

Opportunity and Ownership over the Life Cycle

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A key driver of hardship is a lack of savings and assets. Assets are often critical in times of economic uncertainty—cushioning the blow of financial emergencies and forming the foundation of a secure retirement. Investments, including education, play a huge role in moving low-income families to middle-income status and helping them stay there. While public assistance can help families keep food on the table, assets give families the means to help themselves.

Policies to combat poverty or build wealth should be considered from a lifetime perspective—one that accounts for people's needs and ability to acquire different types of assets over a lifetime. Rather than think in isolation about each asset—education, homeownership, or retirement savings—effective public policy should treat wealth building as a whole, understanding how assets play out in each stage of life.

In this spirit, the Ford Foundation and the Urban Institute convened a roundtable of experts in asset, education, housing, and retirement policy to examine the full range of asset and debt issues and help craft a more effective wealth-building policy.

Who Has Assets?

Roughly 30 percent of American households live from paycheck to paycheck and have little or no financial safety net. Without assets, they may be forced to turn to expensive short-term loans in financial emergencies. Some put off paying bills, damaging their credit and forcing them into high-risk pools where credit is either expensive or not available, and fall into a cycle of debt.

Most low-income families (83 percent) have a bank account, though the median value of \$1,100 is too small to see them

through a job loss. Nearly half (48 percent) own a home and 75 percent own a car. Only 23 percent have a retirement account, and the median value is just \$10,000 (figure 1).

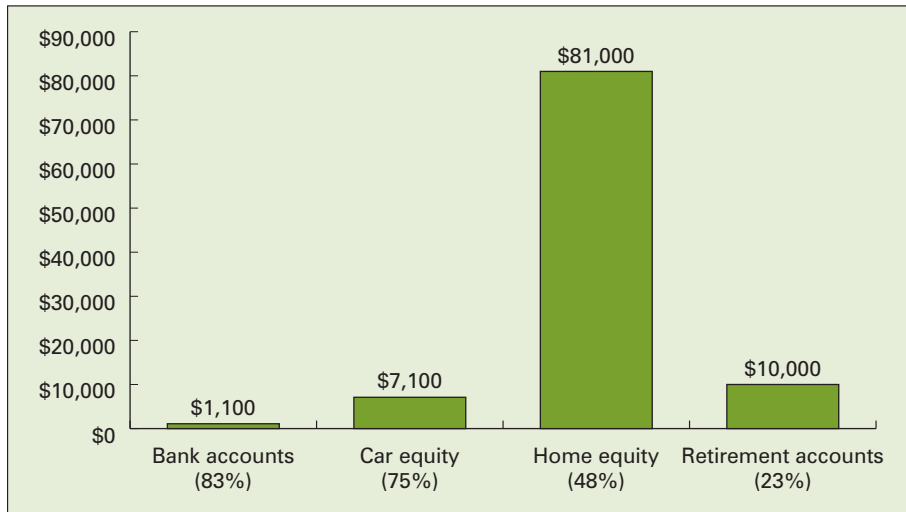
Although the federal government spends hundreds of billions on asset subsidies, mostly through the tax code, much of it misses the poor. Tax breaks to promote savings are worthless for many low-income families, who have little or no tax liability. Higher-income families are more likely to own the assets that do get tax subsidies, such as homes, stocks, business investment, and retirement accounts. While some rents are subsidized for low-income people, those subsidies generally require that the renters *not* own a home.

Leaving the poor out of asset-building policies widens the wealth gap between rich and poor. Wealth disparities, particularly between white households and black and Hispanic households, tend to be much greater than income disparities, and the gaps grow exponentially at each life stage.

It is often hard to assess just how effective wealth-building policies are when people are young and investing in education, small businesses, or other assets that have not yet reached their full potential. We can assess better the ultimate effectiveness of wealth-building strategies by looking at people age 55 to 64 who have reached a peak accumulation point before they start drawing down assets in retirement. Here the differences are quite striking. The median wealth of households in the top fifth of the income scale is nearly seven times more than that of the bottom fifth. White households accrue almost twice as much wealth as black households and 2.5 times that of Hispanic households (Mermin, Zedlewski, and Toohey 2008). While typical households

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FIGURE 1. Asset Holdings for Low-Income Families, 2007 (median values)



Source: Author tabulations from the 2007 Survey of Consumer Finances.

Notes: Low-income families are in the bottom two income quintiles (income less than \$36,500). Percentages listed by each asset indicate the proportion of low-income families who own that asset.

have wealth in Social Security, housing, and pension and retirement accounts, poor households, those without college degrees, and minorities have few assets and wealth outside Social Security.

Assets Early in Life

A life cycle approach to assets begins at birth. Children in poor families have fewer opportunities from the very beginning. Their parents have less wealth. Those in poorer neighborhoods have lower-quality schools. And children and their parents are less likely to be “banked”—meaning they’re less likely to have accounts at banks, credit unions, or other saving institutions.

One way to promote assets early is to give all children a savings account when they are born. These accounts would represent a first step toward future investments in education, homeownership, and retirement. Perhaps most importantly, they would help children attain greater financial literacy by teaching them about saving and compound interest. For the most part, banks are uninterested in small accounts that cost money to maintain. But if these accounts were offered universally, banks would feel compelled to handle such accounts for all their customers. Savings institutions in Great

Britain found ways to accommodate small accounts after the government adopted a subsidy for universal child savings accounts in 2002.

Early in life, education is by far the most important asset. As one roundtable participant said, it is the foundation for accumulating wealth and assets later in life. College graduates, on average, have more than twice as much wealth as high school graduates by the end of their careers (\$539,200 per adult compared with \$247,200) and almost five times as much as those without high school diplomas (\$115,300) (Mermin et al. 2008).

Participants suggested increasing Pell grants and making education tax credits refundable to help more low-income families afford higher education. Nonrefundable tax credits do little for poor families who owe little or no taxes. And many students who do benefit would have attended college with or without the credit.

Affordability, however, is not the only barrier to higher education for some families. One participant suggested that schools may not encourage poor students to see college as a possibility or a necessity. Another participant cautioned researchers that they may be placing too much emphasis on education. The relationship between education and wealth is not necessarily causal, as family

background and class play a significant role.

Assets in Midlife

Housing tends to be the largest asset for many families in the early and middle stages of their lives. Low-income families generally miss out on homeownership subsidies operating through the tax system. They are further disadvantaged when those subsidies raise housing prices, especially in urban areas where land is scarce. Mortgage closing costs (settlement charges) are higher for minority borrowers too (Woodward 2008)—reducing the amount they can use for a down payment and thus housing equity.

Lower-income households often can’t afford to buy homes and therefore lose out on one of the most valuable saving mechanisms around. By paying off a mortgage, whether the home appreciates little or not at all, households end up saving. Simply holding on to a mortgage of \$100,000 for one year with inflation at 3 percent means that \$3,000 of real debt is paid off because of the inflation. (That is, the real debt has declined by \$3,000, which is equivalent to \$3,000 of saving.) An Urban Institute study of typical households showed that families owning a house saved an equivalent of several thousand a year in home equity alone due to rising property values, debt reduced by inflation, and the benefits of compounding (Mermin et al. 2008).¹

As might be expected because of income differences alone, whites have higher rates of homeownership than blacks and home values are typically lower in majority-black neighborhoods. In addition, historic patterns of discrimination and residential segregation have denied blacks the opportunities whites have had through homeownership and wealth building.

The foreclosure crisis has been disastrous for many low-income households, but it hit blacks and Hispanics disproportionately hard. Foreclosures left behind vacant, abandoned properties, which eroded the values of surrounding homes, especially in minority neighborhoods. The housing crisis also shook the confidence of minority communities

that were just beginning to see progress in breaking down long-standing barriers to homeownership.

What can help? Affordable housing and better financial education. More uniform mortgage product regulation and enforcement, particularly as it applies to loans that low- and moderate-income families are more likely to purchase. And regulations that stop unfair, deceptive practices, such as targeting subprime mortgages to minority homebuyers. Participants also discussed the possibility of creating new financial products that put investors on the side of consumers, so both share the risk of loans.

Assets Later in Life

Retirement accounts, pensions, and Social Security can compound in value over a lifetime and then become crucial later in life. But most Americans are not saving very much relative to the cost of their retirement, and the vast majority is primarily dependent upon Social Security and Medicare in retirement. While poor households are less likely to have much of a retirement nest egg stored away, they are not the only ones in jeopardy—moderate-income workers are also in danger of being unable to afford retirement. The recession caused significant declines in home equity and pensions. And, with health care costs rising, how much Americans will need for retirement is unclear.

Social Security is the most important retirement asset for many households. Low-wage workers who do not get pensions through their employers rely heavily on Social Security benefits. Those benefits, though, are shrinking over time relative to past wages, and Medicare premiums are rising and taking more from Social Security checks. Shoring up Social Security for low-income families is a critical part of any reform, whatever is decided for higher-income families in the way of benefits or taxes.

Conference participants discussed several ideas for boosting private retirement savings. As one participant said, seniors with retirement security often share two criteria—they own their homes free and clear and they continue to work at older

ages. Working longer shortens the period over which retirement savings must be used, builds up a larger Social Security benefit, and puts more money into pension and retirement accounts.

With baby boomers retiring, nearly a third of the adult population will be on Social Security for one-third of their adult lives if current patterns continue. Raising Social Security's early and normal retirement age would encourage people to work longer, though adjustments should be made for people who are disabled and cannot work at older ages. Participants also said the federal government should do a better job supporting retirement savings for low- and moderate-income seniors. Two-thirds of federal spending on tax entitlements for retirement savings goes to the top fifth of households (Burman et al. 2004).

Participants also discussed options to boost private retirement saving, such as the "Super Simple" saving plan, originally presented by Pamela Perun and C. Eugene Steuerle (2008). This particular plan would offer strong incentives—reduced regulation, higher allowed tax-favored deposits, and so forth—to employers who also make significant pension contributions for low- and moderate-income workers. A government match would also be added for improved plans. At the same time, an automatic enrollment plan would encourage employee contributions. However the plan was designed, many felt greater private retirement saving was required to protect both low- and moderate-income households in their retirement years. Another participant suggested dropping the early withdrawal penalties on 401(k)s to encourage people to contribute at earlier ages.

Giving Low-Income Families a Boost

Individual Development Accounts (IDAs) help the low-income build assets by matching savings for specific investments, such as a home, business, or college. To support these investments, IDAs are also packaged with financial education, one-on-one counseling, and case management—typically provided by a nonprofit.

The federal Assets for Independence (AFI) program is the largest source of funding for IDA projects in the United States. From fiscal year 1999 to fiscal year 2007, AFI provided nearly \$150 million in grants to support 497 projects. Participants opened 52,531 accounts, depositing \$45.3 million of earned income into their IDAs. Nearly 19,000 have withdrawn money to purchase assets, primarily homes (Office of Community Services 2008). Despite early signs of success, spending on IDA programs represents less than 1 percent of federal spending aimed at promoting savings and assets (McKernan and Ratcliffe 2009).

Originally designed as universal lifelong accounts, IDAs have only been tested in short-term, small-scale demonstrations specifically for low-income households. While it may be difficult for low-income families to save, research has shown that they do save when they are given incentives and supports. The four-year American Dream Demonstration project helped 2,350 low-income people set aside money in IDAs for homes, education, start-up businesses, and retirement (Schreiner and Sherraden 2007).

Bringing IDAs to scale would be costly, especially under current methods of case management, some participants said. One possible solution may be to reserve case management and financial education only for those who need it or to make it available only when participants need it (for example, right before buying a home). Employer-based IDA programs with default options and payroll deductions could boost participation and benefit employers by attracting and retaining workers.

Financial Education

Financial education and support are components of many asset-building strategies, from children's savings accounts to IDAs, but people don't always take advantage of the investment tools and programs available to them. Conference participants discussed the limitations of financial education and whether the lessons stick. One participant said it was important to distinguish between explaining complex investments and

teaching simple financial rules, such as the effect of a bad credit rating or the compound costs of bouncing a check. Educating households about complex investments appears to be more effective if it is event-specific—for example, providing people with resources and counseling when they are about to invest in a retirement account or buy a home. Researchers are finding that financial education in general does little to influence behavior unless it is connected to a specific life event.

Better financial education solves only one side of the equation, however. One participant said complexity itself is a barrier. Financial institutions should make it easier for people to save by simplifying the process and paperwork involved. Rather than teaching people how to fill out complicated forms, for example, enact autoenrollment. Default investments can help people make decisions that will benefit them financially.

And then there is simply learning by doing. One of the arguments behind child savings accounts is that kids will see the value of compound interest.

An Integrated Approach to Wealth Building

A life cycle approach to assets helps researchers and policymakers see how wealth accumulates over a lifetime (figure 2). It distinguishes assets by their relative importance for typical households at different stages in

the life cycle, and it demonstrates how the power of compounding works on steady saving patterns over time. Education leads to higher incomes, financial literacy leads to better and more efficient saving and borrowing, the automatic saving patterns in homeownership lead to greater security, and saving through retirement accounts and pensions leads to a more secure retirement. Low-income households who miss out on earlier opportunities only see their disadvantages compound later.

Policymakers, in turn, can see how their asset-building policies affect people over the life cycle and whether such policies should be better channeled to help low- and moderate-income households.

Conference participants discussed whether a single lifetime account should be available to all. Such an account would provide a ready vehicle to roll over retirement assets when leaving an employer. A single account could start at birth and address changing asset needs over a lifetime. Working within separate legal and regulatory systems would pose a challenge, though.

Even small changes to current savings options could have big results. Autoenrollment, for example, can increase retirement plan participation and savings. Policymakers are also considering autoenrollment in individual retirement accounts for firms that don't offer plans.

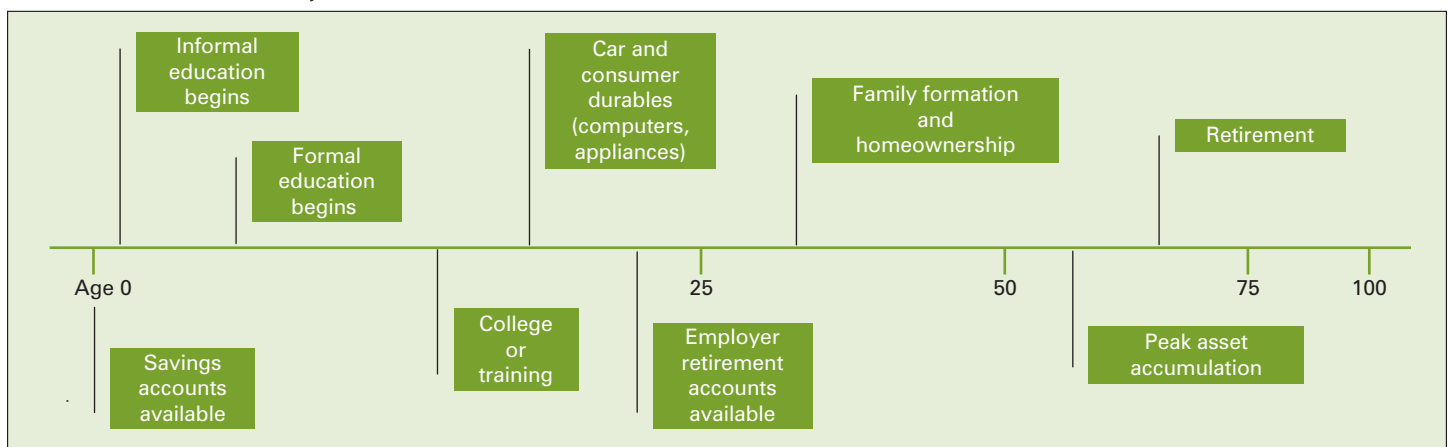
Asset development could also be encouraged by extending housing and pension subsidies to poor families who don't benefit from current

tax subsidies. Raising Social Security's early eligibility age—regardless of the level of benefits provided within the program—would encourage people to save for more years and would add to the annuity value of Social Security received in later years.

Asset tests for social programs can act as another barrier by unintentionally discouraging families from saving. Most means-tested programs require that applicants' savings and assets fall below a certain limit to ensure benefits only go to those most in need. These asset tests are often inequitable and inconsistent, vary widely across programs and states, and are weakly enforced. Research is mixed on how the tests affect asset holdings. Completely eliminating asset tests may not be appropriate if we want to avoid providing benefits to those with substantial means other than earnings. Debts are not usually considered in asset tests, creating a potentially inaccurate picture of a household's finances. But, again, given enforcement difficulties already, counting liabilities could further complicate administration.

What does seem clear is that poorer households would benefit from simplified asset tests that are more equitable across programs. The 2008 Farm Bill takes a step in this direction by exempting retirement savings and education accounts from the Supplemental Nutrition Assistance Program (previously known as the Food Stamp Program).

FIGURE 2. Assets over a Lifetime



Multiple strategies may be employed to boost asset-building opportunities for low- and moderate-income households. Shared ownership of assets, cooperatively owned businesses, and credit unions offer other ways to reduce the risk of investment. Short-term saving tools can help people meet their immediate needs and appeal to those who do not want to lock away their savings.

Future Research

So far, researchers have been able to test promising strategies, such as IDAs, in short-term demonstrations, but long-term evaluations can often reveal much more. Better assessment of the right type of financial education would also be useful, several participants said. When does it make a difference? And what is the best way to teach financial literacy and connect it to real decisions that people make?

Equity considerations call into question whether a higher standard of “proof” should be required for saving incentives for low-income people. For example, while it is valuable to evaluate IDAs to determine whether they increase a person’s net worth or study whether children’s savings accounts result in better outcomes for kids, the retirement subsidies and mortgage interest tax deductions that subsidize higher-

income people have not been proven effective in increasing household saving. Subsidies may be more effective for those of modest means who must save money to use savings incentives; those who already have significant wealth may simply move saving from one account to another.

Participants agreed that the life cycle approach is useful in studying how people accumulate assets and savings. Further research and policy analysis using this life cycle framework may lead to more equitable and effective asset-building policies.

Note

1. “Typical” households were defined as the 20 percent in the middle of the wealth distribution for each demographic and income group.

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Given the chance, many low-income families can acquire assets and become more financially secure. Conservatives and liberals increasingly agree that government's role in this transition requires going beyond traditional antipoverty programs to encourage savings, homeownership, private pensions, and microenterprise. The Urban Institute's *Opportunity and Ownership Project* policy brief series presents some of our findings, analyses, and recommendations. The authors are grateful to the Ford Foundation for funding this policy brief and conference.