Wealth in America

Policies to Support Mobility

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The balance sheets of many American families were already fragile when they took a large hit during the Great Recession. When the economy soured, many households across the United States lost savings or fell deeply in debt. More troubling, younger families, families of color, and those with less education—groups that had already been falling behind their peers and predecessors—were knocked back even farther by the recession, contributing to an even more difficult recovery.

The decline in household balance sheets matters for everyone—regardless of age, race, or educational attainment—because low savings and increasing debt burdens threaten long-term economic growth. Losses in housing wealth in particular have been shown to have an outsized effect on consumption (Case, Quigley, and Shiller 2013; Calomiris, Longhofer, and Miles 2013; Mian, Rao, and Sufi 2013). And graduates leaving college with ever-higher levels of student debt may be more reluctant to take risks and start new businesses.

As families turn to rebuilding their finances, policymakers are asking what role federal policy can play in helping families recover from the Great Recession and how to best help those who were falling behind prior to it. This is no easy challenge. Proponents of inclusive asset-building and mobility policies must find solutions both big enough to be commensurate with the problems of economic stagnation, wealth inequality, and a lack of mobility, and practical and affordable enough to fit within today's budgetary realities.

> "As promising policy directions are considered, it is important to know which families were most impacted by the Great Recession: younger, less educated and non-white families. In fact, they have yet to fully recover their wealth, which is also hampering the nation's economic recovery."
> *Ray Boshara, Federal Reserve Bank of St. Louis*

Solutions do exist. The Urban Institute and Federal Reserve Bank of St. Louis convened nearly 25 national wealth-building experts in October 2013 to identify promising policy directions. These experts identified four reforms that would expand access to long-term savings vehicles and homeownership and put in place the vital financial plumbing required to help Americans build strong balance sheets. Implementing these reforms with changes to existing wealth-building subsidies can result in a reform package that is low cost or even deficit neutral. This brief summarizes the convening discussion.

Household Balance Sheets before and after the Great Recession

"The young are on a strikingly different trajectory," when it comes to wealth building, said Caroline Ratcliffe, a senior fellow at the Urban Institute. Americans have long lived with the expectation that each new generation will grow up to be better off than the one before it. The trend of ever-rising generational prosperity may now be in danger, however, as millennials (people in their 20s) and generation X (people in their 30s and early to mid-40s) have fallen behind in wealth accumulation relative to where their parents were at the same age. Americans in their 30s in 2010 had an average net worth 21 percent lower than households of similar age nearly three decades before, even though the economy roughly doubled over that time (Steuerle et al. 2013).

Older households fared relatively better during the recession, but many face their own problems, including surprisingly high levels of mortgage debt, the educational debts of their children, and inadequate retirement savings. Middle-aged adults often find themselves sandwiched between providing for their children, with expensive college costs around the corner, and for their parents, who face medical bills, expensive long-term care, and vulnerability to financial fraud.

Families of color, meanwhile, are not on the same wealth-building trajectory as white families. When people are in their 30s and 40s, whites have about 3.5 times more wealth than people of color. By the time people reach their early to mid-60s, white families have about 7 times the wealth of families of color. An entire group of people isn't moving up.

Disparities in wealth losses during the Great Recession by education are on the same order of magnitude as those by age and by race (Boshara and Emmons 2013; Emmons and Noeth 2013). Education continues to be among the key determinants of inequality and lack of mobility, a problem now compounded by both the alarming number of youth who do not complete college and the rapid growth in student loans, which now well exceed $1 trillion and represent the second-largest item on household balance sheets after mortgage debts (Ratcliffe and McKernan 2013).

How Did We Get Here?

The drivers of wealth inequalities and precarious household balance sheets stem from short- and long-term macroeconomic trends and from a policy environment that often disfavors wealth-building and upward mobility by low- and moderate-income families.

Like financial institutions, young people, families of color, and the middle class were all highly leveraged on the eve of the Great Recession (Wolff 2013). Then housing prices tanked. High household debt— particularly among lower-income groups who spend a greater portion of their income than higher-income groups—is contributing to the sluggish recovery as families deleverage (Dynan and Edelberg 2013). By late 2013, the average real wealth of families headed by someone age 40 or older had recovered to its pre-crisis level, but families headed by someone under 40 had recovered only about a third of its decline (Emmons and Noeth 2014).

Federal asset-building policy plays a role in wealth inequality. The federal government spends hundreds of billions of dollars each year to promote asset development, but this money is poorly targeted. The vast majority of asset-building subsidies flow through the federal tax code, such as through deductions and exemptions for homeownership and retirement savings (Harris et al. 2014; Woo, Rademacher, and Meier 2010). For low- and moderate-income families who often lack access to employer-provided retirement accounts and do not claim itemized deductions, these incentives remain out of reach. Social welfare policies focus on meeting today's needs and are not geared toward asset building and mobility. In fact, many safety net programs discourage saving because families can become ineligible if they have a few thousand dollars in assets.

"Government shouldn't be in the business of generating inequality."
Michael Sherraden, Washington University in St. Louis

Incentives for asset building are greatest for the highest earners who likely require less incentive to save. The evidence is mixed about whether these subsidies actually create new savings or encourage new homeownership. Economists certainly have doubts, including Benjamin Harris of the Brookings Institution. "It's a really poorly designed tax incentive for housing," he said of the home mortgage interest deduction. "You will not find a single mainstream economist who will stand up here and say this is a great way to get people into housing. There's tens of billions of dollars on the table that can be reformed and used in a better way."

Lack of access to wealth-building vehicles (e.g., retirement accounts, homeownership), ill-designed incentives, and wealth-penalizing means tests bring into question the fairness of current asset policy. "Government shouldn't be in the business of generating inequality," said Michael Sherraden, director of the Center for Social Development at the Washington University in St. Louis. While one can debate the merits of government involvement in subsidizing savings or encouraging homeownership, principles of fairness suggest that these subsidies should not shut out the country's most economically vulnerable.

Beneath this lies an even more troubling generational problem. "Children can't choose where they're born, but their economic circumstances limit their life choices," said Trina Williams Shanks, a scholar at the University of Michigan. Her research has shown that, in stark contrast to white households, many black and Latino households raising children today live below the poverty level and have low wealth or no assets at all. Families of color will soon make up a majority of the population, but they continue to struggle with building wealth and attaining the household stability that comes with it.

"If half a country's population is held back, you have to consider the ultimate effect on the economy."
Signe-Mary McKernan, Urban Institute

Having and building savings can have powerful effects on attitudes and expectations about the future for parents and for their children. A compelling and growing body of research suggests independent social, psychological, educational, and aspirational effects from the ownership of savings and assets. More inclusive policies that steer today's young and economically vulnerable onto on-ramps for acquiring, building, and keeping assets may have profound benefits for America's future growth and stability.

Promising Policies

What role can public policy play in helping families strengthen their balance sheets? It's clear that one policy does not fit all. Policymakers must identify ways to help families go from "zero to some" assets, and others from "some assets to mobility."

Approaches that offer the most promise of success should connect Americans with automatic and institutional savings mechanisms, cut across generations, and work within existing budget and policy frameworks, as well as with existing financial products. Finally, families who diversify their assets—for example, through greater amounts of emergency, college, and retirement savings—and those who keep their debts linked to productive assets are likely to be more resilient and better manage downside risk.

The following four policy recommendations could be implemented in a low-cost or deficit-neutral way by reforming existing subsidies that disproportionately benefit high-income families who need them least.

1. Universal Children's Savings Accounts

Building wealth is a long-term endeavor, and starting young adds more years to saving's compounding effects. Teaching financial capability will be more effective if it is connected to an account owned by the child and the family. In this case, "doing" can be the best learning vehicle. Children's savings accounts are a way to connect both children and their parents to the financial sector and instill a long-term mindset and savings habits early in life.

Early childhood accounts could serve various purposes, such as savings for education ("Early Pells") or retirement ("Kids' Roths"). To help low- and moderate-income families save, create a "savable moment" at tax time by allowing families to deposit a portion of their child tax credit or earned income tax credit, perhaps sweetening the pot with an additional match.

"Access to financial tools should be as universal as access to clean water," Sherraden said. "It's not really possible to operate without financial services. If you do, you pay a very heavy cost either in not having or having bad financial services."

2. Homeownership Incentives That Work

"When folks were asked, what's your idea of the American dream? It's a home. It's engrained in what our cultural fabric is."
Diana Elliot, Pew Charitable Trusts

For some, homeownership remains an essential part of the American dream and can be a powerful automatic wealth-building tool. With each mortgage payment, families build equity, which later can be tapped for additional income in retirement or to finance a child's college education. But the mortgage interest deduction, which cost roughly $70 billion in 2013, has proven ineffective at putting low- and moderate-income families into homes (Harris et al. 2014).

Repealing or limiting the mortgage interest deduction and replacing it with a credit for purchasing a home for the first time could provide greater assistance and incentive for those shut out from today's homeownership subsidies. The credit could be designed to be deficit-neutral compared with current homeownership tax incentives. In addition to being a more progressive and more powerful incentive, such a design could also directly subsidize ownership rather than rewarding more interest and greater debt (Harris, Steuerle, and Eng 2013).

3. Automatic Retirement Savings

Recent scholarship on behavioral economics has shown that defaults—something as simple as having to opt out of a retirement plan instead of opt in—can have powerful effects on plan participation and contributions. Such findings underscore the potential for a more universal, more automatic system for private retirement savings. The benefits of auto-enrollment would compound over time as the earnings on people's contributions are reinvested in their accounts.

Some states are already advancing in auto-enrollment, the most notable being California's Secure Choice Retirement Plan, which will establish automatic enrollment individual retirement accounts for much of the state's workforce (Calabrese, Cramer, and Sprague 2013; Sprague 2013). These efforts should be closely monitored to explore which strategies work best in achieving adequate retirement savings. Getting the retirement account pipeline in place also creates further opportunities to increase future savings, through reform of retirement savings tax incentives such as the saver's credit, for instance.

4. Saving for a Rainy Day

Families need savings not just for planned expenses such as education and retirement, but also for the unexpected disruptions in life—job loss, medical emergencies, and vehicle repairs. Access to liquid savings during emergencies can be a critical first step for successful homeownership and retirement saving down the road, but current policies, such as asset tests in safety net programs, can actually punish saving by low-income groups. Addressing these barriers and experimenting with better tools for promoting emergency savings—such as incentives linked to savings at tax time and prizes for saving and debt reduction—could help more families prepare for a rainy day and a leaky roof.

Conclusion

Even in today's tight budget environment, new policies can help low- and middle-income families onto the path to more stable finances and can be enacted without breaking the bank. Doing so requires reforming existing subsidies to provide incentives for wealth building among low- and middle-income families, not just high-income families. And it requires drawing lessons from recent behavioral research and state experiments that connect all families to traditionally powerful wealth-building tools. Whether families across the economic spectrum have access to wealth-building tools and incentives could have long-lasting implications for economic mobility and economic growth in an increasingly financialized world.

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