The Two-Income Trap: Why Middle-Class Mothers and Fathers are Going Broke

Authors: **Elizabeth Warren** and **Amelia Warren Tyagi**
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You may recognize the name Elizabeth Warren. A Harvard law professor, she is one of the co-authors of *As We Forgive Our Debtors* and *The Fragile Middle Class*. The co-author of this book is her daughter, Amelia Warren Tyagi, a business consultant. Together they bring an interesting perspective to the financial reality faced by many families today.
They point out that bankruptcy is becoming increasingly common. The authors argue that bankruptcy is not the result of deadbeats and extravagant spenders as is argued by many of the proponents for change in the bankruptcy laws. Increasingly fragile middle-class families living too close to the edge without any safety net are causing the increase in bankruptcy numbers in today's society. The most common attributes of persons filing for bankruptcy today are a lost job, a serious medical problem, and divorce. Almost 90 percent of the new bankruptcy filings, according to the authors, follow one of these three life events.

Another point raised by Warren and Tyagi is the cost of children. At one time, children were considered assets to a family, but that is no longer true. Children are expensive and the benefits that parents enjoy from children today are strictly non-financial. The authors go so far as to say that having a child is the best predictor that a woman will end in financial collapse.

Many middle-class families believed that sending the second parent into the labor market would make life easier, at least financially. It is true that women have opportunities and incomes that were unheard of just a generation ago. But even with that, having two earners in the family appears to have lessened the family's ability to withstand financial disaster because these two-income families have given up the backup provision of having a parent at home who could tend to aged parents, take care of children outside of school, and enter the labor market in times of disaster, such as job loss or disability.

Additionally, if families were spending that second income on frivolities, as is suggested by some proponents for changing the bankruptcy laws, they would be better off. In that case, if one of the wage earners were laid off or disabled, the family could cut out the spending on extras and use that income to survive. Instead, families have used the second wage-earner's salary to buy houses in better and safer school districts, allowing their children better educations and more secure lifestyles. These families have committed themselves to large fixed expenses dependent on two incomes. In our volatile labor market, the chance for job loss is extraordinarily high. Following a job loss or disability, these former two-income families may reach financial exigency quite quickly.

The authors are not advocating that all women should return home; they clearly state that they feel that women who want to be in the labor market should be. However, both families and society should make some adaptations to allow families to be more resilient in times of economic distress.

School vouchers allowing students to move freely among public schools are recommended, because the authors argue that two-income families have driven up the price of houses in good school district areas and that bidding wars continue for these houses, making it impossible to buy a house or even keep a house in these areas with a single earner family. The authors suggest that with school vouchers, families could live in less expensive housing while sending their children to the school of choice.

A second recommendation by the authors is one that all good financial planners would recommend, that families review their insurance coverage and make sure they are adequately covered with health insurance, disability coverage, and long-term care coverage. Little mention was made about the cost of these coverages, however. The authors also recommended that the government could step in and provide disability coverage to a broader percentage of those in need at a more modest cost to taxpayers than providing universal health insurance.

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Warren and Tyagi also encourage the revival of usury laws to limit what creditors can charge for loans. They argue that predatory lenders have made credit so easy and so expensive that many families are lured into using this expensive form of credit when disaster occurs. To avoid another savings and loan fiasco, the authors suggest that usury rates should be tied to the inflation rate or prime rate so lenders do not needlessly suffer when interest rates change. The authors did not present a flattering view of many of today's creditors.

Warren and Tyagi point out that the proposed changes to the bankruptcy laws would have been devastating to families. Currently, many families are doing the right thing for their families by filing bankruptcy. In most cases, it is a divorce, a disability, a major health problem, or a job loss that led to financial disaster, not profligate spending. Without a safety net of a potential worker at home who could enter the labor market if needed, and with fixed expenses based on the income of both earners in the household, two-income families have very little hedge room. When disaster strikes, there is only so much families can do. But their willingness to file bankruptcy should not be viewed as taking the easy way out. Instead, it should be viewed as their last ditch effort to provide for their children. Warren states that under the most recent proposed legislation, credit card debt would have received equal treatment. This would have meant that child support payments and past-due mortgage payments would no longer have taken precedence over credit card debt, leading to devastating consequences for many families.

Other author recommendations include families establishing a disaster plan, so they can tell if they can withstand a job loss or disability. Families should see if they can survive on one income, possibly downshifting expenses so they can. If there is a second

wage earner in the family, they should save a portion of that second income, establishing an emergency fund to help them through financial emergencies, and then they should spend the remainder on things which they can do without if ever there is an emergency.

The dedication of the book says much about the book. The dedication reads as follows: "This book is dedicated to all parents who wake up with hearts thudding over the possibility that buying school shoes and Girl Scout uniforms will mean that there won't be enough left over to pay the mortgage. These people are our neighbors, our brothers and sisters, our friends and coworkers. They travel anonymously among us, but we know them. They went to college, had kids, bought a home, played by the rules–and lost. It is time to rewrite the rules so that these families are winners again."

The book is thought provoking. Young persons contemplating marriage should read this to help them formulate a spending plan for their two incomes. Financial counselors and planners who have clients who are reluctant to establish an emergency fund should encourage those clients to read this book. Many others could benefit from reading this book by realizing that middle-class Americans can, and must, fight back. There will continue to be proposals for revising the bankruptcy laws, but unless we as individuals fight back, the proposals will continue to favor business over families.

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Why are middle-class mothers and fathers going broke? Authors Elizabeth Warren and Amelia Warren Tyagi may know why—and they offer solutions, all the way from public policy to lending practices to individual financial management strategies. Their suggestions may surprise you.

The Two Income Trap: Why Middle-Class Mothers and Fathers Are Going Broke, based on well-documented evidence from the Consumer Bankruptcy Project 2001, U.S. Census data, and Bureau of Labor Statistics, reveaks that households with two earners are more vulnerable to financial disaster than one-earner households were only a generation ago. But not, Warren and Tyagi claim, because of over consumption.

Elizabeth Warren, Professor of Law at Harvard University, is a principal investigator of the Consumer Bankruptcy Project 2001. A long-time scholar of bankruptcy law, Warren first taught us about debtors and creditors in As We Forgive Our Debtors (Sullivan, Warren, & Westbrook, 1989) and The Fragile Middle Class (Sullivan, Warren, & Westbrook, 2001). Warren's co-author (and daughter) is Amelia Warren Tyagi, a Wharton MBA and former McKinsey consultant.

Warren and Tyagi show that today's two-income family earns 75% more (inflation adjusted) than a comparable one-income family of the early 1970s. But after housing costs, health insurance, and expenses related to having two adults in the workforce (higher taxes, day care, a second car), the two-earner family actually has less discretionary income and less money to put away for a rainy day. The two-earner family has one more important problem. In the face of financial crisis, there is no safety net. There is no "extra" adult willing and able to pitch in during an emergency. When Dad is laid off, or junior is sick, or Grandma needs assistance, Mom is not available to replace income or provide free care. A stay-at-home Mom is an all-purpose insurance policy against financial disaster.

Should Mom stay home? After all, according to the over consumption theory, families spend money on many things they don't really need. On the contrary, Warren and Tyagi argue. Adjusted for inflation, families actually spend less on clothing, food, major appliances, and vacations. There is no evidence of an epidemic of overspending that explains the 255% increase in mortgage foreclosures, the 430% increase in bankruptcy, and the 570% increase in credit use.

So, what is the problem? Middle-class Americans are engaged in a bidding for homes in good school districts, say Warren and Tyagi. A de-regulated lending industry, job insecurity, and "now-you-have-it, now-you-don't" health insurance compound the problem. Families are locked into fixed costs that must be paid in good times and bad and there are few discretionary expenses that can be cut to save the day.

The authors suggest that housing costs play a major role in the two-income trap. Middle-class parents, they say, are willing to overextend themselves in order to purchase a home in "a good school district." The demand drives home prices out of line with other costs. While it is true that location is a major factor in the value of real estate, this reviewer is not convinced that buyers focus only on schools. Even with school vouchers, demand and prices would remain high. People want to live in "good neighborhoods" even when schools are not a consideration as might be true for childless households, empty nesters, etc. The best financial advice remains-- don't overextend yourself on credit.

As a matter of public policy, personal economics, and social status, homeownership is a high priority for Americans. But the push to increase the homeownership rate may be putting people in situations that they are not ready for. When a household purchases their first home, and especially if they choose the very real risk of an over-budget home, they should delay the purchase until they have adequate emergency savings and insurance.

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Otherwise, when problems arise—and they often do—there will be financial disaster.

For a professional in the financial management field, The Two-Income Trap may not be a surprise. Some of the solutions offered—providing school vouchers to reduce good-school-district bidding wars, increased regulation of the lending industry—are fodder for passionate political debate. But for individual families, the news has changed very little. Families must prepare for financial disaster by building a 6-month emergency fund, making sure they have adequate disability and life insurance, and avoiding overextending themselves for credit—even for a house.

In trying to provide a better future for their children, many are pushed to the breaking point. Warren & Tyagi believe that "collectively and individually these families have the tools to change the structure of their schools, to bring their politicians to heel, and to fight back against big businesses that would steal their economic vitality. The can release the trap" (p. 180).

You may not agree with all that Warren and Tyagi have to say. But their outline of the problems and suggestions for change are thought-provoking reading for financial management professionals.

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