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Are Low-Income Households Accumulating Assets and Avoiding Unhealthy Debt?

A Review of Recent Evidence

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Those with few assets are no doubt constrained in their capacity to enter the middle class. Another worry is that they must work off high liabilities to accumulate adequate net worth.

Building up assets and avoiding excessive debt can help families insure against unforeseen disruptions, achieve economic independence, and reach the middle class. Assets are especially important for low-income families because they can spend assets on necessities when unemployment (or another shock) suddenly reduces their incomes. Some authors label as "asset poor" those who lack the assets to replace three months of income (e.g., Caner and Wolff 2004); families also need assets to secure loans during income shortfalls. According to a recent paper by James Sullivan (2004), unemployed families with assets often borrow to maintain their consumption levels. Without assets, their consumption declines, partly because they have trouble borrowing—access to a $500 loan reduces hardship as much as a 300 percent increase in income (Mayer and Jencks 1989).

Have low- and moderate-income families been able to turn asset-building objectives into reality? Or do American families do too little saving and investing? This brief examines two national data sets that include representative samples of American families.[1]

First, we ask what levels of assets and liabilities one should expect for low- and moderate-income families choosing a sound saving and investment strategy. Theoretical considerations suggest the importance of life cycle factors in the ability to accumulate assets. Next, we examine the assets that American families actually own and the debt that they owe. The focus is on age profiles of low-income families and of families headed by less-educated individuals. Third, we analyze the variation across families and consider which families achieve healthy balance sheets in spite of low long-term incomes and/or low education. Fourth is the role of debt that may limit families' ability to reach sound levels of net worth. The concluding section summarizes the findings and highlights unanswered questions about asset formation for low- to moderate-income American families.

Asset and Debt Accumulation Over the Life Cycle

Economic success requires a long-term perspective, including a willingness to forego consumption today for higher living standards in the future. At the same time, people may reasonably link their current consumption to permanent income levels and avoid large sacrifices when income falls below long-term levels. Young people borrow to invest in education and training expecting substantial increases in earnings when they are older. This borrowing allows young people to meet basic consumption needs by spending more than they earn. As they age into their prime working years,

individuals consume less than they earn so they can repay loans and save for retirement. In retirement, most people will consume more than their much-reduced income and draw down their wealth. So, from life cycle considerations alone, we should observe net dissaving and negative net worth among the young, net savings and gradual asset accumulation over the 30-to-60 age range, peak levels of net worth just before retirement, and net dissaving over the retirement years—about 74 percent of families report that liquidity, retirement, or education is the most important reason they save (Aizcorbe, Kennickell, and Moore 2003).

Families also accumulate net worth by earning returns on investments that exceed borrowing costs. Returns may come as increased earnings from education and training, as flows of transportation or housing services, or as capital appreciation (if the value of a stock or home rises faster than the borrowing rate). When families borrow to buy a home, their net worth increases partly because mortgage payments typically involve repayment of principal (and thus forced savings) as well as interest payments.

Just as families can raise their net worth with high returns on investments, families can lose net worth when interest on a debt exceeds any gains from an investment. Consumer debt and associated high interest rates make asset accumulation difficult, if not impossible, since a large proportion of income must service the debt.

The evidence documents the projected pattern of accumulation with age and spending down with retirement. Median net worth, as tabulated by Aizcorbe, Kennickell, and Moore, rises from $12,000 for household heads under age 35 to $132,000 for 45- to 54-year-olds, peaks at $181,500 for 55- to 64-year-olds, and then gradually declines to $151,000 for heads older than 74.

What proportions of American families, and specifically low- to moderate-income families, are following these borrowing, investment, and accumulation patterns? In examining the data, we take account of the life cycle, the relation between assets and liabilities, and the type of asset. Moreover, since income fluctuates over time, we recognize that some of today's low-income families will have high or adequate lifetime earnings.

Measuring Net Worth of U.S. Families

The data in this brief come primarily from two sources: (1) the third wave of the 2001 panel of the Survey of Income and Program Participation (SIPP) and (2) the 2001 Survey of Consumer Finances (SCF). The SIPP has the larger sample (27,000 vs. 2,000 households) while the SCF includes more detailed asset and liability data.

Neither data set includes the current value of the rights to future payments that households have already earned in a defined benefit pension and in social security retirement income. Such rights constitute wealth in the same sense that the values of bonds or insurance contracts come from a promise of future payments. These omissions are substantial, particularly for low-income populations. Kennickell and Sunden (1997) estimate the present value (net of future pension and social security contributions) of defined benefit pensions, defined contribution pensions (which are included in the SCF and SIPP data), and social security. As of 1992, the combined wealth from these sources made up over 90 percent of net worth of households with incomes below $25,000. Even among households with incomes between $25,000 and $100,000, pensions and social security accounted for 80 percent of total net worth.[2] The Kennickell-Sunden approach overestimates *already accrued* net worth from pensions and social security, since, for most household heads under 55, some of the wealth projected at retirement will come from future benefits linked to future contributions.

On the other hand, their procedure does not include accumulated rights to Medicare or private health benefits.[3] Notwithstanding this omission and an overestimate of accrued pension wealth, their findings point to components of wealth that, if included, would alter our

perspectives on the wealth of low- to moderate-income families.

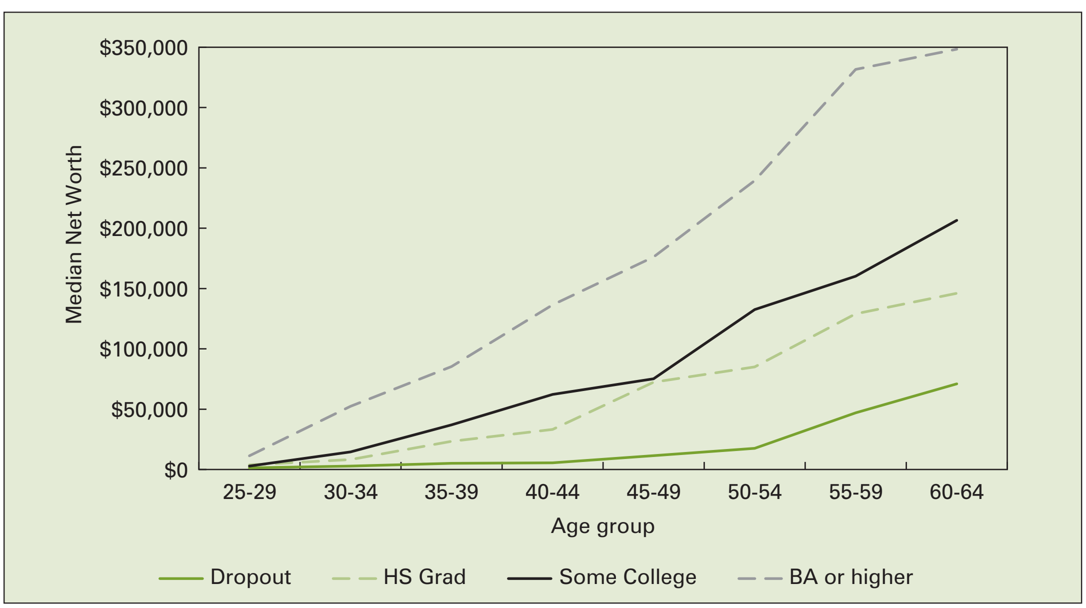
Age-Wealth Profiles of U.S. Households

A snapshot of net worth (excluding defined benefit and social security accruals) reveals interesting age profiles across groups of households.[4] We begin with education, one of the best proxies for long-term economic status. Figure 1 displays the median wealth (defined as net worth, or assets less liabilities) for households of at least two persons. The life cycle patterns for all groups are evident during the accumulation phase, but we do not see the expected spending down of assets after age 65. More educated households quickly gain more wealth, and the wealth advantage of the most educated group expands sharply with age. This result is somewhat surprising. One would think that more educated households would take more years to overtake other groups because of the need to repay education loans. Wealth gaps by education actually increase with age faster than do income gaps (not shown in the table). By ages 45 through 49, the median net worth of households headed by high school dropouts was less than $11,000. A sizable increase occurs by 55 to 59, as net worth rises to $47,000 and subsequently to over $70,000 by ages 60 to 64. The median net worth among high school graduates reached only about $30,000 by ages 40 through 44. However, by their early sixties, the median high school graduate has accumulated nearly $145,000.

The medians reveal only one point of the highly dispersed net worth distributions within education groups. For example, consider households headed by high school graduates in their late forties. The net worth of the bottom 25 percent of this group was only $10,000 or less while the top 25 percent had net worth of $164,000 (not shown). In translating net worth figures into income flows based on the lifetime annuity value over the remaining approximately 37 years of expected life, the difference amounts to about $7,000 to $8,000 per year.

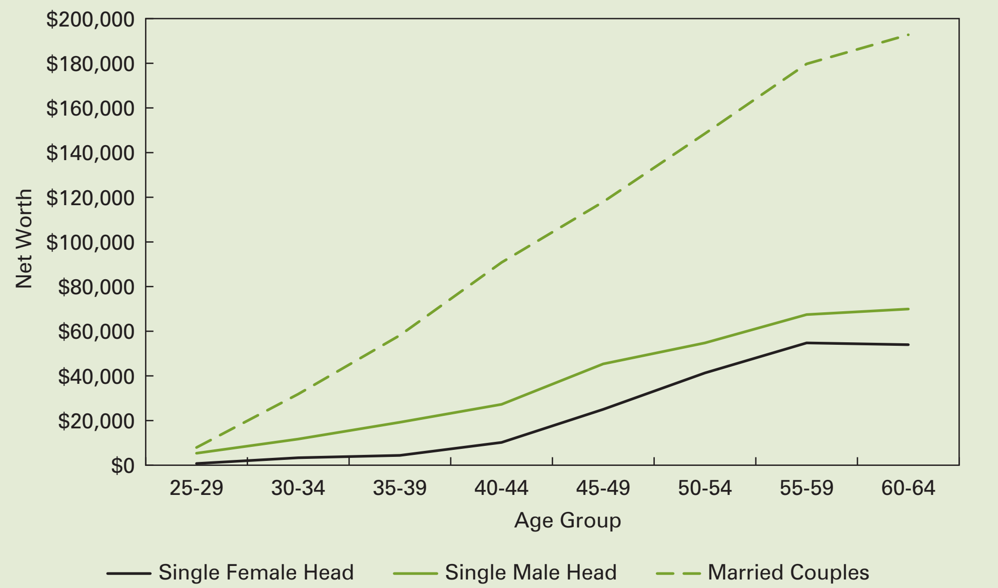
Household structure accounts for major differences in wealth accumulation. The expected advantages of married couples widen substantially with age, but all three family types, including single-female-headed and single-male-headed households, increase their net worth over the life cycle (see figure 2). As with education, the household structure advantage

FIGURE 1. Age-Net Worth Profiles by Household Head Education, Households with Two or More People: 2001



Source: Urban Institute tabulations from wave 3 of the 2001 SIPP panel.

FIGURE 2. Age Profile of Median Net Worth by Family Structure



Source: Urban Institute tabulations from wave 3 of the 2001 SIPP panel.

increases with age faster for net worth than for income (not shown). At younger ages, single men have higher asset levels than single women. But single women catch up by their early fifties, suggesting that single women accumulate assets faster than single men over the long haul.

Low-income households generally have minimal to modest levels of net worth. Note in table 1 that the median level for households in the bottom 25 percent reaches only about $9,000 at ages 45 through 54 and about $32,000 at ages 55 to 64. However, the spread within this low-income group is wide. As of about age 50, net worth runs from zero (at the 25th percentile) to $63,488 (at the 75th percentile). The 25th to 75th percentile range for 45- to 54-year-olds for lower-middle income households is much wider, extending from $11,000 to $139,000.

What Assets Do Less-Educated and Low-Income Families Hold?

U.S. families accumulate assets primarily through home ownership, car ownership, and pensions. As table 2 shows, even among less advantaged subgroups, home and car ownership and pension coverage are substantial. By their late thirties to mid-forties, 43 percent of high school dropouts owned homes, 72 percent owned cars, but only 27 percent had a pension. Households

TABLE 1. Distribution of Net Worth of Low- and Lower-Middle Income Families by Age: 2001

		Age			
Income Ranges	**Net Worth Distribution**	**Less than 35**	**35–44**	**45–54**	**55–64**
0 to 25th Percentile	25th percentile	0	0	0	4,400
	50th percentile	867	2,708	8,667	32,425
	75th percentile	5,404	27,135	63,488	129,750
25th to 50th Percentile	25th percentile	(2,546)	2,250	11,397	23,900
	50th percentile	5,025	24,608	56,300	93,650
	75th percentile	27,199	82,617	138,800	214,954

Source: Tabulations by the Urban Institute from the 2001 SIPP panel, wave 3.

TABLE 2. Ownership of Homes, Autos, and Pension Coverage

Ownership by Characteristic	All	Under Age 35	35–44 Years Old	45–54 Years Old	55–64 Years Old
			Share Owning Homes		
Education					
H.S. Dropout	45.0	27.1	42.8	51.8	67.5
H.S. Graduate	64.0	46.6	63.7	72.5	79.6
Some College	63.9	46.4	65.0	73.2	80.6
B.A. or Higher	72.2	53.3	73.5	83.0	85.7
Income Classes					
Less than 25th percentile	36.3	20.2	32.7	46.6	57.3
25th to 50th percentile	53.4	37.4	53.7	62.9	75.2
50th to 75th percentile	70.8	56.7	71.3	78.6	85.1
			Share Owning Cars		
Education					
H.S. Dropout	72.1	70.1	72.2	71.1	76.7
H.S. Graduate	86.5	84.7	87.0	86.1	89.9
Some College	88.6	86.5	88.6	88.9	92.6
B.A. or Higher	91.3	89.5	91.5	91.9	93.1
Income Classes					
Less than 25th percentile	66.9	68.3	65.4	63.7	73.6
25th to 50th percentile	87.5	86.3	87.8	88.2	89.1
50th to 75th percentile	92.6	91.8	93.2	92.1	94.2
			Share with a Pension		
Education					
H.S. Dropout	30.1	16.3	26.6	39.3	42.9
H.S. Graduate	54.9	41.6	57.0	60.2	68.4
Some College	57.8	41.5	60.9	67.2	71.5
B.A. or Higher	73.4	63.4	76.5	76.6	76.3
Income Classes					
Less than 25th percentile	22.7	14.6	19.0	30.6	35.7
25th to 50th percentile	50.2	38.9	50.3	55.4	68.5
50th to 75th percentile	73.9	66.8	76.7	74.3	80.5

Source: Tabulations by Urban Institute from the 2001 SIPP panel (for homeownership and car ownership) and from the SCF (pension data).

at the bottom 25 percent took longer to reach these levels. Still, by ages 45 to 54, 47 percent owned homes, 64 percent owned cars, and 31 percent had a pension.

Do Low-Income, Low-Asset Households Build Up High Levels of Debt?

If families have more debt than assets, they must lower their debt levels to reach any positive level of net worth. The U.S.'s 1.5 million consumer bankruptcies per year[5] suggest that too much debt limits the net worth of low-income families. On the other hand, those with few assets and low income are less likely to qualify for loans and might have little debt to overcome.

Nearly 12 percent of households carry debt that exceeds their assets. As table 3 shows, in line with the life cycle theory, negative net worth is twice as common among young households (at 19 percent) than among older ones (8.5 percent). Note that excess debt levels among the less educated were only slightly higher than average across all households. However, as college graduates reached their late forties and older, their households were most able to own more than they owe. For the other

TABLE 3. *Households With Debts Greater Than Assets*

	All	H.S. Dropout	H.S. Graduate	Some College	B.A.+
25- to 44-Year-Olds					
Percent with negative net worth	18.9	19.7	19.9	21.4	16.8
Mean Assets (Assets < Debts)	$41,475	$21,636	$35,257	$37,372	$54,366
Mean Debts (Assets < Debts)	$64,940	$37,638	$60,797	$56,330	$80,998
45- to 64-Year-Olds					
Percent with negative net worth	8.5	11.9	9.7	9.4	6.2
Mean Assets (Assets < Debts)	$53,203	$27,816	$47,114	$52,633	$76,095
Mean Debts (Assets < Debts)	$81,512	$42,364	$80,941	$79,370	$107,803

Source: Tabulations by Urban Institute from 2001 SIPP panel.

groups, the incidence of negative net worth is similar, though the size of the gap varies. High school graduates with no college experienced the highest shortfall—about $25,000.

Renter households were twice as likely as homeowners to have more debt than assets. Again, the problem was not tied to low education; the percentages of renters with negative net worth were lower among high school graduate and high school dropout households than for all renter households. Most had low asset as well as low debt levels.

Which Households Accumulate Assets Despite Low Income and Education?

Income and education are certainly important determinants of wealth. But some low-income and less-educated households are more effective at increasing net worth than others; we used regression analysis to estimate the role of age, education, race, family status, immigrant status, and income. The findings revealed the importance of marriage and other systematic factors leading to higher wealth.[6] Within the bottom 25th percentile of income, marriage was associated with $25,120 more in wealth, holding education, age, race, immigrant status, and income. This gain was almost twice as high as the $12,567 differential between high school graduates and dropouts and was nearly 57 percent of the $44,392 differential between college graduates and dropouts.

Racial minorities had much lower net worth, even compared to other low-income and less educated counterparts. Within the lowest 25 percent of income units, black and Hispanic households had $21,502 and $19,604 less, respectively, than others with the same education, immigrant status, age, and income (and being an immigrant was associated with $8,045 less in wealth). However, each year of age added about $2,000.

Conclusions

One key challenge of any asset or opportunity-building agenda is to identify the populations least able to accumulate assets. Data from this brief show that the median person in the lowest education group, high school dropouts, is generating few if any assets over their pre-retirement periods. Some have a defined benefit pension and most carry enough social security to replace much of their pre-retirement income. However, their inability to build up assets no doubt constrains their capacity to enter the middle class.

Another potential worry is that those with few assets will have high liabilities to work off before accumulating adequate net worth. The SIPP data reveal this is a problem only for a modest share of low-asset, mostly low-income households, especially the minority who do not own their homes. A subset of the asset-poor—often those who do not own a home—carry debt in excess of their meager assets.

The regressions reveal factors linked to asset-building among low-income households. Even among those with very low income, households headed by a college graduate accumulate sharply higher assets than other groups. This might suggest that education helps low-income households accumulate assets or that the low-income group includes many temporarily poor college graduates who accumulate assets eventually.

Two limitations of this brief worth noting are the absence of good information on consumer durables and the gap in the data measuring retirement assets. The SIPP and the SCF do little to quantify properly the amount of defined benefit pension plans. The older low-income, who skew toward blue-collar jobs, are more likely to have this type of pension, if they do have coverage. The Health and Retirement Survey and the Asset and Health Dynamics among the Oldest Old (AHEAD) survey may shed light on this topic.

The brief only touches the surface of wealth accumulation among U.S. families. Several suggestions emerged from a roundtable of experts. Research should examine how productive forms of debt help build wealth while unproductive forms limit wealth. Another topic is the role of institutions, especially those making savings their default. A third is whether differences in specific assets translate into overall wealth differentials or into differences in the composition of assets.

Notes

The author thanks Henry Chen for excellent research assistance and Adam Carasso, Signe-Mary McKernan, and Eugene Steuerle for comments.

1. The two data sets are the Survey of Consumer Finances and the Survey of Income and Program Participation. An important data set not included was the Panel Survey of Income Dynamics.
2. Steuerle and Carasso (2004) provide a tabulator to calculate the present value of social security wealth for individuals and couples retiring in various years with varying lifetime earnings. They report the social security wealth of a low-earning couple retiring in 2005 would amount to about $256,000.
3. The present value (at the time of retirement) of the future flow of Medicare benefits is between $133,000 and $155,000 for a single worker retiring in 2005 and is nearly double this figure for a couple. See Steuerle and Carasso (2004).
4. The data come from the 2001 SIPP panel. Assets include equity in homes, vehicles, businesses, stock, mutual funds shares, and 401k and Thrift Savings Plans; interest-earning assets held at banking and other institutions; real estate; and IRA and KEOGH accounts. Note that the list does not include the accrued value of defined benefit pensions, social security, or accrued rights to Medicare or retiree health benefits.
5. See U.S. Courts, Bankruptcy Statistics, http://www.uscourts.gov/bnkrpctystats/statistics.htm#march.
6. The regression findings are available from the author on request.

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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* held five roundtables in 2004 to explore these options. This policy brief series presents some of our findings, analyses, and recommendations. The authors are grateful to the Annie E. Casey Foundation for funding the roundtables and policy briefs and to the roundtable participants for their insightful comments.

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