Savings in America: Building Opportunities for All

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Savings policy in the United States is at a critical juncture. The U.S. personal saving rate has declined from 10.8 percent in 1984 to zero in 2005.1 The national saving rate, which includes government and business savings, is the lowest among the G-20 countries and has decreased significantly in recent decades. These low levels of saving generally suggest lower growth rates of income and standards of living in the future.

1 Personal saving as a percentage of disposable personal income. Bureau of Economic Analysis.
Raising the rate of personal saving is a significant challenge, given that the lower-income half of all Americans has an average net worth of only $23,000 while the bottom quarter has an average net worth that is negative. However, allowing current patterns to continue places many in unnecessarily precarious circumstances. Seventy-six million baby boomers in the United States are fast approaching retirement, and the vast majority has yet to acquire the amount of savings to carry them through what could be two or more decades of retirement. As such, the difficult reality of America’s savings issue is likely to become more pronounced in the next few years.

The Goal of Boosting Savings
Increasing savings can foster economic opportunity through enhanced investment, both at the national and household levels. More investment should act as a catalyst for gains in real wages and economic growth. Such growth can aid in the correction of America’s current account deficit and lessen reliance on overseas investment. An increase in household assets should also provide families with more educational and related economic opportunities, which has become especially important in our increasingly knowledge-based economies. Increased savings also should improve the economic security of families by providing greater opportunities for homeownership, retirement income and greater protection against unanticipated needs and financial insecurity.

While raising the net national saving rate will likely require an across-the-board increase by U.S. households at all income levels, business and government, the potential contribution of low- and moderate-income Americans should not be discounted. Even relatively modest increases in annual personal saving by these households would help move the country more toward a savings society.

Lack of Universal Savings Policy
Increasing economic opportunity and security for the country and for individual households requires a savings policy that works for all Americans. Saving goals include getting an education, owning a home, obtaining access to capital, establishing a business and creating jobs, and saving for retirement. These goals apply to U.S. households at all levels of income, but most experts agree that existing savings policies provide very limited subsidies for low-and moderate-income Americans. Estimates from both the Joint Committee on Taxation and the Office of Management and Budget show that the vast majority of housing and saving tax subsidies—often more than 90 percent, depending on the particular subsidy—accrue to those households making over $50,000 annually. These federal subsidies—largely for retirement savings and homeownership—have grown to approximately $300 billion in 2005.

\textsuperscript{2}Survey of Consumer Finances, 1989-2004 surveys, Federal Reserve Board.
Paths for Reform
This paper considers barriers in current policies that confront households trying to save more. These include the complexity of laws affecting retirement and saving plans, and the exclusion of many households from using incentives that are worth the most to those facing the highest tax rates. It also discusses the effect of asset tests in welfare and education policies and other institutional barriers that discourage saving, especially for low- and moderate-income families.

Without advocating any particular savings policy or reform, this paper discusses several proposed policies to build assets for all Americans. These include new initiatives such as universal children’s accounts and enhanced Individual Development Accounts (IDAs). The paper also explores improvements to existing programs such as matched subsidies for retirement savings, and an enhanced, refundable tax credit for low-income savers. Although many of these ideas have not been fully developed and are open to debate on their merits, we believe they form an important part of the discussion about how to boost savings in the United States.

Conclusion
As U.S. policymakers grapple with new solutions to solve the savings situation, it is time for a broader conversation about how to make savings policies more effective and create a savings society for all Americans. Assets are like ladders that are used to bring opportunity and security within greater reach. Creating a nation of savers can be accomplished via partnerships among the financial community, the government, and individuals. Successful collaboration may provide greater opportunity for all Americans to save throughout the lifecycle, creating funds for major events such as attending college, starting a family, buying a home, building a business, preparing for emergencies, and retiring comfortably.
Section II: The Challenge of Saving in the United States

National and Personal Saving

Whether we examine national saving rates for the United States as a whole or the adequacy of household saving to meet the most important needs, there is reason for concern. The U.S. net national saving rate—defined as the sum of saving by households (or “personal saving”), companies, and the government—is the lowest saving rate among the 20 countries of the world that comprise the G-20, as seen in Exhibit 1. In 2003, the U.S. net national saving rate was 1.6 percent compared to 38.6 percent in China, 25.3 percent in Saudi Arabia, and 19.2 percent in South Korea (the top three net national saving rates in the G-20).
The personal saving rate (which excludes the saving of most businesses and the deficits of government) has been declining for over two decades. Indeed, it was negative by the end of 2005 as per Exhibit 2. Not since the Great Depression has the personal saving rate been so low.

<table>
<thead>
<tr>
<th></th>
<th>Argentina</th>
<th>Australia</th>
<th>Brazil</th>
<th>Canada</th>
<th>China</th>
<th>European Union</th>
<th>Germany</th>
<th>India</th>
<th>Indonesia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percent of disposable income</td>
<td>10.6%</td>
<td>3.6%</td>
<td>8.4%</td>
<td>7.5%</td>
<td>38.6%</td>
<td>7.0%</td>
<td>5.4%</td>
<td>15.2%</td>
<td>13.4%</td>
</tr>
<tr>
<td>Source: Bureau of Economic Analysis.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: 2003 data, as a share of Gross National Income.

Whether this decline will cause short-term economic disruption must be separated from the issue of whether it is prudent. Optimists note that although personal saving rates are at a record low, the aggregate level of household assets is at or near a record high. As shown in Exhibit 3, household net worth has not fallen relative to income.
This paradox can be explained by significant increases in capital gains. Household net worth has averaged around five times disposable income over the last two years. In recent years, extraordinary gains in equities and housing assets have offset the decrease in personal savings, resulting in a net increase in household assets. Appreciation in capital, first in equities and recently in housing, has bolstered the perception that households can safely spend more of their income than they otherwise would, thereby reducing the personal saving rate.

Increases in capital gains and declines in savings do not offset each other over the long run. Such appreciation is likely to be unsustainable at its current rate, and does not imply increased investment. Consider a generation of parents whose home values suddenly increase. It does not make it any easier for their children to buy homes even if it temporarily gives the older generation an incentive to spend more and maybe even work less. All of this can lead to declines in future national income, particularly if less is invested as a consequence.

Although unusual levels of capital gains have increased the measured wealth of many households, much of this may not represent lifetime gains in well-being. Without some additional investment or higher level of productivity of existing assets, higher valuation of those assets by itself is typically accompanied by their lower future return. In the long run, there is not more to consume, and possibly less if investment declines.
The Lack of Assets for Many American Households

Assets are valuable not just for the current consumption they can finance. They provide long-term stability and make economic mobility easier. However, for many households, the discussion of recent capital gains is not applicable because they have no assets. Many low- and moderate-income families are less able to plan for the future or pay for medical, employment, and other unplanned family emergencies as a result.

While income inequality in the United States is considerable, the distribution of net worth or assets is even more uneven, as shown in Exhibit 4. As a benchmark, in 2003, while the average household in the poorest income group had about half the income of the average for all households in the population, it had essentially zero net worth. Put another way, households of poor and moderate means have much smaller shares of net worth than they do of income.

![Exhibit 4: Distribution of Net Worth and Income of U.S. Households (2004)](image)

Note: Date points for the net worth are 647% for the ninth decile and 3344% for the tenth decile. Income in the tenth decile is 580%.
Source: Federal Reserve Board. Our calculations.

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Exhibit 5 shows that the bottom 50 percent of households (ranked by net worth) in 2004 had an average net worth of just $23,000, the bottom 25 percent of households, meanwhile, held no net worth. Net worth here is defined as the difference in value between total assets and total liabilities (excluding consumer durables such as televisions and furniture, as well as the future value of Social Security benefits and retirement benefits from private defined benefit pension plans). Between 1989 and 2004, while the average net worth of the top 25 percent grew 65 percent, the net worth of the bottom 25 percent did not change, hovering just below zero. In general, most studies of wealth distribution—whether confined to this measure of net worth or some other—have shown not only that disparities in wealth are much larger than disparities in annual income, but that they have been increasing in recent decades.4

Exhibit 5

<table>
<thead>
<tr>
<th></th>
<th>Top 25%</th>
<th>Next to Top 25%</th>
<th>Next to Bottom 25%</th>
<th>Bottom 25%</th>
<th>All</th>
<th>Top 10%</th>
<th>Bottom 50%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. NET WORTH</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>944.6</td>
<td>131.4</td>
<td>33.9</td>
<td>(0.8)</td>
<td>277.6</td>
<td>1,860.9</td>
<td>16.5</td>
</tr>
<tr>
<td>2004</td>
<td>1,560.3</td>
<td>185.5</td>
<td>47.2</td>
<td>(1.3)</td>
<td>448.0</td>
<td>3,110.5</td>
<td>22.9</td>
</tr>
<tr>
<td>% change</td>
<td>65</td>
<td>41</td>
<td>39</td>
<td>NA</td>
<td>61</td>
<td>67</td>
<td>38</td>
</tr>
<tr>
<td><strong>B. FINANCIAL ASSETS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>340.7</td>
<td>39.7</td>
<td>13.0</td>
<td>2.2</td>
<td>110.7</td>
<td>674.7</td>
<td>7.6</td>
</tr>
<tr>
<td>2004</td>
<td>670.5</td>
<td>63.7</td>
<td>17.2</td>
<td>3.0</td>
<td>200.6</td>
<td>1,345.2</td>
<td>10.1</td>
</tr>
<tr>
<td>% change</td>
<td>97</td>
<td>61</td>
<td>32</td>
<td>34</td>
<td>81</td>
<td>99</td>
<td>33</td>
</tr>
<tr>
<td><strong>C. NON-FINANCIAL ASSETS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>1,017.1</td>
<td>176.2</td>
<td>60.2</td>
<td>11.2</td>
<td>119.3</td>
<td>1,956.4</td>
<td>35.7</td>
</tr>
<tr>
<td>2004</td>
<td>1,707.7</td>
<td>278.2</td>
<td>102.9</td>
<td>21.0</td>
<td>538.2</td>
<td>3,324.9</td>
<td>61.9</td>
</tr>
<tr>
<td>% change</td>
<td>68</td>
<td>58</td>
<td>71</td>
<td>88</td>
<td>351</td>
<td>70</td>
<td>74</td>
</tr>
</tbody>
</table>

Source: Survey of Consumer Finances, 1989-2004 surveys, Federal Reserve Board. Net worth is essentially assets net of debt (not shown). Financial assets include transaction accounts, stocks, bonds, retirement accounts, and the like. Non-financial assets include homes, cars, and businesses.

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Next to housing, retirement assets may be the most important set of assets for most Americans. There is a significant gap in ownership of retirement accounts between those at the top and bottom quintiles of income, as shown in Exhibit 6. Of the bottom 20 percent of households (ranked by income), only 10 percent own tax-favored retirement accounts. The median account value for this group is $4,500—a small fraction of total retirement needs. The bottom quintile of earners owns just 1 percent of total retirement account assets. The stratification is made clear by comparing this poorer group to the top 20 percent of earners, where 85 percent own retirement accounts. The median account value for the top 10 percent is $130,000, which represents 50 percent of total account assets. Even this account value of $130,000 falls short of one year’s median income ($169,000) for this cohort.

Most households do not save enough to provide even half of their own support in retirement. Urban Institute economists C. Eugene Steuerle (an author of this paper) and Richard Johnson have shown that about two-thirds of households have less in total assets—including homes, retirement accounts, and all other assets—than the value of their Social Security and Medicare wealth (Exhibit 7). In a related study, the Congressional Budget Office’s research concluded that even with Social Security and other benefits, roughly a quarter of baby boomers are unprepared for retirement, another quarter are somewhat unprepared, and only half are fully prepared.¹

Homeownership has long been recognized as a potential means of monetizing savings in retirement. It is also a key asset that often brings families the economic stability and opportunity necessary to become stakeholders in a savings society. However, homeownership is contributing to the assets gap in America when viewed in terms of racial and ethnic disparities (Exhibits 8a and 8b). The data show that in 2004, 76 percent of all White non-Hispanic Americans were homeowners, compared to 51 percent of all Non-White or Hispanic Americans. The median value of the primary residence of a White non-Hispanic American was $165,000 while the median value for a Non-White or Hispanic American was $130,000. Similarly, 56 percent of all White non-Hispanic Americans held retirement accounts with a median value of $41,000 compared to 33 percent of Non-White or Hispanic Americans with a median value of just $16,000.
These summary data suggest the critical imperatives to increase savings in the United States. The aging of the baby boomer generation makes the challenge even greater. Traditionally, the peak years for saving are in one’s 50s and 60s, after which savings generally decline.6 The U.S. Census projects that the over-65 cohort of the population will grow from about 12 percent currently to 18 percent by 2025 and 21 percent by 2050, meaning that the United States will have increasingly more net spenders relative to net savers in the future. This demographic shift will add to the problem of increasing personal savings and government savings (because of the pressures on Social Security and Medicare). Additionally, the significant challenges for asset creation among low-income households and minority communities further heighten the precariousness of today’s savings situation in the United States. In total, the combination of low savings for the nation and vulnerable circumstances for many Americans makes a case for developing an effective and inclusive savings policy.

Section III: The Opportunity for Increasing Saving in the U.S.

Savings at the Bottom of the Income Distribution and the National Savings Picture

While the potential contribution of additional wealth to the well-being of households of lesser means is easy to understand, the potential contribution of their savings to the national savings picture is easy to overlook. Even relatively moderate increases in annual personal saving by these households would help move the country toward a savings society. Exhibit 9 demonstrates some hypothetical gains to aggregate personal savings and net national savings resulting from different scenarios for increased saving by the bottom 40 percent of households in the income distribution.
Average Annual Increase in Saving Per Household for the Poorer Half of Households Only (numbers in parentheses demonstrate this saving as a share of household income at 20\textsuperscript{th} and 40\textsuperscript{th} percentiles)

<table>
<thead>
<tr>
<th>Increase in Aggregate Personal Saving</th>
<th>Rise in Net National Saving*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>$ 500 (2.7%, 1.4%)</strong></td>
<td><strong>$ 28 billion</strong></td>
</tr>
<tr>
<td><strong>$1,000 (5.4%, 2.9%)</strong></td>
<td><strong>$ 56 billion</strong></td>
</tr>
<tr>
<td><strong>$1,500 (8.1%, 4.3%)</strong></td>
<td><strong>$ 84 billion</strong></td>
</tr>
<tr>
<td><strong>$2,000 (10.8%, 5.8%)</strong></td>
<td><strong>$ 112 billion</strong></td>
</tr>
</tbody>
</table>

*This analysis assumes no impact on government saving.

Note: Net national saving was $106 billion in 2005. Household incomes at the 20\textsuperscript{th} and 40\textsuperscript{th} percentile are $18,500 and $35,000, respectively. Number of households in U.S. is 112 million.

Source: Bureau of Economic Analysis. Our calculations.

As the table illustrates, low- and moderate-income groups can play a role in boosting national savings and help move the country back towards a more sustainable saving pattern. If the bottom 40 percent of households increased annual savings by just $500 (or about $42 per month), the country’s aggregate personal savings would increase by $28 billion, and net national savings would increase by 26 percent (at least relative to some recent levels). If the bottom 40 percent of households increased annual savings by $2,000 (or about $167 per month), the country’s aggregate personal savings would increase by $112 billion, and net national savings would increase by 106 percent.\textsuperscript{7}

Returning the personal saving rate back to the historical 10 percent range and substantially raising net national savings will likely require an across-the-board increase by all income groups and by business and government. Still, as Exhibit 9 illustrates, the potential contribution of low-and moderate-income Americans to increasing national savings should not be discounted.

Although saving by households at any income level may help the national savings picture, it may seem difficult, if not impossible, for families with only modest incomes to set aside money for the future. However, recent research has shown that in spite of the barriers they face, many low- and moderate-income families do save when presented with the proper opportunities and incentives.\textsuperscript{8} Furthermore, the decline in the personal saving rate has not been uniform across socio-economic groups. As Exhibit 10 demonstrates, there is some evidence that the saving rate for low- and moderate-income Americans increased in the 1990s. It was the spending habits of high-income Americans, who benefited the most from the capital gains boom, which instead drove down the personal U.S. saving rate.\textsuperscript{9}

\textsuperscript{7} We implicitly assume that current federal savings incentives could be re-shuffled to achieve this goal. Therefore, there need not be any additional cost to government. This argument is developed later in this paper.


<table>
<thead>
<tr>
<th>Income Quintile</th>
<th>Saving Rate, percent (1992)</th>
<th>Saving Rate, percent (2000)</th>
<th>Change, percentage points</th>
</tr>
</thead>
<tbody>
<tr>
<td>First 20%</td>
<td>3.8</td>
<td>7.1</td>
<td>3.3</td>
</tr>
<tr>
<td>Second 20%</td>
<td>4.2</td>
<td>7.4</td>
<td>3.2</td>
</tr>
<tr>
<td>Third 20%</td>
<td>2.7</td>
<td>2.9</td>
<td>0.2</td>
</tr>
<tr>
<td>Fourth 20%</td>
<td>4.7</td>
<td>2.6</td>
<td>-2.1</td>
</tr>
<tr>
<td>Fifth 20%</td>
<td>8.5</td>
<td>-2.1</td>
<td>-10.6</td>
</tr>
</tbody>
</table>


Exhibit 10 shows that those households in the fourth and fifth quintiles lowered their savings rate by 2.1 and 10.6 percentage points respectively, while households in the first two quintiles raised their saving rates by 3.3 and 3.2 percentage points. However, as those households in the fourth and fifth quintiles enjoy substantially higher incomes, reductions in their saving tend to more than offset increases in saving of the lower quintiles.

Economic Opportunity & Prosperity

The National Case

The macro-economic gains from savings—higher productivity and real wages, and higher domestic income if less is owed abroad—would produce clear economic benefits for the entire country. There is strong economic evidence that growth is shared between labor and capital, so that the benefits of additional savings do not accrue merely to the savers. Increased investment sparked by higher saving rates drives productivity gains, and thus real wages and economic growth. Capital funneled to companies through investment allows firms to expand their factories and to introduce the latest technologies. Providing new generations of workers with greater access to capital ensures greater production and employment. While increasing saving might dampen consumption in the short term, it can increase future consumption through the higher incomes it generates in the future.

While higher productivity comes from more investment, the United States has increasingly garnered the financing for much of its investment from abroad. One consequence is that domestic returns from this higher productivity are reduced because much of the income from that higher level of investment must be repaid to investors overseas. The U.S. saving rate is low, in part, because Americans purchase more overseas goods and services than they sell abroad, and then depend on those abroad to reinvest the proceeds back into the United States. Savings from outside the United States is now providing over 80 percent of net domestic investment, as illustrated in Exhibit 11.
U.S. indebtedness to the rest of the world has climbed sharply to over $2.5 trillion, or well in excess of 20 percent of GDP, as illustrated in Exhibit 12. By increasing domestic savings, the country not only can increase the income of its own citizens (even for the same level of aggregate investment), but also reduce the risk of an economic slowdown should overseas investment fall. If overseas lenders should no longer be willing (e.g., there are more attractive opportunities elsewhere) or able (e.g., because of their own demographic pressures on savings) to lend to the United States, then this would lead to U.S. dollar weakness and a deterioration in the U.S. terms of trade with negative consequences for living standards.
The Household Case
At the household level, a higher level of saving would not only increase future income, but increase opportunities as well. For example, research shows that a family’s assets are correlated strongly with a child’s educational achievement, even after controlling for income. In fact, children from asset-rich and income-poor families tend to perform better than children from income-rich and asset-poor families. This occurs for a variety of reasons. Homeowners tend to live in better neighborhoods than renters, and for longer periods of time, which improves educational opportunities for children by limiting disruptions. Additionally, more assets mean more available resources at all stages of a child’s education, thereby providing some measure of insurance and stability. For instance, the decision to attend college by paying tuition or taking out student loans is easier when one’s family has at least a moderate level of assets.

Owning assets opens up economic opportunities and can help lift people into the middle class. Some savings may allow a household to finance the purchase of a car that will help with transportation to a new, higher paying job; earnings from that job, in turn, may eventually finance the purchase of a home and equity from that home may in turn finance a small business start up or college tuition for a child. Asset building begets more asset building. Research has also shown that asset building increases confidence, self-sufficiency, and civic involvement.

Economic Security
All households face risks associated with unplanned events such as losing a job or incurring costly medical bills. Low- and moderate-income households are particularly vulnerable to being thrown into poverty from such economic setbacks. Assets provide stability and economic security during such times, buffering the family against hardship.

There is some evidence that American families bear higher economic risks than they did a few decades ago, at least as measured by variability in income (Exhibit 13). Other economic and demographic changes can also add to risks: rising longevity in retirement combined with the trend to retire earlier; the threat of shortfalls in Social Security and Medicare on the benefits payable under those programs; the increase in the number of single-headed households entering retirement (even while there are more two-earner couples than before); and the decline in traditional pension plans (defined benefit plans) that provided a relatively more stable income in retirement, as contrasted with 401(k) and similar (defined contribution) plans that tend to be more variable in their value and rate of return.

Building assets may be timely now, considering the recent growth in household debt. Bankruptcies and delinquencies have risen significantly in recent years as shown in Exhibit 14. Increasing the assets of households at all income levels would better cushion against bankruptcy and, as a byproduct, strengthen the financial system for the nation as a whole.

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**Exhibit 13**


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*Pretax family income from all sources, including transfer payments.

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In sum, building assets among low- and moderate-income Americans provides the United States with the opportunity to expand economic opportunity, prosperity and security at both the household and national levels. Higher savings promotes increased educational and economic opportunities, as well as greater economic security during shocks such as unemployment or illness or during times of increased income volatility. At a national level, meaningful additions to savings would spur greater investment, thus improving our economic health, and in time, raise future wage levels. At a minimum, increased savings would reduce U.S. dependence upon overseas sources of lending. Increased savings at both a national and household level are intertwined goals requiring a savings policy that works for all Americans.
A universal savings policy has long been a goal of strategies aimed at economic growth, but it has become clear that such a goal will not be achieved by focusing only on income-based policies. Also required are savings policies that enable all Americans, regardless of income, to save, invest and own for their future. We next look at the incentive structure that supports saving in the United States to ask what is working, what can be improved, and what would truly accelerate saving at the bottom of the income ladder.

Section IV: Savings Policy in the United States
Despite substantial differences on many fronts, several researchers and legislators have reached a growing consensus over the last twenty years that asset-based policies, not just income-based policies, need attention. A first step in approaching an asset-based policy is to acknowledge that the government already spends hundreds of billions of dollars each year subsidizing various forms of household savings. However, the bulk of these subsidies benefit higher-income families that would likely save in any case, and the level of subsidy generally increases as income goes up, not down.

In 2005, the federal government spent an estimated $317 billion subsidizing housing (mainly homeownership) and encouraging private retirement savings (Exhibit 15). The greater part of these subsidies came in the form of tax expenditures (tax code preferences that reward certain behaviors), while the remainder was in the form of outlays (direct government spending appearing as budget line items), mainly for low-income housing.\(^{14}\)

A significant share of current savings vehicles and federal subsidies accrues to individuals who already have reached middle- or upper-income status. The subsidies are effectively proportionate to the taxpayer’s tax rate. For low-income taxpayers who owe no tax, there is no subsidy. Those in a 10 or 15 percent tax bracket, in turn, receive a much smaller subsidy than those in a 30 percent or higher tax bracket. As a result, those who benefit the most from these subsidies include households that already own a home, have steady employment, have disposable income in excess of average living costs, are enrolled in an employer-provided pension plan, have a positive income tax liability, and have basic financial literacy skills. For example, the Joint Committee on Taxation estimates that over 90 percent of the subsidies going to homeownership accrue to those households making over $50,000 annually.\(^{15}\) As a result, these incentives do not reach families at the bottom of the income scale—those whom have the least assets to begin.

\(^{14}\) Further subsidies are provided, primarily for some forms of retirement saving, when income put into pensions and some retirement accounts is not subjected to Social Security tax, but we deal only with the income tax subsidies here.

\(^{15}\) U.S. Congress Joint Committee on Taxation, in its Estimate of Federal Tax Expenditures for Fiscal Years 2006-2010, April 2006.
### Exhibit 15
**Total Retirement Savings and Housing Subsidies,¹**
(1996-2010) (billions of 2005 dollars)

<table>
<thead>
<tr>
<th></th>
<th>Actual 1996</th>
<th>Estimated 2000</th>
<th>Projected 2005</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RETIREMENT SAVINGS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Savings Subsidies</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net exclusion of pension contributions and earnings:</td>
<td>78.1</td>
<td>121.3</td>
<td>112.92</td>
<td>117.7</td>
</tr>
<tr>
<td>Low and moderate income savers credit</td>
<td>3.7</td>
<td>1.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other²</td>
<td>3.7</td>
<td>3.9</td>
<td>4.2</td>
<td>4.7</td>
</tr>
<tr>
<td><strong>Total Pension Tax Expenditures</strong></td>
<td><strong>81.8</strong></td>
<td><strong>125.2</strong></td>
<td><strong>118.2</strong></td>
<td><strong>122.4</strong></td>
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<tr>
<td><strong>HOUSING SAVINGS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Savings Subsidies</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discretionary Housing Assistance</td>
<td>31.3</td>
<td>31.8</td>
<td>37.2</td>
<td>33.8</td>
</tr>
<tr>
<td>Mortgage Credit (Mandatory plus Discretionary)</td>
<td>-5.6</td>
<td>-3.7</td>
<td>-1.0</td>
<td>-4.6</td>
</tr>
<tr>
<td>Other¹</td>
<td>4.7</td>
<td>4.2</td>
<td>4.8</td>
<td>4.2</td>
</tr>
<tr>
<td><strong>Subtotal - Housing Outlays</strong></td>
<td><strong>30.4</strong></td>
<td><strong>32.3</strong></td>
<td><strong>41.0</strong></td>
<td><strong>33.3</strong></td>
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<tr>
<td><strong>Tax Expenditures</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deductibility of mortgage interest on owner-occupied homes</td>
<td>55.9</td>
<td>66.6</td>
<td>68.9</td>
<td>92.8</td>
</tr>
<tr>
<td>Capital gains exclusion/deferral on home sales</td>
<td>23.1</td>
<td>20.5</td>
<td>32.8</td>
<td>65.0</td>
</tr>
<tr>
<td>Exclusion of net imputed rental income on owner-occupied homes⁴</td>
<td>22.9</td>
<td>27.3</td>
<td>28.6</td>
<td>40.4</td>
</tr>
<tr>
<td>Deductibility of state and local property tax on owner-occupied homes</td>
<td>18.7</td>
<td>24.5</td>
<td>16.6</td>
<td>11.6</td>
</tr>
<tr>
<td>Other¹</td>
<td>13.2</td>
<td>16.2</td>
<td>11.2</td>
<td>5.6</td>
</tr>
<tr>
<td><strong>Subtotal - Housing Tax Expenditures</strong></td>
<td><strong>133.7</strong></td>
<td><strong>155.0</strong></td>
<td><strong>158.1</strong></td>
<td><strong>215.4</strong></td>
</tr>
<tr>
<td><strong>TOTAL SUBSIDIES</strong></td>
<td><strong>246.0</strong></td>
<td><strong>312.4</strong></td>
<td><strong>317.3</strong></td>
<td><strong>371.3</strong></td>
</tr>
<tr>
<td><strong>Memorandum: Personal Savings</strong></td>
<td><strong>268.5</strong></td>
<td><strong>186.1</strong></td>
<td><strong>-33.9</strong></td>
<td><strong>NA</strong></td>
</tr>
</tbody>
</table>

**Notes:**

1. Note that tax expenditures are not truly additive. Also, the cash flow measures above do not reflect the present value of pension subsidies.
2. Includes exclusion of railroad retirement system benefits; small business retirement plan credit; exclusion of military disability pension; and exclusion of veterans pensions.
3. Includes veterans housing (mandatory plus discretionary); military family housing; and mandatory housing assistance.
4. Exclusion of net imputed rental income was not included in budget data until 2004. Values for prior years are Urban Institute estimates.
5. Includes credit for low-income housing investments, exception from passive loss rules for $25,000 of rental loss; exclusion of interest on owner-occupied mortgage subsidy bonds; deferral of income from post-1987 installment sales; and accelerated depreciation on rental housing (normal tax method).

Perhaps more disconcerting, the subsidies for homeowners may actually discourage savings and homeownership by low- and moderate-income families. The distribution of benefits from most housing programs—both tax subsidies and expenditures for renters or homeowners—has a U-shaped curve, as shown in Exhibit 16. At moderate income levels, most families are eligible for very little—neither tax subsidies nor direct expenditures. Since the tax subsidies probably lead to some increase in the cost of land and buildings, especially in major urban areas, the net effect on households with little or no subsidy is a higher cost of both owning and renting.

Exhibit 16
U-Shaped Curve: Average Annual Federal Housing Incentives (Subsidies and Tax Deductions) Per Household by Total Household Income (2002)

Note: Chart includes households without subsidies. Housing subsidies include federal public or subsidized housing subsidies. Deductions include mortgage and property tax deductions. Not included are the exclusion of net imputed rental income; deductions such as exception from passive loss rules for $25,000 of rental loss; or accelerated depreciation on rental housing.

Source: The Urban Institute, 2004. Based on data from the March 2002 CPS. Sample includes individuals less than 65 years of age.

Furthermore, some of these low-income families may face negative incentives to buy. Since the rental and public housing subsidies almost never can be converted into ownership, they may effectively discourage ownership.

The evidence suggests that federal tax subsidies for savings, as currently designed, actually do little to encourage saving. Exhibit 17 shows how personal savings has declined relative to the tax subsidies that are supposed to spur saving. Despite the enactment of many new forms of savings incentives, personal saving in 2005 fell below the amount of tax subsidies provided by government for retirement savings by themselves. The decline of personal savings to zero calls into serious question the effectiveness of existing policies in spurring household saving.17


One important reason why tax subsidies for saving are ineffective is that most of these subsidies are really applied to contributions, not saving. Households often borrow on one side of their ledger (e.g., through a mortgage or home equity loan) while making deposits in these tax-subsidized accounts on the other side of the ledger. As a result, many subsidies go to those who do not increase their savings at all. Of course, while those tax breaks are valuable in achieving lower taxes, they do not require additional saving. Low- and moderate-income households are generally unable to benefit from these tax breaks (or the tax breaks for housing), as they often owe very little or nothing in taxes that could be offset.

**Barriers to Effective Savings Policies**

Many government programs—both those targeted to increase savings and those designed for very different goals—may create impediments to saving. The following examples are meant more to be illustrative than exhaustive, but they show the necessity of strategically thinking about asset policies in many different legislative arenas and avoiding unintended barriers to saving.

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**Exhibit 17**

*Retirement Saving Incentives Versus Personal Saving (1985-2005)*

Note: Tax expenditures are not strictly additive. The cash flow measures above do not reflect the present value of pension subsidies.

Source: The Urban Institute, 2006. Based on data from the Office of Management and Budget, Analytical Perspectives (prior to 1990, Special Analyses), Budget of the United States Government, various years. Personal savings data from the Bureau of Economic Analysis.
ASSET TESTS IN WELFARE, FOOD STAMPS, AND OTHER SAFETY-NET PROGRAMS. Currently, the asset tests in social safety net programs deny otherwise-eligible families federal aid if they have accumulated even limited assets. In many cases, households that participate in social safety net programs like Temporary Assistance for Needy Families, food stamps or Supplemental Security Income cannot hold more than a few thousand dollars in financial assets without losing eligibility. These asset tests do not always apply to items like housing, but many low-income families do not own these excluded assets, and those that do still need additional savings for other contingencies. These tests can result in a tremendous disincentive for low-income families to save. A number of proposals have been made to deal with this barrier, including not counting retirement savings accounts towards the asset limit, raising the asset limit, or eliminating the asset test completely.

INCOME TESTS IN EDUCATIONAL GRANT PROGRAMS. The penalty for savings applies not just to programs associated more commonly with welfare but to educational programs. Subsidies for students in higher education, such as Pell grants, have very strict rules that penalize some forms of savings for all eligible income groups. These tests place the heaviest strictures on student saving in their own accounts, often taxing away not just the income from those savings but almost all the savings over the course of a college career.

COMPLEXITY OF LAWS AND REGULATION. Handling retirement plans and pensions has become very complex—and expensive. Many types of retirement plans and arrangements are possible, and each contains rules and regulations regarding deposits, withdrawals, penalties, and other matters. Firms and financial advisers spend substantial resources trying to sort through these offerings. Even when choices are made, record-keeping and fiduciary responsibilities increase, as do requirements to hire and maintain a larger human resources staff to handle questions from employees. Many reform options have been suggested, including a paring of the number and types of tax incentives available, adopting common sets of rules for deposits and withdrawals, and the creation of a clearinghouse that would centralize the collection of small pension contributions, manage the investments and disbursement of benefit payments or withdrawals, and assume most or all of the fiduciary risk.

ENROLLMENT IN EMPLOYER-SPONSORED PLANS. Generally speaking, most employer plans are set up in a way that workers must enroll, choose investment funds, and decide on a contribution level in order to participate. These “opt-in” plans have often been found in some research to be much less effective in encouraging savings than “opt-out” plans. Under the latter approach, the employer puts aside a portion of the employee’s money each pay period unless the employee opts out of that system. Employers could voluntarily offer automatic enrollment to new hires as a way to prompt workers to contribute regularly to

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their accounts, and likewise to automatically invest their monies in balanced, diversified funds unless the employee overrode these options. Employees could still opt out of the plans. In addition, some of these opt-out systems automatically increase the rate of employee contribution as the employee’s earnings increase.21

Current law may technically allow opt-out plans already. Yet the fear of being sued under various laws—pension, labor, and age discrimination laws—leaves many employers reluctant to act without legislation. Their fears could be alleviated if it were made clear that certain types of opt-out plans would be treated as “safe harbors”—places where, if a set of rules or standard practices were followed, any firm and its plans would be automatically considered in compliance.

REFUNDS FOR TAX CREDITS AND OTHER TAX REFUNDS. Currently, refunds of the Earned Income Tax Credit or other tax refunds can only be deposited to a single bank account if a tax filer selects direct deposit. This encourages many lower-income filers to select a cashier’s check over a savings account when some of the money is needed immediately to cover consumption needs or to pay off other debt. One suggestion is to allow a refund to be automatically split between two or more accounts, so that the filer can more easily direct some of the money into a savings account.

New or Recently Enacted Savings Policy Approaches

Advocates, academics and policymakers have suggested a range of new policies to address the country’s weak saving rates and inspire greater asset creation among those at the lowest-income levels. Some of these policies would partially replace older ones, while others would be added to the existing mix. A few have been adopted on an experimental or temporary basis in U.S. law. While new structures and incentives may run counter to the goal of simplifying or rationalizing existing savings policies, they compel us to consider fresh approaches to persistent problems. Although there is a lively debate over how they should be designed and if they can be brought to scale, they are listed here because they form an important part of the broad discussion on how to better encourage saving, especially among low- and moderate-income households.

CHILDREN’S SAVING ACCOUNTS. Children’s accounts represent a new approach to gathering savings and contributions from families and eventually from children. Such an approach has a precedent in the United Kingdom.22 In the United States, bi-partisan legislation was introduced in 200523 to provide every newborn child with a Kids Investment and Development Savings (KIDS) account, and a national demonstration of children’s accounts is underway with funding from private foundations. Several states are also considering model programs of this concept.24 These proposals often vary in form, but generally, an account would be funded

22 In 2005, the United Kingdom launched the first national system of children’s investment accounts, sending vouchers worth 250£ to all children born since September 2002. Accounts are invested until age 18, when children are free to withdraw the funds. Five million children are expected to hold accounts by 2008. Interview with David White, CEO of The Children’s Mutual, November 28, 2005.
23 The ASPIRE Act of 2005 (S 868/HR 1767) was introduced in the Senate by Sen. Rick Santorum (R-PA), and in the House by Rep. Harold Ford (D-TN).
24 The Saving for Education, Entrepreneurship, and Downpayment (SEED) Policy and Practice Initiative is a multi-year national initiative focused on children’s savings programs.
with some initial amount, such as $500 (which is close to the amount that the U.K. now provides to each newborn child). Some proposals would also provide modest matching incentives for, say, $250 of annual saving. Some would restrict the subsidies to lower-income families, while some tend to be more universal. Note that a major goal of policy here is not simply adding to savings, since the annual sums involved are usually modest—but creating a climate for savings and financial literacy, and teaching long-term financial planning to children by way of example.25

INDIVIDUAL DEVELOPMENT ACCOUNTS. Helping families build funds for a down payment on a home, a college education or a small business is the intent behind Individual Development Accounts (IDAs). IDAs are matched savings accounts currently offered by some 400 non-profit organizations through demonstrations which seek to show that low-income, working-poor Americans can save and devote those savings to long-term goals such as promoting economic security and mobility. While individual savings patterns within IDAs have varied, experiments over a four-year span among 1,100 initial participants (of which 840 were still active after four years) suggest that IDAs have a positive affect on homeownership.26 IDAs were first authorized under the Personal Work and Responsibility Act of 1996. The IDA proposal in the President’s 2007 budget would create a tax credit to subsidize current IDA programs offered by non-profits and other government entities, contribute to their matching funds, and provide financial education to participants.

MATCHED RETIREMENT SAVINGS. While removing barriers to retirement savings and simplifying pension offerings may accelerate workplace savings, matched savings has also been suggested as a way to subsidize private retirement savings in a way that is less dependent upon the taxpayer’s marginal tax rate. A recent study of matching grants offered at the moment of tax filing through tax preparer H&R Block found that offering matching dollars could have a significant impact on savings behavior. H&R Block offered an Express-IRA (X-IRA) to low- and moderate-income customers who were randomly assigned to a 20 percent match, a 50 percent match, or no match on X-IRA contributions. The study showed that the higher the match, the higher the participation. When offered no match, only 3 percent of customers contributed to an IRA. When offered a 20 percent match, 10 percent contributed, and when offered a 50 percent match, 17 percent contributed. The study also showed that the higher the match, the higher the savings.27

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SAVER’S CREDIT. Tax legislation passed in 2001 created a saver’s credit with the intention of spurring retirement savings, especially for more modest income households. It provides for a matching tax credit for household contributions made to IRA or 401(k) plans. The credit can be claimed only against the taxes a household owes; as in the case of deductions, most low-income tax filers owe little or no tax already, so the credit is of limited value to them. Indeed, the number of households who manage to receive the maximum credit may be negligible. For these reasons, some proposals would make the credit refundable (e.g., allowing savers to claim the credit even when they do not owe the government any tax), thus encouraging and subsidizing retirement savings for many more households. The saver’s credit is an example of a reform that complements the existing systems of both employer and personal savings by trying to create more incentives at moderate income levels where tax deductions are less valuable.

Further Reform Considerations

This brief survey of the weaknesses of existing savings incentives, the barriers to savings in non-savings programs, and the newer approaches to increasing savings reveal an array of potential mechanisms or reforms that might increase savings in society, especially among low- and moderate-income households. Given the low level of aggregate savings, the evidence is compelling that the country can do better in encouraging new saving.

However, caution still is required. Partly because of the vast array of saving policies already in place, care needs to be taken to weave a consistent and workable policy “fabric.” For instance, subsidized savings plans for low-income families should not discourage participation in other subsidized savings plans for moderate-income families. Another example is the nature of restrictions on withdrawals of assets. Restricting asset withdrawals may help fulfill key goals such as paying for education or purchasing a home, but it can also deter some families’ participation as well as raise issues of administration and enforcement.

One unwanted consequence of policy reform would be an unnecessary weakening of the employer-based system. Workers earning between $30,000 and $50,000 are almost 20 times more likely to save when covered by a workplace retirement plan than when offered individual incentives not involving employers, like Individual Retirement Accounts. As the national savings situation garners more attention and legislators begin to consider a variety of savings proposals, it is important to preserve many of the valued features developed through workplace savings systems.

Savings is never far removed from the policy arena. Recent debates over pension, tax, welfare, and Social Security reform have been at the forefront of the domestic economic policy debate, and each contains large and vital elements of U.S. savings policy. As the nation engages in these debates, it is appropriate to focus considerable attention on asset development, especially for those who have limited net worth, as well as increasing the national saving rate.

Savings policy is not new. What is relatively new is the critically low level of personal savings in the United States, which calls into question the effectiveness of savings policies overall. Subsidies for savings have grown to around $300 billion, mostly benefiting households that already possess the private means to build assets. The very small amount of assets owned by low- and even moderate-income households ought to signal the need for greater attention to the proper targeting of these subsidies, including the extent to which they induce net savings—not just deposits—and whether they should be aimed primarily at those families who already possess substantial assets and are in the highest tax brackets.

If we as a society can meaningfully raise the stock of assets owned by low- and moderate-income households, we will not only boost our nation’s saving rate, but also extend new channels of economic access to working families. In so doing, we will help to bridge the economic divide between those who have and those who want. The outcome is a more cohesive society where the gains of national prosperity are more equitably available. However, these gains will be difficult to achieve until existing incentives are made more effective, and barriers to saving—often the unintended consequence of other policies—are removed. Also worthy of attention are efforts to move beyond existing structures. With collaboration between the financial community, the government and individuals, a careful consideration of these ideas will help the country move one step closer to a universal savings policy that helps restore the promise of economic opportunity for all.