

Risk and Recovery

Documenting the Changing Risks to Family Incomes

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Policymakers and the public are increasingly sensing that families are on their own, at the mercy of uncontrollable events such as illness or downsizing and at ever-increasing risk of suffering financial losses and declines in their material well-being as a result of these events. A spate of recent research has begun to assess whether this perception is borne out by data on income and earnings. Most of this work has focused on the volatility of earnings and income—for example, how much a family's income moves up or down from year to year¹—while some hones in on substantial declines in income. The data and research generally support the popular perception that income has grown more volatile over time, although the magnitude and timing of changes are sensitive to the data and measure of income used, the period and population studied, and the analytic approach taken.

A focus on volatility captures the uncertainty families face in knowing what their income will be from one year to the next; however, more volatile incomes do not necessarily mean families or individuals are worse off. Increased variance of income over time also indicates that the income distribution is becoming less rigid and that families at the bottom are more likely to move up. Indeed, increased mobility is the flip side of increasing volatility.

In contrast, a focus on substantial income losses captures the downside of volatility. Short-term losses are also important as even they can disrupt family routines, elevate stress, and impede the ability to plan in addition to reducing total family resources. Each effect may have lasting

consequences for adults and children even if the loss of income is short-lived.

This brief examines the likelihood that non-elderly individuals in families with children experience a substantial drop in family income as well as the likelihood that their income returns to pre-decline levels. We also put income drops in context by examining how often these drops are preceded by a short-term spike in income. We use data from the 1996, 2001, and 2004 panels of the Survey of Income and Program Participation (SIPP). Unlike studies that rely on annual data, we assess income changes (drops and recoveries) over a shorter time horizon of four-month periods.

Steep income drops are common, with 13.6 percent of families seeing their incomes fall by half at some point over the course of a year. The likelihood of income drops across the income distribution is U-shaped, with the lowest- and highest-income families the most likely to experience a substantial income loss. Further, only two in five individuals recover to at least 100 percent of their pre-drop income in the year after the drop.

Background

A considerable amount of recent research has examined the volatility of earnings and incomes. There is no strong consensus about whether individual earnings volatility has increased over the past two decades, and variations in the populations considered, how volatility is measured, and the treatment of extreme data points can influence



the level, trend, and timing of changes in volatility.² By and large, studies that focus on family income rather than individual earnings tend to note increases in volatility.³

A handful of studies explicitly examine large drops in income and earnings. Burkhauser and Duncan (1989) use data from the 1974 through 1983 waves of the Panel Study of Income Dynamics to assess the likelihood that individuals experience a 50 percent drop in their annual family income (adjusted for family size). They find that over this 10-year period, about one-quarter of 26- to 45-year-olds experience a substantial income loss. Gosselin and Zimmerman (2007) report that the annual probability that a 35- to 55-year-old experiences a 50 percent drop in income rises from an average of about 4 percent from 1974 to 1983 to an average of over 7 percent between 1994 and 2003. The chance of a drop in income adjusted for needs rises from 3 to 7 percent over the same periods.⁴

The Congressional Budget Office focuses on earnings losses using administrative data (the Continuous Work History Sample, or CWHS) and supplements its findings with data from the 2001 SIPP (CBO 2007). Using the CWHS data from 1980 to 2003, CBO reports that about one in seven workers age 22 to 59 experience a 50 percent decline in annual earnings, but the chance of an earnings drop does not increase over time. Focusing on drops between 2001 and 2002 using the SIPP, CBO finds that about 11 percent of workers experience a substantial earnings drop. Lower earners and those with less education are more vulnerable to such drops than other workers (CBO 2007).

Like these three studies, our study focuses on substantial income drops, but our work differs in several important ways. First, rather than assessing changes in income from year to year (or over a two-year period), we examine dramatic drops in monthly income, since even short-term dislocations may have adverse effects. Second, we supplement our research on income declines by assessing the factors associated with income recoveries. Third, we compare income drops and recoveries across cohorts from the mid-1990s and the early 2000s using data from the 1996, 2001, and 2004 SIPP panels. And fourth, we focus on individuals residing in families with children, as income dislocations may have particularly strong implications for them.

Data and Methods

We use data from the 1996, 2001, and 2004 Survey of Income and Program Participation panels for our analyses. The SIPP collects data on the income, employment, program participation, demographics, and well-being of U.S. households. Each panel starts with a fresh sample of households and interviews each household once every four months over a period of 36 to 48 months. At each four-month interview, known as a wave, respondents are asked core questions focusing on income, program participation, and employment. In addition, each wave gathers some specific information (e.g., work history, welfare history, asset holdings) through special sets of questions known as topical modules. When weighted, the SIPP provides nationally representative estimates of the U.S. population. We use the SIPP core files to construct our main analysis file and to merge on topical modules as appropriate.

Our sample consists of individuals between the ages of 25 and 61 living in families with children.⁵ We restrict the sample to include only those adults who are the family heads and their spouses or unmarried partners. We further restrict our sample by excluding adults whose family income is negative, for whom information is available in less than three months of any given interview wave, and whose income is entirely imputed.⁶ All analyses use cross-sectional monthly weights.

Our unit of analysis is the individual, but we focus on changes in the individual's social family income. Our definition of social family is the SIPP household reference person (or household head) and all individuals in the household related to that person as well as the reference person's unmarried partner and all persons in the household related to that unmarried partner. We also include foster children of the reference person in the social family. Our definition of a social family is narrower than the SIPP household definition (which is essentially all persons who share food or a kitchen and can include individuals that are neither related to nor romantically linked to the family head) but more inclusive than a SIPP/Census family, which excludes cohabiting partners.⁷ Implicitly, we assume that all of a family's resources are available to family members. A social family's income consists of all earnings (including self-employment income), interest,

capital gains, and public and private transfers the family members receive.

To measure an income drop, we have to compare current income to past income at some interval, and our measurements are sensitive to these choices. We are interested in short-term changes that may not be captured by annual income measures, so we exploit the fact that SIPP data are collected once every four months. Although the SIPP gathers information for each of the past four months, most changes in income are observed, not between months within a wave, but across waves. As such, we focus on wave-to-wave changes in income rather than month-to-month changes. We consider various levels of income drops (such as 25%, 50%, and 75%), although for the most part, we focus on drops of 50 percent or more, referred to as “substantial” income drops.

The first wave in the sample where a person is “at risk” of an income drop is the second wave of the survey; if income in wave 2 is substantially lower than income in wave 1, we consider that individual to have experienced an income drop. We continue to compare income from a given wave (t) with income in preceding wave ($t-1$) until we find a substantial drop in income or until we run out of data on that individual. For the most part, we focus on the income drops that occur within the first four waves of the SIPP panels in order to be able to observe recoveries from income drops.

We deem an individual to have fully recovered from an income drop when that individual’s social family income returns to or exceeds its pre-decline level. Once individuals experience a substantial income drop, they are not at risk for

experiencing subsequent drops until they first experience a recovery. As a consequence, for each person, at most two income drops can be observed in each calendar year. In this brief, we focus on only the first observed income drop, if any, and define recovery for those who experience a substantial income drop using the maximum income attained in the year following the drop. We can then define whether an individual has attained recovery of a minimum percentage of pre-drop income in the year following the income drop.

We also assess the likelihood of substantial income drops and recoveries for individuals at different points in the income distribution to see if the poor or the rich are more vulnerable to losses and whether the chances for recovery depend on the level of baseline income. All tabulations are done using sample weights and are adjusted for clustering.

Results

Understanding Major Drops in Income

We begin by examining the incidence of substantial declines in income over the course of a year. In table 1, we show the share of adults in social families that experiences income drops of at least 25, 50, and 75 percent. A 25 percent drop in income from one wave to the next is quite common: two in five individuals living with children lose a quarter of their income at least once in the space of a year. More than 1 in 8 adults in families with children experience a 50 percent or greater drop in family income in a year, and almost 1 in 25 suffers a 75 percent drop at some point over a year.⁸

TABLE 1. Percent Experiencing Income Drops of Various Sizes Over a Year

Income drop	All years	SIPP Panel		
		1996	2001	2004
At least 25 percent	37.4	37.9	41.9	33.1
At least 50 percent	13.6	12.5	15.4	13.2
At least 75 percent	4.1	3.4	4.2	4.8
Sample size	39,444	13,921	9,780	15,743

Source: Authors’ calculations based on Survey of Income and Program Participation (SIPP).

Notes: Income drops are defined using the change in family income between consecutive four-month periods, or waves; drops may be seen in the second to fourth waves (one calendar year). Individuals with all income imputed in any month are excluded, and statistics are weighted using wave 1 SIPP survey weights.

The chance of a drop in income varies somewhat over time. For example, the likelihood of a 25 percent drop in income rises from 38 to 42 percent between 1996 and 2001 but falls back to 33 percent by 2004. The chance of a 50 percent drop in income follows a similar pattern, rising from 13 percent in 1996 to 15 percent in 2001 before falling back to 13 percent in 2004. The chance of a 75 percent drop in income is low but increases across all three SIPP panels, from 3 percent in 1996 to 4 percent in 2001 and 5 percent in 2004.

The proportion of individuals in families with children experiencing a drop in income is U-shaped across the income distribution: Individuals in the lowest and the highest income quintiles are substantially more likely to experience income drops than individuals in the middle quintiles (figure 1). About 20 percent of individuals in the lowest income quintile⁹ lose at least half their income at some point during the course of a year. The portion declines to 12 percent for the second quintile and falls to about 10 percent for quintiles three and four. The proportion of individuals with a substantial drop then rises to 16 percent for the top income quintile. This U-shaped pattern holds true across all levels of drops shown.

Recovery from Income Drops

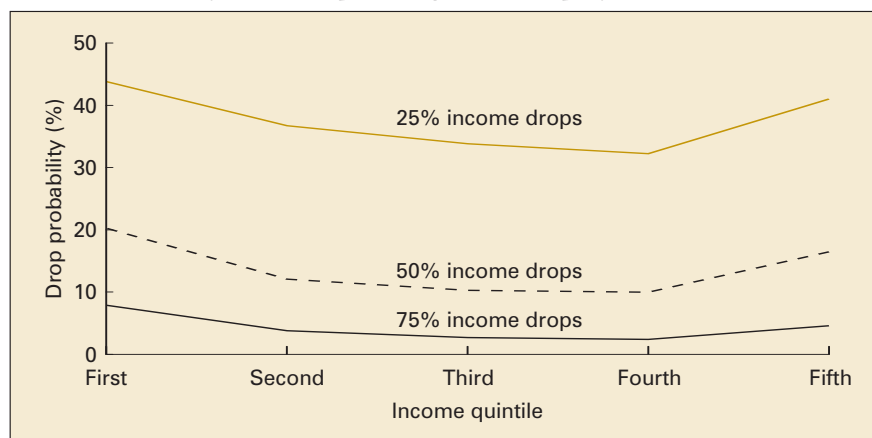
Although large income drops are fairly common, their ultimate impact on well-being is at least

partly related to the permanence of the decline. If individuals in families with children quickly recover their lost income, then the consequences for well-being of a short-term drop in income may be modest. We examined recoveries for individuals who experience substantial income drops by examining the maximum income attained at some point in the year following the drop. We focused on individuals who experienced at least a 50 percent decline in income and considered the share who make a full recovery to 100 percent of pre-drop monthly income as well as those who return to at least 75 percent of their pre-drop income.¹⁰

Table 2 shows that about two out of five individuals whose monthly family income drops by 50 percent or more make a full recovery within a year. Full recovery rates range from 35 percent in 1996 to 39 percent in 2001. Partial recovery rates, with incomes returning to at least 75 percent of pre-decline income, average 59 percent, ranging from 55 percent in 2004 to 61 percent in 2001.

Another way to appreciate the duration of income drops is to consider the share of individuals whose monthly family income drops by at least 50 percent and remains below 50 percent for at least a year, referred to here as “no recovery.” Table 2 shows that for more than one in five families experiencing large income drops there is no recovery. Their income remains at less than half its prior level for at least a year.

FIGURE 1. Share of Families Experiencing Income Drops by Initial Income Quintile



Source: Authors' calculations based on Survey of Income and Program Participation.

TABLE 2. Percent Experiencing Recovery of Pre-drop Income within a Year, among Those with Income Drops of 50 Percent or More

Recovery type	All years	SIPP Panel		
		1996	2001	2004
Full recovery	36.7	35.3	39.1	35.9
Partial recovery	59.0	61.1	61.3	55.2
No recovery	23.4	20.8	20.9	28.2
By Quintile				
Full recovery				
Quintile 1	51.0	50.9	47.3	53.9
Quintile 2	40.9	43.9	43.4	36.3
Quintile 3	32.2	25.9	41.0	29.0
Quintile 4	33.9	28.8	36.8	35.7
Quintile 5	23.3	22.2	29.5	17.7
Partial recovery				
Quintile 1	72.1	74.6	67.1	74.0
Quintile 2	61.2	66.6	67.6	51.6
Quintile 3	59.0	60.5	63.1	53.3
Quintile 4	55.6	56.3	58.4	51.9
Quintile 5	45.9	46.3	53.3	37.6
No recovery				
Quintile 1	16.1	13.0	18.0	16.9
Quintile 2	21.7	18.6	17.4	27.7
Quintile 3	21.3	22.8	13.3	28.3
Quintile 4	21.2	18.2	16.3	29.3
Quintile 5	34.9	30.6	32.4	41.6
Sample size	4,237	1,398	1,185	1,654

Source: Authors' calculations based on Survey of Income and Program Participation (SIPP).

Notes: Income recoveries are defined using the ratio of family income in four-month periods, or waves, following an income drop to family income in the wave before an income drop; recoveries may be seen in the third to seventh waves (one calendar year after a drop). Individuals with all income imputed in any month are excluded, and statistics are weighted using wave 1 SIPP survey weights. "Partial recovery" denotes income reaches 70 percent or more of pre-drop income; "full recovery" denotes income reaches 100 percent or more of pre-drop income; "no recovery" denotes income reaches no more than 50 percent of pre-drop income in the three waves following a 50 percent drop in income.

The likelihood of total recovery is somewhat higher for those in the lowest two income quintiles than for those in the highest quintile. Over half of those experiencing a 50 percent decline in income in the bottom income quintile fully recover within a year; 7 in 10 recover partially, and about 1 in 6 experience no recovery. In contrast, 23 percent of those in the highest income quintile recover fully, 46 percent recover partially, and 35 percent do not recover at all. The same

basic patterns hold true for 1996, 2001, and 2004 considered separately.

Income Changes before a Substantial Drop

In addition to the duration of a decline in income, another issue for interpreting the impact of income drops on well-being is the possibility that pre-drop income was unusually high. In other words, if a substantial drop in income

follows a temporary spike in income, an observed “drop” may simply be a return to a more typical level of income. The high percentage of families that do recover to prior income levels or greater suggest this is not the modal case. However, this could explain part of the group who never fully “recover.” To understand how common this is in our sample, we examine income drops and recoveries for those cases in which we can observe multiple waves of pre-drop income. Note that 40 percent of all first observed income drops occur between waves 1 and 2 in our data—as such, we do not know whether the drop in income was preceded by an unusually large increase in income. We exclude these observations from this analysis.¹¹

We divide the sample of individuals with drops into three groups: those whose pre-drop income does not represent an unusual spike in income (income two waves before the drop is at least 70 percent of income in the wave before the drop); those whose pre-drop income shows moderate increase before the drop (income two waves before the drop is between 50 and 70 percent of income in the wave before the drop); and those with a localized peak in income before the drop (income two waves before the drop is less than 50 percent of income in the wave before the

drop). Table 3 shows the distribution of people with income drops of 50 percent or more across these different levels of pre-drop income changes.

A majority of the substantial income drops we observe are not merely returns to a stable income level after large increases or spikes in income. For 58 percent of individuals, income is stable or even declining in the two periods before we observe the substantial income drop. For another 16 percent of individuals, income in the two waves before an observed drop increases modestly. For these individuals, income is lower after the substantial drop than in the prior two waves, but this new income level is not necessarily much lower than what the family had been accustomed to. For example, an individual whose family income rises from \$5,000 to \$8,000 between two waves and then falls to \$4,000 in the next experiences a 50 percent drop in income, but the new level of income is not dramatically lower than it had been eight months earlier. Finally, for 26 percent of individuals, income in the wave immediately preceding a substantial drop in income is twice as high as income two waves ago—in other words, the wave before the income drop represents a localized peak in income. However, it is also important to note that among these individuals, 13 percent experi-

TABLE 3. *Distribution of Substantial Income Drops by Income Changes in Two Waves before Income Drops*

	Stable or declining income	Moderately increasing income	Spike in income
All	57.5	16.4	26.1
Quintile 1	46.2	17.2	36.6
Quintile 2	58.0	16.7	25.3
Quintile 3	61.8	15.2	23.0
Quintile 4	60.5	17.6	22.0
Quintile 5	69.7	15.0	15.3
1996 panel	55.1	18.2	26.7
2001 panel	60.7	16.4	22.9
2004 panel	56.8	14.7	28.4

Source: Authors' calculations based on Survey of Income and Program Participation (SIPP).

Notes: Does not include individuals whose observed income drop is between waves 1 and 2 of the data. A substantial income drop is an income decline of 50 percent or more between waves. Stable or declining income means that income in the two waves before a substantial drop are similar. Moderately increasing income means that income in the two waves before the drop is 50 to 70 percent of income in the wave just before the drop. Spike in income means that income two waves before the drop is no more than 50 percent of income in the wave just before the drop (income in the wave before the drop was at least twice as high as it was in the prior wave). Rows may not total 100 because of rounding.

enced such large declines in income that post-drop income is 50 percent or more below their pre-spike incomes (income two waves before the drop). For these individuals, even if their income had not risen markedly before the income drop, it still dropped substantially. Thus, even a cautious reading of the data suggests that over half of all substantial income drops we observe represent a large decline in the material well-being families had enjoyed for at least the preceding eight months.

Table 3 also shows how often our observed drops reflect localized peaks in income by quintile and by year. Individuals who begin in lower income quintiles are more likely than individuals in higher income quintiles to have spikes in income preceding a substantial income loss. In quintile 1, 37 percent of individuals are in this category compared with only 15 percent in quintile 5. This is consistent with our finding that lower-income individuals are more likely to recover from an income loss and suggests that lower-income families are more subject to large percentage swings in their income from one four-month period to the next. Even though small dollar amounts can lead to large percentage changes in income for low-income families, small dollar amounts represent a large share of these families' budgets. We find only modest differences across the three SIPP panels regarding income spikes preceding income losses.

We also consider how recovery rates vary based on whether an income drop necessitating a recovery was preceded by an income spike. Among those whose incomes did not rise substantially before an income drop, 44 percent recovered their lost income within a year (table 4). In contrast, only 19 percent of individuals whose income drop followed an income spike fully recovered. This lower rate of "recovery" makes sense given the observed substantial income drops were really more of a return to a stable income level for these individuals. This same pattern holds across all income quintiles, although recoveries are generally more common among lower-income families than among higher-income families.

Discussion

Taken together, our findings suggest that many individuals in families with children experience substantial declines in their incomes from one four-month period to the next. More than one in seven experience a drop in income of 50 percent or more over the course of a year, and the incidence of income losses throughout the income distribution is U-shaped, with the poorest and richest families more likely to experience losses than middle-income families. For some, the decline is short-lived—almost 40 percent return to their pre-drop income within a year—while for more than

TABLE 4. Percentage Chance of Full Recovery from Income Drops of at Least 50 Percent, by Wave of Drop and Income Two Waves before Drop

	Stable, declining, or moderately increasing income	Spike in income
All	43.7	18.5
By quintile		
Quintile 1	55.3	28.6
Quintile 2	41.7	9.7
Quintile 3	40.9	7.3
Quintile 4	42.6	11.3
Quintile 5	34.3	14.0

Source: Authors' calculations based on Survey of Income and Program Participation (SIPP).

Notes: Does not include individuals whose observed income drop is between waves 1 and 2 of the data. A substantial income drop is an income decline of 50 percent or more between waves. Stable or declining income means that income in the two waves before a substantial drop are similar. Moderately increasing income means that income in the wave before the drop is 1.42 to 2 times higher than it was in the prior wave. Spike in income means that income in the wave before the drop was two or more times higher than it was in the prior wave.

20 percent, income remains below half of its prior level for at least a year.

Even a short-term substantial drop in income may adversely affect these families due to the attendant stress and loss of resources associated with such sudden declines.¹² A 50 percent decline in income for even four months represents a substantial drop in annual income. For example, if a family that typically earns \$17,000 over a four-month span experiences a 50 percent drop in income for four months, its annual income would fall by \$8,500, from \$51,000 per year—about median income in 2007—to \$42,500. Put differently, even a short-term drop in income translates into almost a 17 percent decline in annual income.

For about a quarter of families experiencing a substantial drop in income, the drop follows a brief period of higher income. In some cases, the income drop is simply a return to the family's normal income level after enjoying a short-term windfall. For others, the observed drop following a rapid rise in income can signify very volatile income that makes it difficult for a family to save and plan. It can also represent a "false start" in their attempts to move up the economic ladder. We cannot completely distinguish between these circumstances. However, our analysis suggests that most of those experiencing a substantial income drop are at a significantly lower income levels than they were in the previous eight months.

Notes

1. Volatility is usually defined as the variance of potential income, but measured as the variance over time, a practice we follow here.
2. See, for example, Congressional Budget Office (2007), Gottschalk and Moffitt (1994, 1995, 2002, 2006), Haider (2001), and Nichols and Zimmerman (2008).
3. See, for example, Bania and Leete (2007); Batchelder (2003); Dynan, Elmendorf, and Sichel (2007); Gosselin (2008); Gosselin and Zimmerman (2007); Hacker (2006); and Nichols and Zimmerman (2008).
4. The work of Burkhauser and Duncan (1989) and Gosselin and Zimmerman (2007) are not strictly comparable because, simplifying, the unit of analysis for Burkhauser and Duncan is the person over a decade while for Gosselin and Zimmerman, it is a person-year. As such, Gosselin and Zimmerman's report of income drops in any given year are lower than Burkhauser and Duncan's reports of drops over a ten-year period.

5. More specifically, we include individuals at least 25 years old and younger than 58 in wave 1, month 1 of the panel, so the sample is age 25–61 (someone who is 57.92 in month 1 of the 1996 panel would be 61.83 in month 48) in the 1996 SIPP and 25–60 in the 2001 and 2004 SIPP panels (which ran for 36 months).
6. Sensitivity analyses suggest that this restrictions greatly reduces the incidence of income drops due to imputation while still preserving a representative sample for our analyses. For more details, see Acs, Loprest, and Nichols (forthcoming).
7. The unmarried partners of adults who are not household reference persons are not included in the social family. For most individuals, our definition of social family income and SIPP family income are identical, and the correlation of the two variables is high (over 97%).
8. The frequency of total losses (100% income drop, not shown) is very low; only about 1 percent experience a drop to zero income.
9. The income cut-off for the first quintile is \$7,175 per wave in 1996, \$8,890 per wave in 2001, and \$9,000 per wave in 2004; all figures are in nominal dollars.
10. The same pattern of results appears when considering larger and smaller income drops.
11. The share of individuals for whom their first observed 50 percent drop in income is between wave 1 and wave 2 is fairly stable across quintiles and years. The one exception is that a higher percentage (55.5 percent) of individuals in the fifth income quintile experience drops in this period.
12. For example, research on how parental job loss and attendant income losses influence children suggests that a father's job loss is associated with poorer academic and behavioral outcomes for children (Kalil and Ziol-Guest 2008).

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