contract terms for the entire residential real estate mortgage market. We offer three principles to guide the development of mortgage product regulations.

- *The government must play an active role in managing risk.* The government itself must monitor the risk-shifting aspects of mortgage finance. Lenders and home buyers each would prefer the other bear the risk; in a robust market, we should see these actors pushing those risks back and forth. The government has a poor track record of monitoring risk in homeownership, as evidenced by the savings and loan crisis in the 1970s and today's financial meltdown. The government needs to collect better data about mortgage markets and then needs to invest in risk modeling for mortgages as part of the costs of promoting homeownership. Empirical data and analytical models are themselves valuable public goods. They permit regulators to police lenders to ensure that they are pricing for risk and to monitor the financial reserves of lending institutions. And they permit government to protect families who put their assets, such as home equity and future income streams, on the line in mortgage loans.
- *Mortgage regulation needs to focus on home purchase as a consumer transaction.* The effect of most product innovation was to shift risk from lenders onto consumers or increase the overall risk of default. Yet consumers are ill-suited, even if more adequately prepared with counseling or financial education, to assess the number and variety of risks in exotic mortgages. Regulators must take into account the limits of consumer cognition and not be deterred by unsupported claims that product innovation is always an advance for homeownership. Policymakers need to rely on empirical data when they exist, and supplement those data with theories of risk that account for the realities of consumer behavior. In most instances, consumers will be worse at bearing market-based risks of homeownership such as interest rate risk.
- *Policymakers should be mindful of the difficulty in effective regulatory enforcement in consumer transactions.* The mortgage market is huge and diffuse. An attractive feature of product term regulation is that it is relatively easy to enforce. It has relatively stark boundaries, and while that bluntness may be a substantive disadvantage, it is a corresponding procedural advantage. Making violations easier to identify will prevent evasion and increase the likelihood that regulators actually undertake enforcement activity and to pursue sanctions. The penalties for violations must be steep. They should be sufficient to deter, as well as punish, because relatively few consumers will have the sophistication or resources to identify or pursue violations.

In sum, the mortgage contract establishes not just the affordability of the loan but also determines the overall risk associated with the loan and allocates those risks between the borrower and lender. The development of alternatives to the plain-vanilla mortgage increased the risks in homeownership and pushed more risks onto consumers. Government can regulate the terms of mortgage contracts to monitor the overall risk in mortgage markets and to ensure that such risks are allocated in a sensible way between lenders and consumers.

Health Security

Jacob S. Hacker

Health care is at the epicenter of economic insecurity in the United States today for two interwoven reasons: health care costs have exploded and coverage has dwindled. The only way to address these twin problems is to address them simultaneously, broadening coverage so as to exercise effective control over costs.

Why We Need an Integrated Solution

To see why both costs and coverage must be tackled at once, consider the ubiquitous complaints about Medicare. Medicare's costs are certainly rising rapidly, but that rise has little to do with Medicare and much to do with American health care. In fact, since payment controls were first introduced into the program in the early 1980s, Medicare's costs per patient have risen slower, on average, than private health insurance spending per patient—with the gap particularly pronounced in recent years. Between 1997 and 2006, for example, health spending per enrollee (for comparable benefits) grew at 4.6 percent a year under Medicare, compared with 7.3 percent a year under private health insurance—even as Medicare maintained high levels of provider participation and patient access to care.[1]

Certainly, Medicare faces serious strains. For example, because it covers only the aged, its spending will increase with the retirement of the baby-boom generation in the coming years. Yet the common critique of Medicare—that it is overly generous—is untrue. Medicare coverage is substantially less generous than the norm in the private sector. If we decide as a nation that we cannot "afford" Medicare, then we are deciding that we cannot afford to provide even relatively basic health care to the aged. Few Americans, I am certain, are ready to accept this dismal conclusion—and rightly so. Almost every other advanced industrial country provides insurance not just to the aged, but to all citizens, while spending much less on a per-person basis than the incomplete system of the United States. Furthermore, many of these nations have older populations than we do, have citizenries that go to the doctor more often, and have better basic health outcomes. Yet their overall health spending remains far below ours and, in many cases, has also been growing more slowly.

Moreover, it is crucial to recognize that today's Medicare is very different from the model of thirty or forty years ago. That is because Medicare now allows beneficiaries to choose among a growing variety of private managed-care and fee-for-service options, which meet with overwhelming popular approval so long as they do not increase the cost of staying in the conventional Medicare program.

In the end, the main problem with Medicare it not its effectiveness—though it does need reform—but rather its limitation to the aged and disabled. This limitation hobbles the public sector ability to control costs because the program's reach is so restricted. It also means that paying for Medicare inevitably pits the needs of younger Americans against the needs of older Americans. Rather than take away the security of Medicare because younger Americans lack

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[1] Jacob S. Hacker, "The Case for Public Plan Choice in National Health Reform: Key to Cost Control and Quality Coverage." Berkeley Center for Health, Economic, and Family Security. December 2008. Available online at **http://www.law.berkeley.edu/files/chefs/Hacker_-_Public_Plan_-_Final_1_21_09.pdf**

comparable protections, we need to build on the Medicare model while shoring up employment-based coverage where it works well to ensure that all Americans without secure workplace coverage have access to a new public health insurance plan as well as regulated private options.

"Health Care for America"

How could this be done? All employers would be given an affordable choice: They could provide insurance at least as generous as a new Medicare-like public plan, or they could pay a modest amount to help finance coverage for their workers, who would then be enrolled automatically in a national insurance purchasing pool. People enrolled in this pool would pay subsidized, affordable premiums based on their income and family size, and they could choose among a range of private plans as well as the new Medicare-like public plan.

I have developed this proposal, which I call "Health Care for America," in considerable detail, and its costs and effects have been carefully estimated.[2] (The proposal, which I first introduced in 2001, is quite similar to the reform blueprint embraced by President Obama during the 2008 presidential campaign and currently under debate in Congress.) Employers that now provide insurance would experience substantial savings since many pay much more than what the new system would charge. Yet the costs for firms that do not now provide insurance would be modest.

Expanding coverage in this way would not eliminate private employment-based insurance. It would simply give employers a new choice, while requiring that they make at least a minimal commitment to financing coverage for their workers. In higher-wage firms and unionized industries, it would still be in the best interest of companies to provide broad coverage—although some might decide it was better to supplement the new Health Care for America public plan than provide coverage directly. The new framework would ensure, however, that everyone who works has secure health insurance, that many more workers can choose their plan (including a plan with free choice of doctors and specialists), and that firms that now struggle to provide health benefits, or cannot provide them at all, have an attractive, low-cost option for doing so. Because the new public plan would cover a substantial share of those without secure workplace coverage, moreover, it would have strong leverage to bargain for low prices on behalf of covered Americans and their employers.

Over time, the program could evolve in different directions, depending on how employers and Health Care for America fared in controlling costs. If employers came under greater financial strain in their management of health costs, they would have the option of Health Care for America. If, however, they improved their ability to control costs, they would be more inclined to provide coverage on their own. Thus, this system would create a constructive public-private dynamic that would enroll the largest number of patients in the sector best able to provide affordable, high-quality health care—without holding the health security of ordinary Americans in the balance.

[2] Jacob S. Hacker, "Health Care for America," Economic Policy Institute Briefing Paper #180. Washington, DC: Economic Policy Institute, January 2007. Available online at **http://www.sharedprosperity.org/bp180.html**

Bigger and Better: Redesigning Our Retirement System in the Wake of the Financial Collapse

Alicia Munnell

The financial crisis has dramatically demonstrated how a collapse in equity prices can decimate retirement savings. The crisis has also highlighted the fragility of existing 401(k) plans as the only supplement to Social Security. Investing in equities is a central tenet of any effective retirement saving strategy, because the higher expected return offers the potential for lower required contributions. But the upside of equities comes with the risk of sudden and steep declines or extended periods of sluggish returns. Absorbing such blows is difficult in any circumstances. It is especially difficult given the large-scale shift in risk from employers to individuals that has occurred over the past quarter century.

The inadequacies of our current retirement system go beyond the vulnerabilities revealed by the current crisis. Even without the stock market collapse, future retirees were projected to end up with too little retirement income because the whole system is contracting – including, notably, Social Security replacement rates – while retirement income needs are increasing due to rising longevity and health care costs.

The Impact of the Collapse in Equity Prices on Retirement Plans

Equity prices fell 42 percent between the peak of the stock market on October 9, 2007 and October 9, 2008. Over that one-year period, the value of equities in pension plans and household portfolios fell by $8.9 trillion. The market declined another 25 percent between October and early March, but then rallied for a few months so that equity prices in late 2009 look very much like prices in October 2008.

Defined benefit and defined contribution plans were affected similarly by the market collapse because both types of plans had about two-thirds of their assets invested in equities. But the impact on participants differed dramatically. The immediate burden in defined benefit plans fell to the plan sponsor. While in the case of 401(k) plans, participants took an immediate direct hit from the financial crisis. Individuals saw the value of equities in their 401(k) plans or IRAs, whose balances consist largely of rollovers from employer-sponsored plans, decline by $2.0 trillion. Those approaching retirement with a substantial portion of their 401(k) balances in equities suffered the largest losses and have the least time to recover. But the historical pattern of boom and bust has also created a situation where younger cohorts could be in even worse shape unless the stock market soars going forward.

The Need for More Retirement Savings in the US

There is more to the story than 401(k) participants being exposed to financial risk. Even without the financial crisis, future retirees were projected to end up with too little retirement income. The reason is that the existing retirement income system is contracting and people are living longer. At any given retirement age, Social Security benefits will replace a smaller fraction of pre-retirement earnings than in the past.

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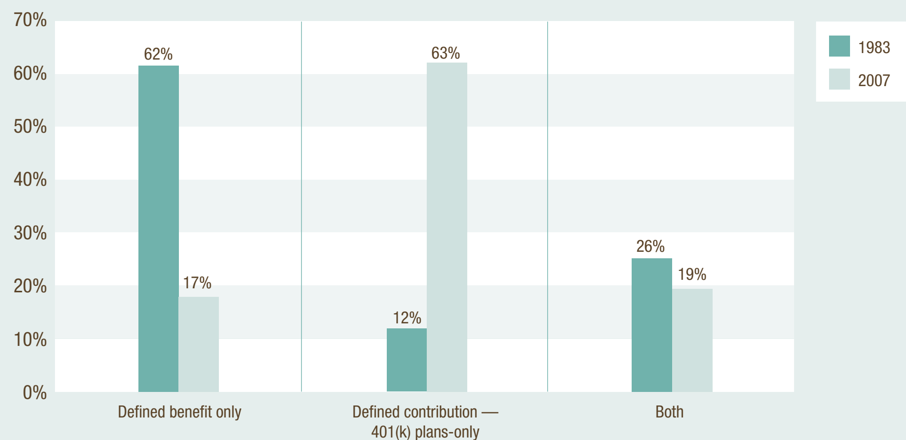
BIGGER AND BETTER: REDESIGNING OUR RETIREMENT SYSTEM IN THE WAKE OF THE FINANCIAL COLLAPSE

With a diminished role for Social Security, retirees will be increasingly dependent on employer-sponsored pensions. At any moment in time, however, less than half of the private sector workforce age 25-64 participates in an employer-sponsored plan of any type. While the level of pension coverage has remained flat, the nature of pension coverage has changed dramatically. Twenty-five years ago, most people with pension coverage had a traditional defined benefit plan that pays a lifetime annuity at retirement. But traditional defined benefit plans – at least in the private sector – no longer fit the business needs of employers and, in many cases, are ill suited to the needs of a mobile workforce. Today, most people with a pension have a defined contribution plan – typically a 401(k). Given the decline in Social Security and employer-provided pensions and the rise in longevity, workers should have been accumulating more wealth on their own to generate an equivalent retirement income. But that does not appear to be the case.

Percent of Workers with Pension Coverage by Type of Plan from SCF, 1983 and 2007



Source: Author's calculations based on the U.S. Board of Governors of the Federal Reserve System, *Survey of Consumer Finances*, 2007.

The outlook for future retirees is dismal. And it is dismal both for those who must rely only on Social Security and for those who have a supplementary 401(k) plan. The U.S. retirement system is too small and the employer-sponsored component does not work well; the whole system needs to be bigger and better.

Adding a New Tier of Retirement Savings

In response, a new direction is needed that would tackle both problems – concentrated equity exposure and insufficient retirement income – at the same time. The best bet is to establish a new tier of universal retirement saving that would aim to replace about 20 percent of a worker's pre-retirement income. Since contributions would take decades to produce this level of replacement, the new tier would not provide much in relief to those currently approaching retirement, but would be of great value to middle-age and younger retirees who are unlikely to do as well on their investments as baby boomers have done, even with the recent market collapse. This proposed 20-percent replacement rate from the new tier combined with 36 percent (before Medicare deductions and taxes) from Social Security would produce 56 percent of pre-retirement earnings for the average earner at age 65. Middle and high-income workers would want to save more through 401(k)s and other mechanisms.

Participation in the new tier should be either mandatory or strongly encouraged (through defaults). The accounts would be funded by contributions from employees, and perhaps employers, with low-income workers receiving some form of government subsidy. Participants should have very limited access to money before retirement, and benefits should be paid as annuities. The new tier should reside as much as possible in the private sector. However, the question of how to handle the investments in such accounts is a vexing one.

One option would be to have the government guarantee a rate of return. For such a guarantee to be consequential, it would need to be above the riskless rate. While an analysis of past market returns suggests such an approach would have been quite feasible, guarantees for unknown prospective returns would only work if the government were less risk averse than the market as a whole. Theory suggests that the government could shoulder greater risk, but setting up a new system of universal accounts run by private investment managers with a meaningful government guarantee could prove challenging.

Therefore, a second approach would remove the challenge of equity risk from the new accounts. The accounts would instead invest more conservatively, while the Social Security Trust Fund would take on the task of equity investment. This approach would thus use an existing mechanism to share equity risk across generations and, by reducing the cost of funding Social Security, it would free up government resources to help subsidize the new accounts. Under this structure, 401(k)s would return to their original place as a third tier on top of a strengthened Social Security system and the new universal second-tier savings accounts with low risk exposure.

Some might argue for skipping the new tier altogether and simply expanding Social Security. But several considerations argue against such an approach: the new tier should be viewed solely as a mechanism for generating replacement income not as part of a program with redistributive goals; the funded nature of a new tier will supplement the PAYGO structure of Social Security in a way that provides a more balanced retirement system; and, from a political standpoint, providing additional saving through the private sector is likely to be much more palatable than substantially expanding a government program.

The final challenge would be designing the Social Security equity investment program to adjust to financial shocks in an equitable way. Other countries with central equity investment have adjustment mechanisms, but the impact of the market crash suggests that these mechanisms are incomplete. For example, the intergenerational risk sharing mechanisms in Canada, Sweden, and the Netherlands place a disproportionate share of the burden on current retirees, who tend to be the most risk-averse portion of the population. Ideally, those who are more risk averse should bear less of the aggregate risk. Employed workers can adjust their earnings and consumption and how long they might work; and because their remaining life expectancies are longer, they can more easily smooth consumption following an unexpected income shock, by making smaller adjustments over more years. These considerations should be taken into account when designing any intergenerational risk sharing mechanism for the United States. Surmounting this final hurdle is important for establishing an efficient and resilient retirement system that can stand the test of time.

Government's Role in Aging and Long-Term Care

Andrew Scharlach and Amanda Lehning

For more than two decades, the federal government has abrogated its leadership role in long-term care (LTC), devolving responsibility to local and state governments and the private sector. Lacking any overall nationwide approach to LTC, the United States has a fragmented patchwork of isolated community-based programs which, while sometimes innovative, serve relatively small numbers of seniors. The overall picture is one of substantial vulnerability to impoverishment in later life and inadequate care, especially for the most disadvantaged Americans. This has been accompanied by tremendous personal and societal cost, particularly for those women from racial and ethnic minority populations who comprise the vast majority of the paid and unpaid LTC workforce.

Needed now is a comprehensive federal LTC policy designed to allocate more equitably the direct and indirect costs of LTC among government, individuals and families, enhance the quality of services provided and ameliorate disparities in the benefits received, and incentivize innovative new initiatives designed to reduce the need for LTC. The government's traditional focus on cost control needs to be accompanied by more attention to cost effectiveness and the quality and adequacy of the care that is being provided so as to promote the best possible quality of life for Americans throughout their lives, regardless of ability or disability. Ultimately, there need to be adequate community supports for all individuals with disabling conditions, regardless of race, ethnicity, gender, socioeconomic status, or location of residence.

In order to make America's long-term care system more equitable and affordable for individuals, families, and society, six types of LTC financing approaches should be considered:

- *A government-sponsored mandatory social insurance program*. Such a program would provide a package of basic long-term care services through a combination of dedicated payroll and income tax receipts. While this could most easily be done by expanding Medicare to include LTC, a more politically-feasible approach may be to create a National Insurance Trust that would collect voluntary payroll deductions and provide a cash benefit to offset the cost of current LTC expenses. Existing Medicaid recipients could easily be folded into such a universal scheme, and individuals with the necessary income could purchase supplementary private insurance if they wanted more extensive coverage.
- *Expanded eligibility for Medicaid to include individuals who currently are above Medicaid eligibility thresholds*. The cost of covering these near-poor individuals would be offset by means-tested graduated co-payments, but would still require some government subsidization, perhaps accompanied by deferred payment or repayment utilizing some portion (e.g., 15-25%) of the value of consumers' real property or other existing assets.

- *Liberalized Medicaid eligibility for individuals who have purchased private long-term care insurance*. For example, the Long-Term Care Partnership policies that currently are available in at least 30 states allow purchasers of approved long-term care insurance policies to become eligible for Medicaid coverage once their LTC insurance benefits are exhausted, enabling them to shelter some of their remaining assets rather than deplete them entirely to pay for long-term care.
- *Mandatory tax-deferred individual long-term care accounts*. Tax codes regarding Health Care accounts (Internal Revenue Code section 106(b) for Medical Savings Accounts, created by Title III of HIPAA of 1996) could be expanded and liberalized to enable workers to set aside funds that could be used to purchase either long-term care services or long-term care insurance. Funds would grow tax-deferred and, other than regulation of abuse and some amount of foregone taxes, the government role would be modest. Making such savings accounts mandatory, and beginning at younger ages, would spread the risk of long-term care costs quite dramatically.
- *Tax incentives for reverse annuity mortgages or home equity conversion mortgages*. An alternative approach could involve tax incentives for homeowners to use reverse annuity mortgages or home equity conversion mortgages to pay for home modifications and home services designed to enable individuals to remain in their home or apartment and prevent costly institutionalization. Adequate consumer protections would be needed in order to prevent financial exploitation of vulnerable elders.
- *Increased government regulation and incentives for purchasing private long-term care insurance products*. Expanding the group LTCI market, and making purchase and premium payment more automatic, would greatly increase penetration, especially among younger, healthier individuals. This could be done through tax incentives for employers and other organizations to offer group LTCI plans that can be purchased through payroll deduction with pre-tax dollars, perhaps coupled with enhanced tax deductions or tax credits for the purchasers. Some industry experts estimate that, given sufficient tax incentives, the penetration of private LTCI could grow to cover nearly 30% of nursing home costs by 2030. However, tax subsidies could further exacerbate discrepancies in financial vulnerability, as subsidies are apt to be of greatest benefit for individuals who already can afford to purchase policies rather than for those who are unable to do so.

In addition, an expanded government quality assurance role is needed to assure that vulnerable elderly persons receive adequate care, have basic needs met, and are not abused or neglected. LTC workers and family caregivers need improved protection and support, including pay and benefits commensurate with the demands of the work, worker protections consistent with other service professions, and adequate training and supervision. Finally, the federal government can contribute to a reduction in the actual need for LTC as well as improvements in the quality of life of older adults and their families through investments in health promotion, technological innovations, and community interventions.

Income Security When Temporarily Away from Work

Stephen D. Sugarman

If a worker becomes ill, injured or temporarily unemployed, is needed to care for a newborn or an ill relative, or is on vacation, what does the worker do for income while temporarily away from work? On their own, workers could save up for such needs, borrow when such needs occur and repay from future earnings, buy insurance in advance that would cover at least some types of lost income, turn to charities or friends for help, or temporarily reduce expenditures to lower their need for income. In practice, these strategies are very often woefully inadequate.

Existing Income Security Regimes

In response, both employers and government have stepped in to help in various ways with this aspect of income insecurity (and indeed by doing so have, at least in part, relieved many workers from having to deal on their own with the need for income during at least some periods when they are away from work). Put generally, employers are likely voluntarily to provide their employees with paid leave for various reasons when it is seen to be the firm's interest in doing so. Employers can arrange for such paid leave by buying insurance or paying out of current resources as claims are made and paid. In terms of economic reality what on the surface may look like an employer-provided employee benefit, like paid vacation leave, may well be best understood as a kind of forced savings plan in which workers give up what would be higher hourly or weekly wages in return for remaining in full pay status while on the vacation they earned.

Government can also force or entice workers to save up for income needed during periods when they are temporarily away from work. It can provide insurance that workers must or may obtain. It can deliberately redistribute income to those temporarily in need of income, perhaps restricting that redistribution to special socially important reasons for being away from work.

It is also important to understand that government can deal directly with workers or it can work through employers in various ways – mandating employee benefits, requiring employers to participate in government insurance plans aimed at workers, requiring employers to collect employee insurance contributions, and so on.

Whether through government or employers, U.S. workers have something of a crazy-quilt of temporary income protection, and overall they have a far less generous package than is found in many other rich nations. Hardly any U.S. workers have government assured paid leave for child-bearing, baby-bonding, or kin care. More than half of U.S. workers do not have paid sick leave (aimed generally at a few days of leave per year), and very few employees have income protection against lost wages as a result of non-occupational injuries and illnesses that last from, say, a week to a year. The U.S. unemployment compensation system, while universal in a sense, does not cover many reasons for unemployment, replaces only a small share of lost wages, and ordinarily lasts for no more than six months. A substantial share of U.S. workers is not entitled to paid vacations, and no private employee is guaranteed paid vacations as a matter of law. And so on.

Income Security Policy Options

Many have proposed remedying these shortfalls by having government (whether the federal or state governments is contested) provide or mandate more employee benefits of these sorts. Such reforms are easy to envision in broad brush and difficult to design in detail, given the inconsistent terms of the existing (albeit tattered) regime. Some have proposed trying to do away with this "silo" approach by mandating a single "forced savings" (with back up insurance) scheme on which employees could draw for any of the needs for income discussed here.

As a policy matter, the advantage of the silo approach is that special terms and conditions can be applied as appropriate to the different reasons for which income is to be replaced. This approach can also readily combine insurance for some income losses, savings arrangements for others, and redistributional features for yet others. And it can mix and match employer, government, and required employee roles as seem appropriate. On the other hand, unless the silos cover all employee needs, workers can find themselves with lots of protection they cannot call upon because the reason they are temporarily away from work does not have its own silo. Moreover, employee benefits that require meeting silo-specific eligibility conditions often are expensive to administer and require intrusion into the employee's private life (to obtain eligibility verification and to be sure the employee is engaging, or not engaging, in certain behaviors). A non-silo approach could be easier to administer and more protective of employee privacy, and could be largely indifferent to the reason the employee temporarily needs income replacement. Yet, unless additional features are attached, a "forced savings" approach precludes handling some risks of income loss via insurance and openly subsidizing some reasons for being away from work on redistributional grounds.

The politics of these reforms is also complex. The silo approach so far has left us with many missing silos and even the silos we have often look very different from each other. Still, special interest groups with a focus on one type of temporary income loss are likely to focus on creating or improving a silo that deals with that specific problem and might well be able to create a coalition for what is pitched as a narrow reform. Getting rid of silos is a far more ambitious strategy, and yet, with the right political entrepreneurship behind it, could be even more politically attractive as there could be far more beneficiaries of the change.

Responding to Changing Family and Workplace Demographics: Family-Friendly Workplace Policies for the Federal Government's Hidden Workforce

Mary Ann Mason and Ann O'Leary

The federal government has played a limited role in supporting the needs of workers with caregiving responsibilities. Instead, the federal government has structured the basic building blocks of its social policies on the notion that it is the responsibility of families to provide care for their children and elders. This principle has persisted even as women have entered the workforce in record numbers and the vast majority of our families have no one left at home to care for children, ill relatives, or elderly parents.

In recent years, the federal government has begun to recognize this changing reality and started to respond. Through its antidiscrimination laws—Title VII of the Civil Rights Act of 1964 and Title IX of the Education Amendments of 1972—the government prohibits employers and educational institutions receiving federal grants from discriminating on the basis of sex, which includes a prohibition against pregnancy discrimination and a prohibition against making employment decisions based on gender-stereotypes related to caregiving. In 1993, the Family and Medical Leave Act was enacted which allows 12 weeks of unpaid job-protected family or medical leave to approximately half of all workers in the United States.

Federal Government's Power as Contractor and Grantmaker

The federal government also plays another—less well-recognized—role in supporting workers with family responsibilities. As the largest contracting and granting agency in the United States—the federal government has the authority to encourage federal contractors and institutions receiving federal research grants to create family-friendly, flexible workplaces to meet the needs of today's workers. Currently, it is not doing enough to exercise this authority.

Today an increasing amount of the government's work is not performed directly by the federal workforce but rather by a hidden workforce of employees working for government contractors. From 2000 to 2008, the federal government more than doubled its investment in contracted goods and services to $513 billion. This investment represents over three percent of the total size of the U.S. economy, approximately equal to the economic output of the state of New Jersey.

Similarly the federal government supports tens of thousands of scientists and the universities and institutions that host them. The Obama administration has made scientific research a major priority, with the 2009 American Recovery and Reinvestment Act, including billions of new dollars to the federal granting agencies, most prominently the National Institutes of Health (NIH), the National Science Foundation (NSF), and the Department of Energy (DOE). The intent is to create jobs, maintain America's scientific competitiveness in the global market and to balance a recent decline in real dollars provided by federal granting agencies to support basic and applied research at Universities and Colleges.

Historically, the federal government has provided a standard for employment benefits and equity in employment, and government contracting has often been used as a powerful tool to improve employment benefits and equity in the private sector. Specifically, Presidential Executive Order 11246 prohibits discrimination and insists on affirmative action to assure representation of women and underrepresented minorities in the federal contracting workforce. And decades-old laws such as the Davis-Bacon Act, Walsh-Healy Public Contracts Act, and the McNamara-O'Hara Service Contracts Act all require that federal contractors pay prevailing wages and benefits.

Title IX of the Education Amendments Act of 1972 prohibits discrimination based on sex in educational programs and activities that receive federal financial assistance, which means that all federal grants to educational research universities are covered. The law conditions federal funding "on a promise by the recipient not to discriminate, in what is essentially a contract between the government and the recipient of funds."

The federal government could use these existing executive orders and statutes to encourage family-friendly workplaces policies that would support women in low-wage contracting jobs, as well as women working their way up the career ladder to be our country's scientists.

Family-Friendly Federal Contracting

The federal contracting workforce is increasingly a service-oriented workforce. Like the private-sector workforce as a whole, it is a workforce increasingly made up of women and men who are combining work and care and need support to do so effectively.[1] But too little is known about the federal contracting workforce because there is shockingly little transparency in government reporting on federal contractors.

The government should start by taking responsibility to fully understand the workplace policies of the contract workers supported by the federal government. And at a minimum the government should do more to enforce existing federal contractor equity and benefit laws, including ensuring that federal contractor workers are not discriminated against based on pregnancy or caregiving responsibilities, and that our federal contracting prevailing wage and benefit laws include family leave benefits. The government could also take a further step to ensure that the federal requirement to do business with "responsible" contractors includes rewarding contractors for offering family-friendly benefits at least as good as those offered to federal employees.

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[1] Ann O'Leary, "Making Government Work for Families: The Federal Government's Role as Employer and Contractor in Improving Family-Friendly Policies," Berkeley Center on Health, Economic & Family Security and The Center for American Progress, July 2009.

continued:

RESPONDING TO CHANGING FAMILY AND WORKPLACE DEMOGRAPHICS: FAMILY-FRIENDLY WORKPLACE POLICIES FOR THE FEDERAL GOVERNMENT'S HIDDEN WORKFORCE

Family-Friendly Policies to Support America's Scientists

We have good evidence, based on our own research,[2] of the uneven and inadequate family accommodations provided by Universities who host scientists supported on federal grants. We also know that fewer tenure track faculty women are supported by federal grants than tenure track men with children and that women with children are far more likely to drop out of a scientific career than single women or men with children. This departure of highly trained women scientists, who are a significant part of the talent pool, represents a major investment loss. Together, with increases in European and Asian nations' capacity for research, the long-term dependability of a highly trained U.S. work force and global preeminence in the sciences may be at risk.[3]

To remedy this loss of women scientist, the federal government should act in partnership with America's research universities to provide clear guidance and support for family-friendly workplace policies for all positions along the pipeline from graduate student to tenured professor. In addition, the government could do more to enforce Title IX to ensure that women have full access to scientific careers and that women are not discriminated against with regard to pregnancy or caregiving when pursuing academic scientific careers.

Our full paper offers specific recommendations for both employees supported by federal contracts and for those on scientific grants. By enforcing both the letter and the spirit of current laws government could become a leader in creating family-friendly workplace policies for the vast hidden force of government employees; resulting in a more productive American workforce.

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[2] Marc Goulden, Karie Frasch, and Mary Ann Mason, "Staying Competitive: Patching America's Leaky Pipeline in the Sciences," Berkeley Center Health, Economic & Family Security and The Center for American Progress, forthcoming, October 2009; *see also* Mason, Mary Ann and Marc Goulden, "Do Babies Matter: The effect of Family Formation on the Lifelong Careers of Academic Men and Women," Academe 88, Number 6:21-27 (2002).

[3] Derek Hill et al., National Science Foundation, Division of Science Resources Statistics. *Changing U.S. Output of Scientific Articles: 1988–2003* (Arlington, VA: National Science Foundation, 2007).

The Shared Responsibility, Shared Risk project will be publishing an edited volume of the papers presented at the October 16, 2009 conference held at the Center for American Progress in Washington, DC. The edited volume will be available in the Spring of 2010. If you are interested in ordering one or more copies of the book, please complete the form below and mail it to:

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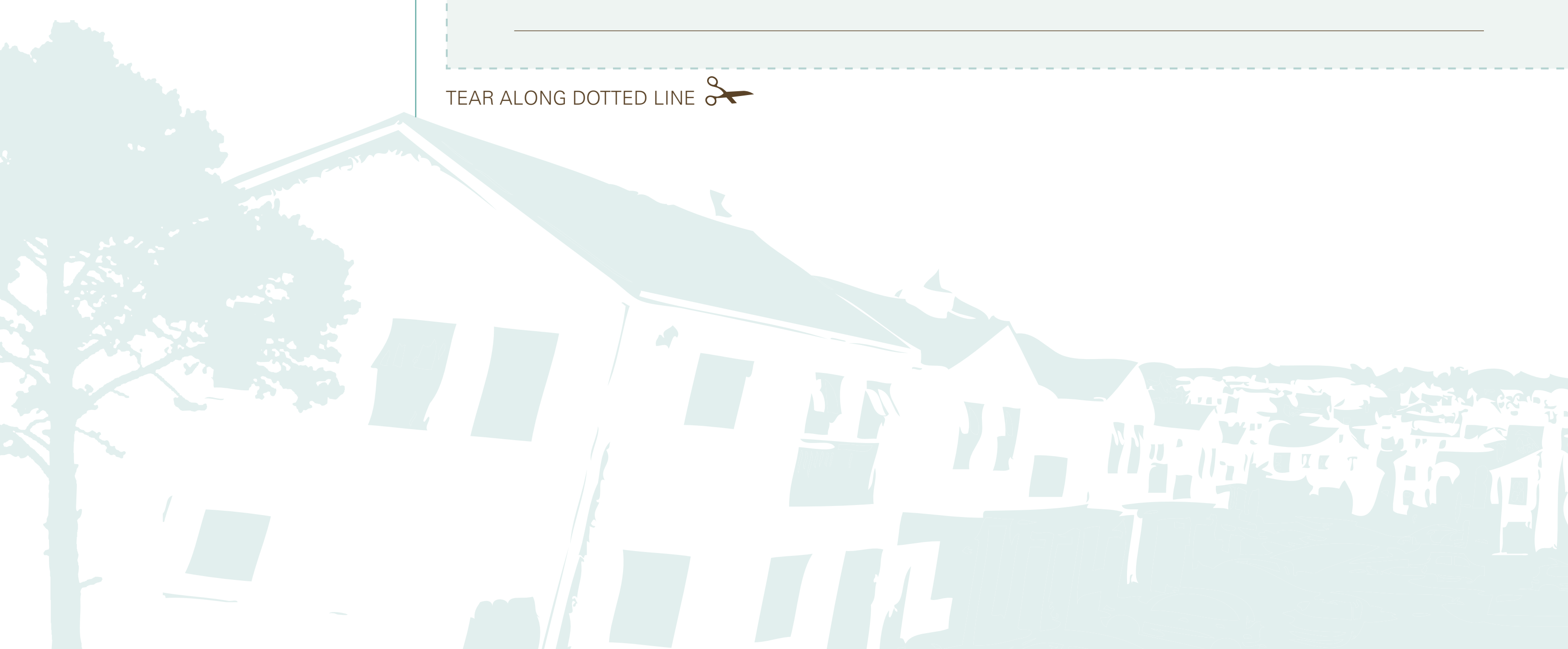

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