THE HAMILTON PROJECT

Advancing Opportunity, Prosperity and Growth

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Jacob S. Hacker

Universal Insurance:
Enhancing Economic Security to Promote Opportunity

THE BROOKINGS INSTITUTION

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Universal Insurance: Enhancing Economic Security to Promote Opportunity

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Abstract

The economic risks faced by American families have increased dramatically over the past three decades. For example, while the share of families experiencing a drop in real income over any two-year period has remained steady at about half, the median income drop for such families has risen from approximately 25 percent of income in the early 1970s to around 40 percent by the late 1990s and early 2000s. Meanwhile, the volatility of family incomes—how much they fluctuate over time—has increased substantially. Several possible policy options need to be debated in response to this increase in economic insecurity. This paper puts forward one potential approach, focused on providing temporary and partial relief from severe economic shocks. This proposed program, Universal Insurance, would be available to the majority of American families and would build on, rather than supplant, existing social insurance programs. It would provide short-term, stop-loss protection to qualifying families whose income suddenly declined by 20 percent or more, or whose out-of-pocket health costs in one year amounted to 20 percent or more of their combined income for that year. Although most families would be eligible, the program would be most generous for lower-income families, which have the fewest resources with which to weather economic shocks. This type of broad-based, stop-loss insurance—covering a range of risks but focused on particularly dramatic cases to minimize incentive problems and target those most in need—could provide a flexible new platform for enhancing economic security in a world of rapidly changing risks. As the nation struggles with rising income insecurity, this proposal, along with other potential policy responses, should be actively debated.

Contents

I. Growing Economic Insecurity for American Families

Over the past generation, the economic risks faced by American families have increased dramatically (Hacker 2004). Yet public programs have largely failed to adapt to these new and newly intensified risks, and private workplace benefits have substantially eroded. As a result, risks have increasingly shifted from government and corporations onto the balance sheets of American families. This "great risk shift" (Hacker 2006) not only creates anxiety, but also threatens opportunity by undermining the security that families need in order to feel optimistic about their futures and to recover when economic shocks occur.

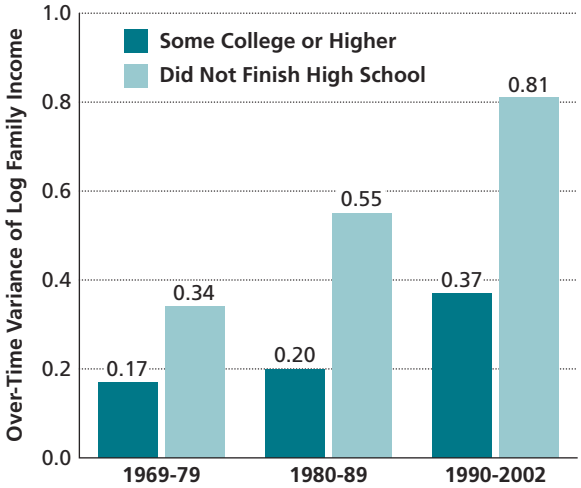
Rising Family Income Volatility

Perhaps the most telling evidence of increased insecurity is the growing volatility of family incomes. The changing variability of family incomes over the past generation can be assessed using the Panel Study of Income Dynamics (PSID), a panel survey that has been tracking a nationally representative group of households since the late 1960s.[1] The PSID data are valuable because most government statistics—such as the unemployment rate, poverty level, and distribution of annual income—are snapshots that tell us what people are experiencing at a given time, rather than moving pictures that reveal what happens to people over a period of several years (Pierson 2004). Because the PSID tracks families over time, it allows us to gain a true dynamic picture of the up-and-down trajectory of Americans over the course of their lives.

What this picture shows is that family incomes are not only increasingly unequal, but also increasingly unstable. Since the early 1970s, family incomes among working-age Americans (aged 25 to 61) have become more than twice as volatile, even when government taxes and benefits are taken into account. Volatility is higher for women than for men, higher for African Americans and Hispanics than for Whites, and higher for less-educated Americans than for more-educated Americans, yet volatility has risen across all these groups.[2] Indeed, as Figure 1 shows, income instability has increased virtually as quickly among people with a college education as among those who failed to finish high school.

FIGURE 1

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



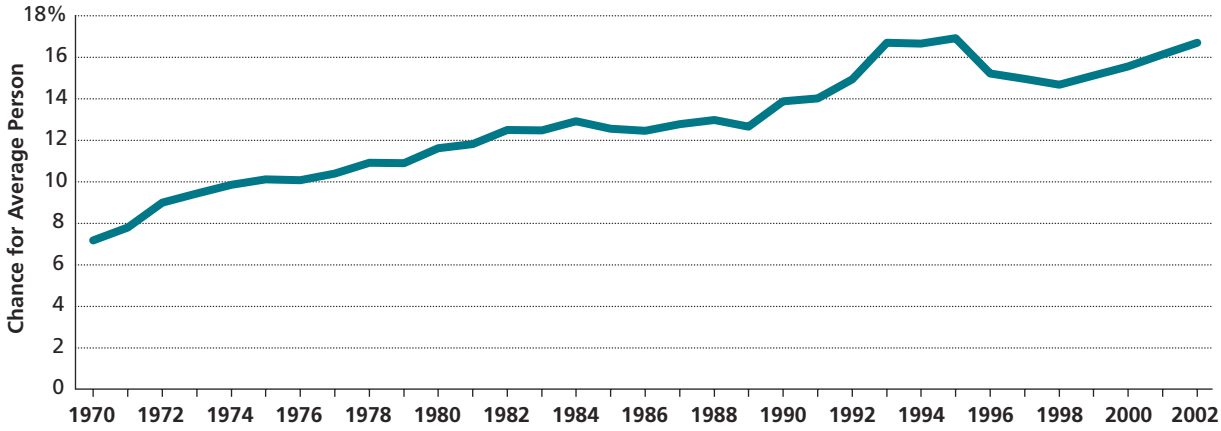
Source: PSID and Cross-National Equivalent File (CNEF), Cornell University. http://www.human.cornell.edu/che/PAM/Research/Centers-Programs/German-Panel/Cross-National-Equivalent-File_CNEF.cfm
Note: For a description of these calculations, see Hacker 2006.

This increase in volatility is dramatic. About half of the families in the PSID survey experience a drop in real income over a two-year interval, a share that has remained steady over time. However, the size of the median decline has risen from around 25 percent of income in the early 1970s to around 40 percent by the late 1990s and

1. All of the estimates in this discussion paper were carried out in cooperation with Dr. Nigar Nargis, assistant professor at the University of Dhaka in Bangladesh, currently a postdoctoral fellow of the Strategic Training Program of Tobacco Research, the Canadian Institute of Health Research, University of Waterloo, Canada. PSID information and data can be found at http://psidonline.isr.umich.edu/Data/.
2. In all these estimates, family income is adjusted for family size. For a description of the basic model used to estimate over-time income variance, see Moffitt and Gottschalk 2002.

FIGURE 2

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



Source: PSID; CNEF.
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.

early 2000s. Meanwhile, the predicted probability (based on a multivariate analysis) that an average working-age individual will experience at least a 50 percent drop in family income has also increased substantially. As Figure 2 illustrates, the predicted probability was just over 7 percent at the beginning of the 1970s; by 2002, it had more than doubled to nearly 17 percent.[3]

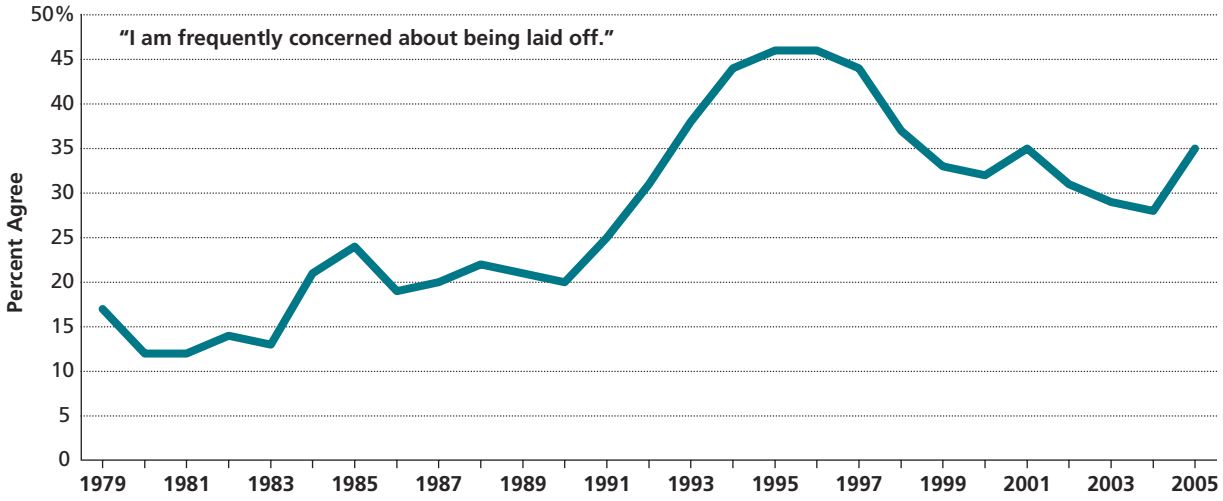
Rising income instability is not the only evidence of increased insecurity. For example, personal bankruptcy has become more common, with the number of households filing for bankruptcy rising from fewer than 290,000 in 1980 to more than 2 million in 2005.[4] Health-care costs also pose substantial financial risks: In 2004, for example, more than 14 million nonelderly Americans (of whom 10 million were insured) paid more than 25 percent of their earnings on out-of-pocket health costs and premiums (FamiliesUSA 2004). One out of six working-age adults is carrying medical debt (Seifert and Rukavina 2006), and medical costs and crises are a factor in perhaps as many as 46 percent of all personal bankruptcies in the United States (Himmelstein et al. 2005). These various risks combine to create a greater sense of insecurity than any one of them alone would generate.

Perhaps not surprisingly, then, poll after poll shows that the majority of Americans today are concerned that their economic security is slipping away (Hacker and Teixeira 2005, Newport 2006). Consider Figure 3, based on a polling series by the private business research firm Institute for Scientific Research (ISR). It shows that in 1982, amid a severe recession that had pushed the unemployment rate up to nearly 10 percent, 12 percent of workers reported they were frequently concerned about being laid off. By 1996, with the unemployment rate hovering around 5 percent—half what it had been when the 1982 poll was done—the percentage of workers who said they were frequently concerned had risen to 46 percent. Even in 2005, with the unemployment rate again at only 5 percent, the number of Americans worried that they would lose their jobs was still about three times higher than it had been during the steep economic downturn of 1982 (see Figure 3).[5]

3. Because public benefits are counted as income, the trend may partially reflect the growing role of in-kind benefits, which are not included in the PSID. Still, with regard to income protection, government is clearly not doing as much as it once did to help nonelderly families that experience economic shocks.
4. The year 2005 was unusual because of the rush of filings before the 2005 bankruptcy bill took effect in October of that year. The number in 2004, however, still exceeded 1.56 million.

FIGURE 3

A Growing Perception of Job Insecurity, 1979–2005



Source: Proprietary data courtesy of ISR; for general information, see www.isrinsight.com.

The Cost of Insecurity

The increased income volatility and insecurity faced by many families imposes costs not just on those families, but also on the economy as a whole. Substantial economic insecurity may impede risk taking, reduce productivity by failing to help families that have suffered an adverse shock get back on their feet, and feed demands for growth-reducing policies.

While some measure of financial risk can cause families to respond with innovation and prudence, excessive insecurity can cause them to respond with caution and anxiety. As a result, families lacking a basic foundation of financial security may fail to make the investments needed to advance in a dynamic economy. It has long been recognized that policies that encourage risk taking can benefit society as a whole, because, in their absence, individuals may be unwilling to undertake valuable investments that involve high levels of risk. This is all the more true because people are highly "loss averse," meaning that they fear losing what they have more than they welcome the possibility of substantially larger but uncertain gains (Kahneman and Tversky 1984). Moreover, the gains of risky investment may entail positive externalities, that is, benefits that are not exclusive to the individual making the investment, but that accrue to others outside the transaction. When investments involve large positive externalities, individuals may not have sufficient incentive to invest in achieving these societal gains.

Many economic investments made by families are risky. Purchasing a home, for example, is beneficial to families and society, but entails substantial financial risk (Shiller 2005). Similarly, investment in workplace skills and education—particularly the education of children—is an investment that pays off handsomely, on average. Yet the returns to skills and education are highly variable, and may be becoming more so (Bernhardt et al. 1999, Farber 2005). In addition, parents who make risky educational

5. The same pattern appears in public responses to the Gallup Poll, which has been asking a standard question about economic conditions since 1992. The share of Americans describing the economy as "only fair" or "poor" was extremely high in the early 1990s (peaking at 90 percent in 1992) and did not fall below a majority until late 1997. It remained low until 2001, when it shot back up to its current high levels of 60–80 percent. This pattern matches up almost perfectly with the trend in income volatility. Indeed, between the beginning of 1992 (when Gallup Poll data began) and the end of 2002 (when the income volatility data end), the correlation between negative public appraisals of the economy and volatility is greater than 70 percent. The wording of the question is, "How would you rate economic conditions in this country today—as excellent, good, only fair, or poor?" Gallup Poll data are available online at http://poll.gallup.com.

investments on behalf of their children do not reap many of the direct benefits from that investment. In short, the wellsprings of economic opportunity—assets, workplace skills, education, good parenting—are high-risk investments that are often accompanied by positive externalities.[6] Providing a basic level of economic security can encourage families to make these investments, aiding the economy as a whole.

Providing a basic level of security appears even more economically beneficial when considered against some of the leading alternatives that insecure citizens may otherwise back. Heavy-handed regulation of the economy, trade protection, and other intrusive measures may gain widespread support from workers when they are buffeted by economic turbulence, yet these measures are likely to reduce growth.

The challenge, then, is to explore ways of protecting families against the most severe risks they face, without clamping down on the potentially beneficial processes of economic change and adjustment that produce many of these risks. The proposal outlined in this paper, Universal Insurance, is one approach to providing limited protection against severe risk. Policy makers should actively explore this approach, in tandem with others, in response to the growing problem of economic insecurity.

Universal Insurance in Brief

A program to provide short-term cash benefits when families experience economic shocks could be designed in a variety of ways, in terms of both scale and scope. Under one view, it could begin modestly and evolve as fiscal conditions allow, incorporating new risks as the need for additional protections become apparent. For example, catastrophic health coverage could be incorporated immediately or added later, or only included if accompanied by enactment of a comprehensive health reform proposal. Benefits could be more or less generous depending on fiscal conditions.

Alternatively, an insurance program could be founded on a much more generous and comprehensive basis, to have the most immediate impact and maximize the returns on the administrative changes required. Such a program would require restructuring existing social insurance programs to reduce duplication of effort and ensure a broad net of protection.

All these are options that should be debated. To encourage discussion and clarify the major cost and operational issues involved, the remainder of this paper develops a middle road—Universal Insurance. On the one hand, Universal Insurance would be more than a limited pilot program: It would insure against major economic shocks stemming from unemployment, ill health, disability, and the death of a family breadwinner, and its benefits would be generous enough to help families truly get back on their feet. On the other hand, Universal Insurance would cover only a limited, yet still meaningful, fraction of the losses suffered when families are hit with covered economic shocks, and it would aim to fill the gaps left by existing social insurance programs, rather than to substitute for those programs. Universal Insurance would thus be similar to private stop-loss insurance purchased by corporations to limit their exposure to catastrophic economic risks.

Like Social Security and other social insurance programs, Universal Insurance would require income-related contributions. In turn, Universal Insurance would pay out short-term benefits in cases of unemployment, disability, illness, catastrophic health costs, and the death of a family breadwinner. Although these benefits would be available to all but the wealthiest families, the share of income replaced by the program would

6. This argument is not merely theoretical: A growing body of evidence backs it up. Cross-national and cross-state statistics suggest, for example, that generous personal bankruptcy laws are associated with higher levels of venture capital and entrepreneurial activity (Armour and Cumming 2004, Fan and White 2001). Research on labor markets suggests that workers who are fearful of job loss invest less in their jobs and skills than do those who are more secure (Osberg 1998). In addition, cross-national studies suggest that investment in specialized education and skills is higher when workers have key risk protections (Esteves-Abe et al. 2001, Mocetti 2004). Workers, it seems, invest in highly specific assets—such as skills that do not transfer easily from one firm or occupation to another—only when the risk of losing the potential returns to those assets are mitigated by basic insurance protections that are not job specific. When insurance is not present, workers may underinvest in the most crucial asset in most families' portfolio—namely, the value of family members' human capital (Neal 1995).

be more generous for lower-income families than for higher-income families.

By providing limited protection against large and sudden income declines that can cripple family finances, Universal Insurance would enhance economic security. Although the protection it would offer would be relatively modest in order to target resources and avoid incentive problems, it would nonetheless provide a more secure backstop against catastrophic economic loss than Americans now enjoy. Universal Insurance would provide this backstop, moreover, through the popular and successful method of inclusive social insurance, pooling risks broadly across all working families. In short, Universal Insurance would cover a range of risks and insure nearly all Americans. Rather than a program focused only on a single risk or aimed only at the poor, Universal Insurance would be a general program of economic security that helps keep families from falling into poverty in the first place.

II. Universal Insurance vs. Major Alternatives

In considering how Universal Insurance could work, it is useful to consider the concept in relation to existing public and private policies, as well as against the backdrop of some alternative arrangements. Such a consideration suggests that the concept of Universal Insurance is superior to—and yet could work in tandem with—a number of leading alternative responses to increased economic insecurity.

The Gaps in Public and Private Policies

As the evidence on income volatility and insecurity suggests, existing public and private policies are not adequately protecting families against economic instability. These shortcomings are not just evident in government policy: Employers also have cut back many of the benefits that they once provided as a matter of course. The United States is unique in the extent to which workers rely on private employers for basic benefits such as health care and retirement pensions—benefits that are provided by government in other industrial democracies (Hacker 2002). Yet private risk pooling is in broad decline, with rates of coverage for lower-wage workers, in particular, falling dramatically. Since 2000, for example, the proportion of employers offering health coverage to their workers has fallen by nearly 10 percentage points,[7] and the proportion that finance the full cost of coverage—once the norm—has declined, from 29 percent to 17 percent for individual health insurance, and from 11 percent to 6 percent for family health coverage.[8]

Perhaps most important, few of America's strained social programs have been retooled to deal with the new and newly intensified risks to income of the postindustrial, two-earner economy. The current framework of social insurance was constructed in an era in which the key economic risks were a temporary interruption of the male breadwinner's wages, and inadequate income in retirement. Today, even well-educated workers face a heightened risk of being displaced from employment without prospects for rapid reemployment at comparable levels of earnings. In addition, women are much more likely to be breadwinners than to stay home to care for children. The distinctive risks to family finances created by these shifts are not well insured by present policies. While Universal Insurance would not eliminate these growing gaps, it would provide a crucial backstop where existing policies are most dramatically falling short.

Will Universal Insurance Crowd Out Private Insurers?

This backstop role may raise worries that Universal Insurance will "crowd out" private alternatives. Crowd out is not an idle concern, but Universal Insurance is tailored to minimize it. For one, it focuses on domains of risk where few good private substitutes exist. For another, even where private alternatives exist, these substitutes are often unavailable or unaffordable for people with lower incomes or higher risks—precisely those who need them most. Moreover, some degree of crowding out of private insurance may actually have beneficial consequences if it occurs in domains that are prone to market failure. For example, taking a portion of the burden of catastrophic health costs off private insurers may lower insurance premiums and decrease the potential for risk segmentation.

Will Universal Insurance Prevent New Forms of Income Insurance?

Some economists, notably Robert Shiller (2003), argue that private income insurance could arise without government intervention. Indeed, Shiller envisions the emergence of a robust market for what he calls *livelihood insurance*—commercial contracts providing protection if earnings in specific occupations decrease over time.

7. Albert Crenshaw, "Workers' Family Coverage Reaches $10,880 Average," *Washington Post*, September 15, 2005.
8. Milt Freudenheim, "Fewer Employers Totally Cover Health Premiums," *New York Times*, March 23, 2005.

This type of private insurance could serve some of the same functions as Universal Insurance, yet livelihood insurance seems highly unlikely to arise in the private market on its own. Not only does it require data about the income trajectories of specific careers that do not yet exist, but it also requires very long-term contracts; otherwise, workers would simply opt out if their earnings rise. As the weaknesses of the market for long-term care insurance suggest, long-term contracts are extremely difficult for private insurers to write or enforce, the more so the more uncertain future costs are. Furthermore, the behavioral biases that Shiller has written about in other publications (e.g., Shiller 2005) suggest that most Americans are not good judges of their need for insurance against low-probability and diffuse but devastating risks, with most people severely underestimating their need for protection. As a result, many workers who would benefit from livelihood insurance may forgo it. Finally, even if the requisite data were available, insurance companies would still face a great deal of systemic risk—the possibility of large, highly correlated losses that are difficult to diversify or hedge against. By contrast, the federal government would have comparatively little trouble dealing with these problems: It could cover all working families, and it is uniquely positioned to diversify systemic risks across citizens and over time.

These, indeed, are some of the most basic arguments for a social insurance approach. Government is well positioned to bear large concentrated losses because it can spread costs and risks across all members of society. Equally important, only government can construct systems of insurance (whether publicly or privately administered) that are favorable to higher-risk groups and lower-income citizens. In a competitive market, private insurers simply cannot sustain such cross-subsidies.

Social insurance is not only effective at overcoming key weaknesses of the private market—it can also be highly efficient. The costs of running a social insurance program are generally far lower than the costs of providing private insurance: Marketing costs are minimal to nonexistent, operational costs are low thanks to economies of scale, and underwriting costs are simply not a factor. Holding the character of insurance coverage constant, social insurance—with its large risk pool, lack of need to differentiate subscribers on the basis of their risk, and low overhead—often costs much less to operate than private insurance. Moreover, none of these efficiency advantages includes the larger efficiency gains to the economy that may accrue if social insurance encourages investments in assets, education, skills, and other productivity-enhancing measures in risky economic contexts.

A better sense of these multiple advantages comes across when comparing Universal Insurance to two other currently favored approaches to dealing with economic insecurity: assistance for the poor, and specialized tax-favored savings accounts.

Universal Insurance vs. Antipoverty Assistance

Although it would be targeted to the most severe cases of hardship and limited in its reach, Universal Insurance would include the majority of families. Would it make more sense to have a program that is more targeted to families living in or near poverty?

Assistance for the poor is the ultimate safety net in a capitalist economy, and Universal Insurance cannot and would not replace it. At the same time, Universal Insurance *would* be an antipoverty program, preventing the drop into poverty of millions of Americans. Most of the poor, after all, are poor for relatively short periods of time—precisely because of the kinds of events Universal Insurance would cover. Mark Rank (2004) estimates, for example, that more than half of Americans have spent at least a year in poverty by the age of 75. Revealingly, Rank and his colleagues have also found that the probability of spending time in poverty has risen dramatically in the last generation (Sandoval et al. 2004). Long-term poverty, however, is comparatively rare: Fewer than 10 percent of Americans have spent five or more consecutive years in poverty by the age of 75. In short, many of the poor in any given year are poor because they lack adequate income insurance. Among this substantial share of poor Americans, insuring against catastrophic economic risks would be a better approach to poverty prevention than requiring citizens to experience serious economic hardship for long enough to qualify for public programs of assistance.

Finally, experience suggests that programs that are structured as insurance, emphasizing shared responsibility as well as shared risk, sustain political support over time. In keeping with this contractual vision, Universal Insurance would require contributions from everyone that it covers, and would incorporate an explicit quid pro quo: Everyone contributes something in return for the promise of help if and when trouble arises. As a result, Universal Insurance promises to create a large and enduring community of shared fate that supports and protects the program and its aims over time.

Universal Insurance vs. Tax-Favored Accounts

Special savings accounts, such as individual retirement accounts (IRAs), share some of the positive qualities of social insurance: They are not stigmatized, they emphasize responsibility, and they are politically popular. In addition, private accounts limit moral hazard because account amounts are the property of account holders (within limits), reducing the incentive for opportunism or gaming. The difference, however, is that tax-favored accounts do not provide true insurance. Although they may soften the blow of income drops and expenses, catastrophic events will quickly exhaust the savings of even the most thrifty middle- and lower-income families. Moreover, tax-favored private accounts almost invariably favor higher-income households, both because such households are most likely to make contributions and because they generally reap the largest tax benefits when they do. In theory, private savings accounts can be made more progressive—and, indeed, a progressive multipurpose savings account could be coupled with Universal Insurance. Even a progressive account, however, will not adequately address catastrophic risks. Finally, unless accounts and contributions to accounts are mandatory, private accounts do not directly confront the problems of myopia and risk misperception that cause families to underestimate the savings they need to deal with economic shocks.

In short, only social insurance is capable of pooling catastrophic risks broadly across the population in a progressive and politically sustainable way. If private accounts were very large, very tightly regulated, and very highly subsidized for lower-income and higher-risk citizens, they could bolster income security. But all these are conditions that raise massive problems of program design and political feasibility (not to mention financial feasibility, since private account proposals are often costly to implement). In contrast, social insurance is a well-tested idea that has proved capable not only of protecting families against pervasive economic risks, but also of creating a strong constituency in favor of program continuance.

III. The Design and Rationale of Universal Insurance

This section examines a specific approach to Universal Insurance. As emphasized, this proposal is only one of various approaches to the Universal Insurance concept that could be pursued.

Under the specific proposal explored here, all workers and their families would be automatically enrolled through their place of employment, paying premiums in the form of a small income-related contribution. In return for their premiums, workers would receive coverage for four potential shocks to family labor income that are large, serious, primarily beyond individual control, and incompletely protected against by present policies: (1) unemployment, (2) disability, (3) illness, and (4) the death of a family earner.[9] In addition, Universal Insurance provides some coverage against catastrophic health costs—a leading source of economic strain.

This coverage would apply to all families whose income is below a relatively high threshold (the 95th percentile of state family income), and available to families that have assets, and those that are wealth poor (however, families with very extensive assets are not covered). Although nearly all families are protected, Universal Insurance is especially generous for lower-income families, who are most likely to experience large financial shocks and be most in need of help when they do. Lower-income families generally have little or no wealth to protect their standard of living when income declines, and they are least likely to have access to workplace insurance. Not surprisingly, therefore, unemployment has a much larger effect on the consumption patterns of lower-income families than it has on those of higher-income families (see, e.g., Dynarski and Gruber 1997).

The label "Universal Insurance" is meant to connote two key features of the program. First, Universal Insurance covers almost every citizen with any direct or family tie to the labor force, providing at least some direct benefits to virtually all families that experience the risks against which it insures. Second, Universal Insurance covers a wide range of risks to family income. The philosophy of Universal Insurance is that Americans should have at least some protection against the major threats to their economic well-being, regardless of whether those threats fit neatly into existing program categories. Universal insurance is not a health program, a disability program, or an unemployment program. It is an income security program.

Administration

Under the version of the proposal envisioned in this paper, Universal Insurance would be administered primarily by the Internal Revenue Service (IRS), which would assess income, authorize checks, and evaluate tax filings to ensure that workers actually qualify for benefits they receive (much as is now done with the Advance Earned Income Tax Credit). The IRS would work in cooperation with the U.S. Department of Health and Human Services and the U.S. Department of Labor, as well as with state governments. State governments would be required to maintain existing programs that provide benefits in areas covered by Universal Insurance. Although some of the administration of Universal Insurance could be contracted out, the federal government would play the core role in pooling risk across all working families and regulating the system.

Eligibility and Benefits

Universal Insurance would insure all legal residents and their families with direct or family ties to the workforce. It would require at least four quarters of employment before an individual would be eligible to receive benefits for the first time. In addition, in order

9. Coverage for short-term exits from the workforce due to illness would extend to women who are ordered by their physicians not to work during a difficult pregnancy, or who require convalescence after giving birth. Given that income needs to drop by at least 20 percent for Universal Insurance to take effect, however, such coverage would likely be rare.

TABLE 1
Coinsurance Rates for Universal Insurance

	Family pays	Universal Insurance pays
Initial 20 percent drop in income or expense	100 percent	0 percent
Remaining loss or expense for….		
Families between 95th and 75th percentiles (inclusive)	80 percent	20 percent
Families from 75th percentile to median (inclusive)	80–65 percent	20–35 percent
Families from median to 25th percentile (inclusive)	65–50 percent	35–50 percent
Families below 25th percentile	50 percent	50 percent

to qualify for benefits at the time of application, workers would have to have minimum earnings equivalent to 20 hours of work at the minimum wage in at least two of the last four quarters, or the same level of earnings for all three months of the most recent quarter (this framework is based on Graetz and Mashaw 1999). When two or more members of the family work and contribute, they would receive coverage for their combined incomes.

To the extent possible, triggering events would create automatic coverage. For instance, employers would report to federal authorities when they terminate workers; those authorities would then contact employees to advertise coverage. Similarly, health providers and insurers would be required to provide information about filing for Universal Insurance to families that have been struck with illness. And state unemployment and workers' compensation programs and the federal disability program would assist in reaching out to the unemployed and disabled.

To be sure, any significant degree of automaticity would require substantial advances in IRS and other government agency computing power and capabilities. Even if those investments were successfully made, some families would still have to file for help themselves. People would be more likely to file for Universal Insurance than many other programs, however, for at least two reasons. First, Universal Insurance would cover a wide range of risks, so people would likely be aware of and file for help. Second, because the program would be universal, wage-related, contributory, and structured similar to private insurance, there would likely be little stigma associated with applying for coverage. Assuming the necessary investments in information technology were made, families would be able to apply online, at their local post office, or through companies contracting with the government to handle applications.

All beneficiaries of Universal Insurance would be required to file tax returns for years during which they receive benefits. If losses determined at the time of qualification were different from actual subsequent losses, the IRS would collect the difference, preferably in the form of additional withholding. Universal Insurance benefits would be taxable as income.

Structure of Benefits

Universal Insurance would mimic private insurance in its basic features: a premium (in this case, related to wages), a coinsurance rate that varies with family income, and a deductible (that is, a threshold expenditure or drop in income that must be reached to trigger compensation). As shown in Table 1, the deductible is 20 percent of income. In other words, in the case of income losses, family income must fall by at least 20 percent relative to the prior year. This relatively high threshold reflects the desire to target assistance to the most severe economic shocks. Once this threshold is reached, additional losses are partially covered on a sliding scale.[10] The replacement rate for losses above the threshold would be 35 percent for a family with median income. For families that, after the loss, are below the 25th percentile of state

10. This partial coverage, consistent with the program's stop-loss role, limits potential incentive problems, which will be discussed below.

family income, the rate would be 50 percent—the maximum replacement rate for losses in excess of 20 percent. The replacement rate would gradually taper to 20 percent for families between the 75th and 95th percentile of state family income. Families with income above the 95th percentile, or with wealth that places them above the 95th percentile of household wealth, would not be covered.[11] Initial maximum annual benefits would be $10,000; this maximum would be updated in line with average family income in subsequent years.

Out-of-pocket catastrophic health costs also represent a severe economic shock that is not always well covered by existing public and private insurance. Universal Insurance, therefore, provides coverage on the same sliding scale to families whose out-of-pocket health costs in any year exceed 20 percent of family income. Thus, for example, Universal Insurance would cover half of out-of-pocket health costs that exceed the threshold of 20 percent of family income for families with incomes in the lowest quartile. (The intent of the catastrophic health protection is to target short-term medical problems. If experience suggests that this program were instead used repeatedly over long periods by families with substantial out-of-pocket health expenditures, policy makers could explore whether some limitation would be warranted.)

A crucial point is that determination of benefits would be based on family income after other public programs are taken into account. In other words, Universal Insurance would apply only if existing public policies do not adequately protect family incomes. Because Universal Insurance is an income-protection program, it does not take into account in-kind benefits such as Medicaid and subsidized childcare. Moreover, Universal Insurance benefits would not be counted in the determination of eligibility for means-tested antipoverty assistance, although they would be counted as taxable income.[12]

To make these terms of coverage more concrete, consider a median-income family that sees a large drop of 75 percent in family income, leaving it at roughly the 13th percentile of national family income. The family's drop from the median to the 40th percentile (the 20 percent threshold loss) amounts to the deductible. The rest of the family's drop is covered with a 50 percent coinsurance rate, because the family has fallen into the bottom quartile. In total, therefore, roughly 37 percent of the family's loss is covered, bringing the family's income back to around the 26th percentile.

The duration of Universal Insurance benefits would be similar to the duration of benefits currently provided by related categorical programs. In the case of an unemployed individual, or an individual who is unable to work due to a disability, Universal Insurance would continue for up to six months, as long as the policyholder continues to look for work (unemployment) or the debilitating condition remains (disability). In the case of temporary unemployment due to illness, Universal Insurance would continue for up to 12 weeks. In the case of the death of a spouse, insurance payments would last one year, or until income rebounds, whichever comes first. Health costs would be covered in any year for which they exceed 20 percent of family income.

Direct Benefits of Universal Insurance

From the PSID, it is possible to extrapolate a rough estimate of the cost of the income insurance component of Universal Insurance—insurance against disability, unemployment, inability to work due to illness, and loss of a spouse's earnings. The total annual cost is just over $27 billion (in 2005 dollars). Table 2 summarizes the PSID analysis of Universal Insurance benefits, their incidence by income group, and their total cost.

These figures are admittedly uncertain. On the one hand, they assume 100 percent participation, which may lead

11. To ensure that middle-income families in areas with high property costs are eligible for coverage, wealth levels are calculated with owner-occupied homes excluded. Tax-favored retirement accounts that can be tapped before age 65 only with a penalty are also excluded from consideration.
12. Excluding Universal Insurance from eligibility determinations would both simplify administration and ensure that families that now receive assistance are not disqualified. Nonetheless, some families receiving Universal Insurance benefits would presumably not apply for means-tested benefits, because Universal Insurance lifted their incomes sufficiently to discourage them from seeking assistance. Indeed, as noted below, Universal Insurance is likely to substantially reduce the number of Americans who experience short-term poverty, thereby reducing the burden on antipoverty programs.

TABLE 2
Estimated Benefits of Income-Loss Protections of Universal Insurance

	Unemployment	Disability	Illness	Death of spouse
Average benefit:				
Bottom quartile	$3,046	$2,356	$1,149	$7,253
Second quartile	$2,591	$2,214	$417	$3,771
Third quartile	$3,080	$481	$1,045	$10,000
Top quartile (up to 95th percentile)	$4,473	—	$586	—
Beneficiaries (thousands):				
Bottom quartile	2,793	4,040	206	358
Second quartile	608	832	304	98
Third quartile	252	259	134	30
Top quartile (up to 95th percentile)	170	—	69	—
Total population covered (thousands)	5,423	3,004	515	781
Total cost of insurance (billions US$)	$11.62	$11.67	$0.54	$3.52

Source: Author's calculations.
— Insufficient observations. For these columns, total costs are calculated using data from the third quartile.

them to overestimate the true cost. On the other hand, the PSID estimates do not take into account any potential behavioral effects of Universal Insurance, which could push up costs. But this upward pressure on costs would be limited by key features of Universal Insurance that militate against the problem of false or induced claims, as discussed.

Table 2 shows that the main cost of the income-protection portions of Universal Insurance would be benefits for the disabled and unemployed (43 percent and 42 percent of total benefits, respectively), followed by benefits for the spouses of deceased workers (13 percent), and 12 weeks of coverage for income losses due to sickness (2 percent).

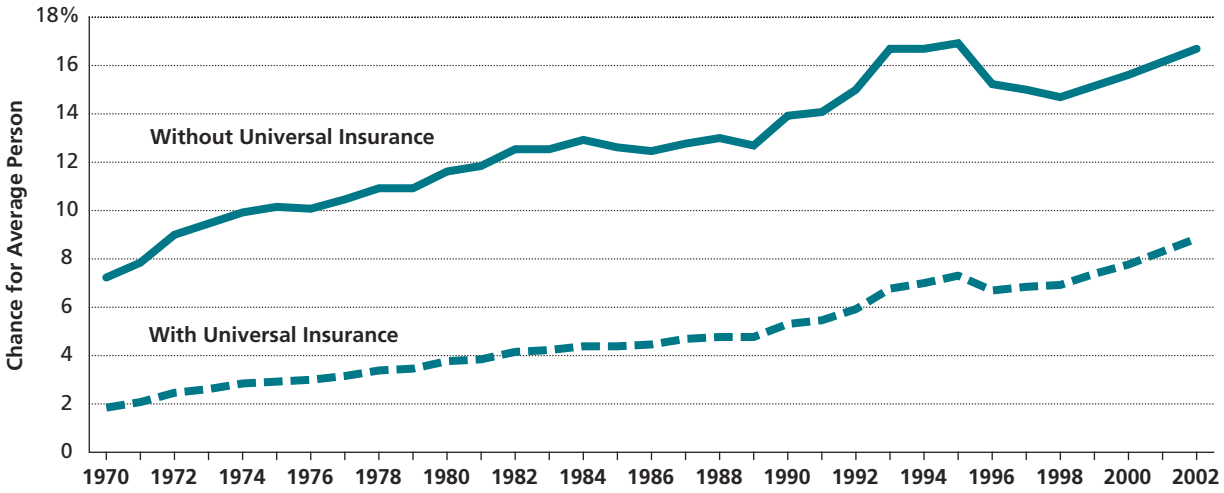
The costs of coverage for catastrophic health expenditures cannot be estimated from the PSID. To estimate them requires using the Medical Expenditure Panel Survey (MEPS), a nationally representative survey of medical use and costs. According to the MEPS (author's calculations), in 2003, more than 7.7 million households had out-of-pocket medical expenditures that exceeded 20 percent of family income. Coverage of all of these expenses under the terms of Universal Insurance—that is, with a deductible of 20 percent of income and the same sliding-scale coinsurance rate—is estimated to cost slightly over $7 billion (in 2005 dollars).[13] If this or other components of Universal Insurance turn out to be more or less expensive than projected here, policy makers could adjust program parameters to meet a given budget goal.

Despite the targeting of the proposed program to severe economic losses and its temporary and partial assistance to families even in those cases, Universal Insurance would still have a major positive effect on the incomes of the families it helped. For example, according to the PSID, more than one-third of the households affected by the four categories of income risk covered by Universal Insurance—more than 3 million Americans in total—end up below the federal poverty line even after receiving public transfers. Although the small numbers of such households in the PSID make any estimates of insurance effects uncertain, the PSID suggests that Universal Insurance would essentially eliminate poverty among

13. Because of the availability of government-provided catastrophic protection, insurers may be tempted to exclude coverage for very high medical costs. One way to counter this (if it is indeed a problem in practice) is to require that all health plans have at least limited stop-loss coverage in order to be eligible for favorable tax treatment.

FIGURE 4

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



Source: Author's calculations based on PSID; CNEF.
Note: See note to Figure 2 for additional information about the analysis.

these least-advantaged households. Universal Insurance would have a more limited, yet still substantial, effect on the risk of large income drops among nonelderly adults, as Figure 4 shows. If Universal Insurance had been in place in 2002, according to the PSID it would have roughly cut in half the predicted chance of a 50 percent or greater income drop.

Costs and Financing

In sum, the annual cost of Universal Insurance given the specific parameters proposed would amount to roughly $35 billion. This cost could be dialed up or down by adjusting qualifying conditions, replacement rates, and other variables, so the foregoing budgetary estimates should not be the principal criteria used in assessing the underlying concept of Universal Insurance. Moreover, although the proposed $35 billion cost is certainly significant, these costs are mostly not new for society as a whole. Many are now borne by families and workers individually—in ways that create great hardship. Others represent a burden on privately financed institutions of social protection, such as our bankruptcy system and communal networks of private relief, neither of which is designed well enough to handle the basic functions of social insurance.

Universal Insurance could be financed in several different ways. Because most family income is from earnings, a wage-based levy would be the most obvious approach. A payroll-based contribution of 0.6 percent of wage and salary income—0.3 percent each for employees and employers—would raise approximately $34 billion (in 2005 dollars). If the levy were only on income up to the Social Security wage base—the level below which earnings are taxed for Social Security—the combined contribution rate would need to be closer to 0.7 percent. Alternatively, Universal Insurance could be financed through a broad-based tax that includes capital income as well as earnings.[14]

Possible Moral Hazard and Incentive Problems

All insurance, social or private, raises the possibility of *moral hazard*—the tendency for insurance to foster excessive risk taking or related opportunistic behavior. In the case of Universal Insurance, the main concern is that the program would create incentives for people to game the system or otherwise behave irresponsibly because of the availability of benefits. For example, workers may remain unemployed longer or find a way to classify themselves as ill or disabled to take advantage of Universal Insurance.

14. For example, a one percent across-the-board income tax surcharge that applies to capital gains and dividends would raise roughly $34 billion.

Moral hazard is a real concern, but Universal Insurance has several features that limit its effects. First, the high deductible and significant cost sharing required by Universal Insurance would likely discourage workers and their families from gaming the system. Universal Insurance does not take effect until family income has fallen by a substantial amount (20 percent), and, even then, it only covers a share of the subsequent losses. To be sure, there are some circumstances under which the replacement rate that results from the combination of Universal Insurance and other programs may be higher than many economists believe prudent. This might result, for example, in the case of an unemployed worker who for a brief period is collecting unemployment insurance and also receiving benefits from Universal Insurance. Because Universal Insurance benefits are modest and decline sharply with income, while unemployment insurance is generally ungenerous for lower-income workers, such scenarios are unlikely. Nonetheless, if such interaction effects prove thorny, a maximum monthly replacement rate encompassing both Universal Insurance and other benefits could be specified, with Universal Insurance benefits adjusted accordingly.

A second reason that moral hazard would likely be minimized is that the risks and costs covered by Universal Insurance are definable and discrete, making them relatively difficult to fake. Furthermore, for unemployment, temporary or permanent disability, and inability to work due to illness, established verification systems already exist. For example, there are well-defined procedures for classifying employees as unemployed, rather than simply out of the workforce. In areas such as these, Universal Insurance would piggyback on existing monitoring processes, rather than need to create new enforcement institutions. In short, even when a family's income drops sufficiently to trigger assistance, the family would still have to comply with basic rules, administered by state and federal governments and private contractors, to obtain compensation.

IV. The Road Ahead

Today, many see the ideal of economic security as dated, yet the opposite is true. The big economic trends of the past generation—deregulation, deindustrialization, increased foreign competition, the decline of unions, the transformation of the family—have unleashed new and newly intensified economic risks. Americans are facing much more dramatic income swings than they faced two or three decades ago. As economic insecurity has intensified, moreover, it has moved up the income ladder, affecting middle-class Americans who once were relatively insulated from economic turbulence and hardship.

In this uncertain new environment, middle-class Americans have a mixed view of their economic standing. On the one hand, most believe that they are losing security, and do not want to be required to manage risks solely on their own. On the other hand, most still strongly believe that, through hard work and wise choices, they can rise and thrive in the economy on their own.

Universal Insurance is intended to speak to both sides of this mixed view. Although it aims to cushion major economic shocks, it is not just about preventing financial disaster. It also has a more optimistic goal: to help families get ahead. Just as businesses and entrepreneurs are encouraged to invest and take risks by basic protections against financial loss, so Universal Insurance aims to encourage families to make the sacrifices necessary for economic opportunity and advancement. In doing so, Universal Insurance would provide a necessary cushion against the sharp edges of a dynamic capitalist economy—a cushion that is far preferable to the more intrusive measures that anxious citizens might otherwise demand, such as extensive regulation of the economy or restraints on international trade and finance.

To be sure, other mechanisms should be explored and debated as policy makers consider the best way to respond to the growing economic insecurity.[15] Universal Insurance represents just one approach, and one that could mesh well with several others. Even within the basic concept of Universal Insurance, a number of different designs are possible. The design offered here is limited to severe risks and the coverage of catastrophic losses. Alternatives that are more generous would provide broader coverage; alternatives that are more limited would focus on fewer risks.

Still, the details should not obscure the aspiration. Universal Insurance aims to cover a variety of risks (because the evolving nature of the economy makes a narrow programmatic approach problematic) and to reach almost all Americans (because a growing array of households face significant insecurity). By creating a flexible foundation for protecting families from a wide range of catastrophic economic shocks, Universal Insurance endeavors to provide the basic security that families need to reach for, and hold on to, the American Dream.

15. The author offers several such proposals in his 2006 book, *The Great Risk Shift*.

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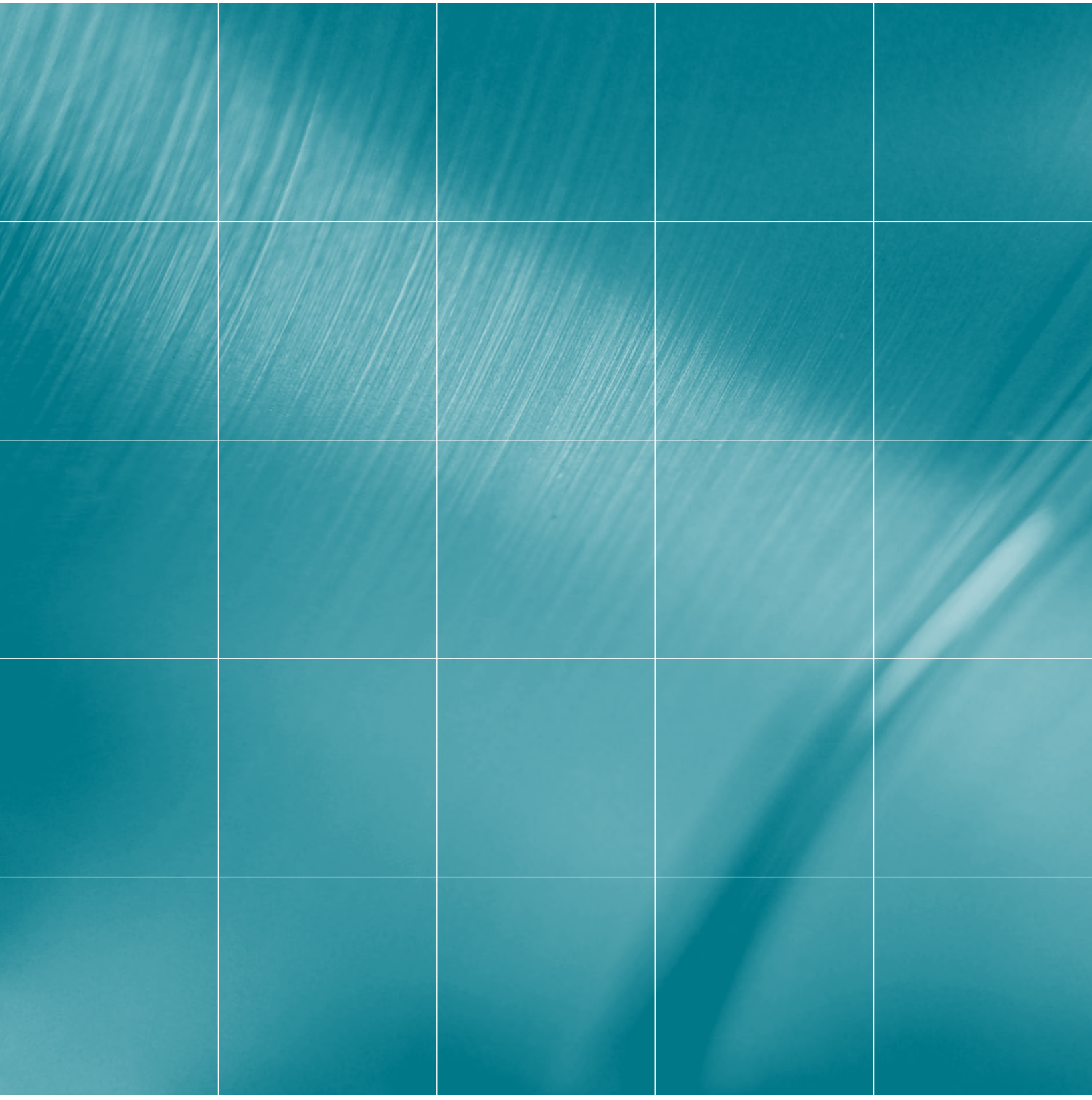

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