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Statement of

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Chairman Brown, Ranking Member Corker, and members of the Subcommittee, thank you for the invitation to appear before you today. My name is Ray Boshara, and I am a senior advisor at the Federal Reserve Bank of St. Louis. Let me state that the views expressed here today are my own views, and not necessarily the views of the Federal Reserve Bank of St. Louis or the Board of Governors of the Federal Reserve System.

At the Federal Reserve Bank of St. Louis, I am organizing a new effort to study mechanisms that promote household financial stability, with a particular emphasis on rebuilding the balance sheets and net worth of American households. My work is focused on families hardest hit by the financial crisis and the economic downturn, those who have experienced significant losses of employment, income, and wealth. We know that balance sheets matter because financially healthy families spend, save, and invest more, and thereby contribute to economic growth.

My testimony is in two parts. In the first part, I discuss why a focus on household balance sheets is necessary. And in the second part, I offer some policy recommendations, based on my own work, to help rebuild the balance sheets of struggling families.

Why Balance Sheets Are Important

Balance sheets, by which I mean the savings, assets and debts of households, merit attention for three reasons. First, over the past few years we have all seen the damage to families, communities, and the broader economy derived from balance sheet challenges. For too many years, household debt levels rose, eventually to dangerous levels, while little was done to build up household savings and to diversify family assets beyond housing. When the housing bubble burst, the wealth of many households plunged, leaving balance sheets, according to some economists, at a historic low.[1] For instance, Mian and Sufi report that both household debt-to-income and household debt-to-assets ratios reached their highest points since 1950, with the debt-to-income ratio skyrocketing from 2001 to 2007 by more than it had in the prior 45 years.[2]

While balance sheets have improved somewhat in the last couple of years, financial instability remains severe among the poor and persons of color, and reaches into the middle class. Consider these points:

- Three-fifths or more of families across all income groups, according to the 2009 Survey of Consumer Finances (SCF) of the Federal Reserve, reported a decline in wealth between 2007 and 2009, and the typical household lost nearly one-fifth of its wealth, regardless of income group.[3]

- The Pew Research Center finds that, in 2009, typical net worth stood at $5,677 for blacks, $6,325 for Hispanics, and $113,149 for whites. About a third of black and Hispanic households had zero or negative net worth that year, compared with 15 percent of white households.[4]

- Almost half of all households surveyed in the 2009 SCF had less than $3,000 in liquid savings, and 20 percent had less than $3,000 in broader savings.[5]

- Nearly half of all Americans consider themselves financially fragile, meaning that they would "probably" (22.2 percent) or "certainly" (27.9 percent) be unable to come up with

[1] Atif Mian and Amir Sufi (2010), "Household Leverage and the Recession of 2007–09," *IMF Economic Review*, vol. 58 (1), pp. 74–117, www.palgrave-journals.com/imfer/journal/v58/n1/pdf/imfer20102a.pdf.

[2] Mian and Sufi, "Household Leverage and the Recession of 2007–2009."

[3] Jesse Bricker, Brian Bucks, Arthur Kennickell, Traci Mach, and Kevin Moore (2011), "Surveying the Aftermath of the Storm: Changes in Family Finances from 2007 to 2009," Finance and Economics Discussion Series 2011-17 (Washington: Board of Governors of the Federal Reserve System), www.federalreserve.gov/pubs/feds/2011/201117/201117abs.html.

[4] Rakesh Kochhar, Richard Fry and Paul Taylor (2011), "Wealth Gaps Rise to Record Highs Between Whites, Blacks, Hispanics," (Washington, DC: Pew Research Center, July), http://pewsocialtrends.org/files/2011/07/SDT-Wealth-Report_7-26-11_FINAL.pdf

[5] Bricker, Bucks, Kennickell, Mach and Moore, "Surveying the Aftermath of the Storm: Changes in Family Finances from 2007 to 2009."

$2,000 in 30 days to cope with a financial emergency.[6] Similarly, almost half of all Americans report having trouble making ends meet.[7]

- In a survey by Holtz, Van Horn, and Zukin on the effects of unemployment and the recession, 70 percent of workers reported withdrawing funds saved in college and retirement accounts in order to make ends meet,[8] likely leading to losses of wealth in future years.

Second, weak balance sheets impact economic growth. Weak balance sheets--especially due to lower household wealth--have had negative "wealth effects" on the economy. Case, Quigley, and Shiller state that "the results indicate that increases in housing market wealth have had positive effects upon household consumption, but declines in housing market wealth have had negative and somewhat larger effects upon consumption."[9] In addition, Mian and Sufi show that "household leverage as of 2006 is a powerful statistical predictor of the severity of the 2007–2009 recession across U.S. counties. Those counties that experienced a large increase in household leverage from 2002 to 2006 showed a sharp relative decline in durable consumption starting in the third quarter of 2006--a full year before the official beginning of the recession in

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[6] Annamaria Lusardi, Daniel Schneider, and Peter Tufano (2011), "Financially Fragile Households: Evidence and Implications," *Brookings Papers on Economic Activity* (Washington, DC: Brookings Institution, Spring), www.brookings.edu/~/media/Files/Programs/ES/BPEA/2011_spring_bpea_papers/2011_spring_bpea_conference_lusardi.pdf.

[7] Annamaria Lusardi (2011), "Americans' Financial Capability," report prepared for the Financial Crisis Inquiry Commission, http://fcic-static.law.stanford.edu/cdn_media/fcic-testimony/2010-0226-Lusardi.pdf.

[8] Debbie Borie-Holtz, Carl Van Horn, and Cliff Zukin (2010), *No End in Sight: The Agony of Prolonged Unemployment*, (New Brunswick, NJ: John J. Heldrich Center for Workforce Development, Rutgers University, May), www.heldrich.rutgers.edu/sites/default/files/content/Work_Trends_May_2010_0.pdf.

[9] Karl E. Case, John M. Quigley, and Robert J. Shiller (2011), "Wealth Effects Revisited 1978–2009," Cowles Foundation Discussion Paper No. 1784 (New Haven, CT: Cowles Foundation for Research in Economics, Yale University, February), http://cowles.econ.yale.edu/P/cd/d17b/d1784.pdf.

the fourth quarter of 2007."[10] Many others, including the Bank for International Settlements and the International Monetary Fund, have recently identified weak household balance sheets as one of the key factors inhibiting economic growth.

And third, a growing body of evidence indicates that families with assets generally do better in life than those without, and generally experience better social, behavioral, and educational outcomes. Conley, using intergenerational data, showed that "parental education and parental assets are the single best predictor of educational (and other socioeconomic) success for blacks and whites. Parental wealth proves so powerful, in fact, that when added to statistical models, parental income, occupation and race no longer appear to matter. That is, while race, income, job status and net worth all tend to vary hand-in-hand, careful statistical parsing shows that it is really net worth that drives opportunity for the next generation."[11] Moreover, Cooper and Luengo-Prado found that among adults who were in the bottom income quartile from 1984–1989, 34 percent left the bottom by 2003-2005 if their initial savings were low, compared with 55 percent who left the bottom if their initial savings were high--that is, 21 percent more adults moved out of the bottom quartile because they had higher savings.[12] And Butler, Beach, and

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[10] Mian and Sufi, "Household Leverage and the Recession of 2007–2009."

[11] Dalton Conley (2009), "Savings, Responsibility, and Opportunity in America," Policy Paper (Washington: New America Foundation, April), http://newamerica.net/publications/policy/savings_responsibility_and_opportunity_america.

[12] Daniel Cooper and Maria Luengo-Prado (2009), "Savings and Economic Mobility," in Reid Cramer, Rourke O'Brien, Daniel Cooper, and Maria Luengo-Prado, eds., *A Penny Saved is Mobility Earned: Advancing Economic Mobility Through Savings* (Washington: Pew Charitable Trusts, Economic Mobility Project, November), www.economicmobility.org/assets/pdfs/EMP_Savings_Report.pdf.

Winfree found that financial capital, along with family structure and educational attainment, are the three strongest predictors of economic mobility in America.[13]

Further evidence suggests that the earlier in life one has assets, the better that person will do. For example, Cooper and Luengo-Prado found that children of low-saving, low-income parents are significantly less likely to be upwardly mobile than children of high-saving, low-income parents. Specifically, they found that 71 percent of children born to high-saving, low-income parents move up from the bottom income quartile over a generation, compared to only 50 percent of children of low-saving, low-income parents.[14] Elliot and Beverly discovered that, remarkably, youth with any kind of a bank account, as long as the account was in the youth's name, are seven times more likely to attend college than those lacking accounts.[15] Similarly, Zhan and Sherraden found that, after controlling for family income and other parent and child characteristics, financial and nonfinancial assets are positively related to, and unsecured debt is negatively related to, children's college completion.[16] And Shapiro, combining data analysis and in-person interviews with a demographically wide range of families, found that the presence of

[13] Stuart M. Butler, William W. Beach, and Paul L. Winfree (2008), Pathways to Economic Mobility: Key Indicators (Washington: Pew Charitable Trusts, Economic Mobility Project), www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Economic_Mobility/PEW_EMP_Chartbook_12.pdf.

[14] Cooper and Luengo-Prado, "Savings and Economic Mobility."

[15] William Elliot III and Sondra Beverly (2010), "The Role of Savings and Wealth in Reducing 'Wilt' between Expectations and College Attendance," Research Brief (St. Louis: Center for Social Development, Washington University, January), http://csd.wustl.edu/Publications/Documents/RB10-04.pdf.

[16] Min Zhan and Michael Sherraden (2009), "Assets and Liabilities, Race/Ethnicity, and Children's College Education," Research Brief (St. Louis: Center for Social Development, Washington University, February), http://csd.wustl.edu/Publications/Documents/RB10-09.pdf.

even small amounts of wealth at the right times can have a "transformative" effect on the life course.[17]

Policy Ideas for Rebuilding Balance Sheets

For families, reducing their debts and rebuilding their savings--or deleveraging--is already, painfully and slowly, underway. The household savings rate has now reached around five percent, which is significantly down from the nine percent average in the 1980s, on course with the five percent average in the 1990s, but well above the nearly zero rates the U.S. fell to in the first part of this century.[18]

Yet millions of families need to delever even more, although, not surprisingly, economists do not agree on ideal or sustainable levels of household savings and debt. Most agree, however, that rebuilding balance sheets and igniting the economy require continuing measures to resolve the housing and foreclosure crisis. Roughly three-quarters of total household debt is mortgage debt, and nearly one-quarter of homeowners nationwide have negative equity.[19] Specific recommendations to resolve the housing crisis are beyond the scope of my expertise and testimony, so I will focus on other ideas to help families build savings and wealth. However, before doing so, I would like to observe that, historically, homeownership has been an effective route to wealth accumulation for generations of families, including for low-

[17] Thomas M. Shapiro (2004), *The Hidden Cost of Being African American: How Wealth Perpetuates Inequality* (New York: Oxford University Press).

[18] Bureau of Economic Analysis, www.bea.gov/newsreleases/national/pi/pinewsrelease.htm; Federal Reserve Bank of St. Louis, http://research.stlouisfed.org/fred2/series/PSAVERT; and Massimo Guidolin and Elizabeth A. La Jeunesse (2007), "The Decline in the U.S. Personal Saving Rate: Is It Real and Is It a Puzzle?" *Federal Reserve Bank of St. Louis Review*, vol. 89(6), pp. 491–514.

[19] Board of Governors of the Federal Reserve System (2011), Statistical Release Z.1, "Flow of Funds Accounts of the United States" (September 16), www.federalreserve.gov/releases/z1/current/z1.pdf; and CoreLogic (2011), "New CoreLogic Data Shows Slight Decrease in Negative Equity," news release, June 7, www.corelogic.com/about-us/news/new-corelogic-data-shows-slight-decrease-in-negative-equity.aspx.

and moderate-income families; accordingly, going forward policymakers and researchers should continue to study responsible paths to homeownership for those who are ready and qualified, with all stakeholders balancing both risks and the rewards.

While several ideas could be offered, let me suggest five savings-based recommendations to rebuild balance sheets that I think hold particular promise.[20] I would like to note that these recommendations are informed by a key insight gleaned from savings experiments in the U.S. and around the world. The most interesting question among researchers is no longer whether low-income families can save, but how they save and what difference it makes. That is, income is *not* the most important predictor of who saves. Instead, what matters more is who has access to structured savings mechanisms--whether through the workplace, schools, financial institutions, tax returns, community-based organizations, and others. A well-funded asset-building policy, one that includes several billion dollars in tax incentives, is already reaching middle- and upper-income households in the United States,[21] making it easier for them to accumulate savings and wealth; the core policy challenge, then, is to extend those savings mechanisms and incentives to families whose earnings fall below median income.

First, build assets as early in life as possible. As discussed earlier, the evidence thus far suggests that children in homes with assets, or children with assets, do better in life than those

[20] For this testimony, I will focus on savings-based approaches to building balance sheets, which have many advantages, although I well recognize that other important approaches exist to help low-resource families build assets, including Pell Grants, micro-enterprise programs, defined-benefit pension programs, various homeownership and rental assistance programs, public safety net programs, and many others.

[21] Butler, Beach, and Winfree, "Pathways to Economic Mobility: Key Indicators;" Reid Cramer and Rachel Black (2011), *The Assets Report 2011: An Assessment of Federal Policies and Proposals to Promote Asset-Building Opportunities* (Washington: New America Foundation, June), http://assets.newamerica.net/sites/newamerica.net/files/policydocs/AssetsReport2011.pdf; and Corporation for Enterprise Development (2010), *Upside Down: The $400 Billion Federal Asset-Building Budget* (Washington: CFED), http://cfed.org/assets/pdfs/UpsideDown_final.pdf.

lacking assets. Policies that automatically create a savings account at birth for every child born in America, with greater resources available for lower-wealth families, hold promise to expand opportunity and build a stronger middle class over time. Such a policy would, if schools structured financial education classes around the accounts, likely have a significant effect on building financial skills for children and youth--some studies show that financial know-how is the result of regular saving, not the source. If such an ambitious policy cannot be achieved in the near term, then I would suggest the creation of a "Kids Roth" or "Roth at Birth" or "Young Savers Account"--a slightly modified Roth Individual Retirement Account (IRA) that, voluntarily, permits children to open and make contributions to a life-long, tax-benefited account that can also be used for postsecondary education and homeownership (as current Roth IRAs allow). The creation of such a nationally sanctioned product directed at kids would likely spur further experimentation around child savings accounts, which has been hampered by product-related challenges over the last several years.

Second, build assets and reduce debts at tax time. Income tax refunds averaged $2,700 in 2008, while about 24 million Earned Income Tax Credit (EITC) recipients received refunds as large as $4,824.[22] These refunds, and the broad reach of the tax system, offer good opportunities to repair or rebuild balance sheets. The IRS's form 8888, which enables all taxpayers to deposit their refunds automatically in up to three separate accounts, holds great promise in leveraging tax refunds into savings and debt reduction. For example, savings bonds, in many ways an ideal product for small savers, can now be purchased directly at tax time. Other interesting pilots,

[22] David Newville (2009), "The Saver's Bonus: Encouraging and Facilitating Savings by Families at Tax Time," Policy Paper (Washington: New America Foundation, June), www.newamerica.net/files/nafmigration/Savers_Bonus_Two_Pager_FINAL_070209.pdf.

including the "Refund to Savings" Initiative, are under way. To further facilitate savings at tax time, the Savers Credit, which encourages retirement savings among low-income taxpayers, could be improved and made available for contributions to college savings accounts, the purchase of savings bonds, and other preretirement assets.

Third, build assets at the workplace. The workplace has always been and remains a fulcrum for building savings and assets. In fact, the vast majority of pension wealth in the U.S. is structured through employers. Experiments, such as those testing "Auto401(k)s" and the "Save More Tomorrow" concept, have generated encouraging results, including for low-income workers, and the Pension Protection Act of 1996 has removed many of the barriers to further expansion of those efforts. To generate more employer-based savings, policymakers could consider proposals to set up automatic payroll deductions into retirement and unrestricted savings accounts outside the workplace, informed by the "AutoIRA" and "AutoSave" concepts currently under discussion. Employers could also encourage direct deposit of paychecks, which appears to lead to better financial inclusion outcomes. Finally, one could also imagine automatic payroll deductions for other assets, such as savings for college or homeownership, with possible incentives to encourage further saving by lower-income workers.

Fourth, build unrestricted savings, which are savings that can be used for emergencies or precautionary purposes and which remain in very high demand by low- and moderate-income consumers.[23] Those with sufficient levels of unrestricted savings are more likely to be banked, more likely to pay down and secure better loans, and more likely to acquire a longer-term asset

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[23] Stephanie Chase, Leah Gjertson, and J. Michael Collins (2011), "Coming Up with Cash in a Pinch: Emergency Savings and Its Alternatives," CFS Issue Brief 6.1 (Madison, WI: Center for Financial Security, University of Wisconsin), www.cfs.wisc.edu/Publications-Briefs/Coming_Up_with_Cash_in_a_Pinch_Emergency_Savings_and_Its_Alternatives.pdf.

such as higher education, a small business, or a home. And they do better: The Consumer Federation of America found that low-income families with $500 in emergency savings had better financial outcomes than moderate-income families with lower savings. In addition, McKernan, Ratcliffe, and Vinopal found that households that are "liquid-asset poor" are two to three times more likely than those with liquid assets to experience "material hardship" after a job loss, health emergency, death in the family, or other adverse event.[24] Policymakers could consider several measures to boost unrestricted savings, including (1) expanding the EITC; (2) further studying and testing prepaid cards, which often include a savings "bucket" in addition to transaction services; and (3) promoting reasonably priced small-dollar lending and small-dollar savings programs among financial institutions, nonprofits, and others.

And finally, consider supporting innovations to state-based 529 college savings plans and other ways to generate savings earmarked for college. Many studies have documented the role that a good education, especially completion of a postsecondary degree, has on one's future earning and wealth, and how the lack of an education and skills are among the strongest predictors of downward mobility. Promising innovations to learn from include (1) the "SEED for Oklahoma Kids" experiment, which is testing 529s established at birth; (2) the "Kindergarten to College" initiative in San Francisco, which is setting up college saving accounts for all of the city's kindergartners; and (3) the "Early Pells" proposal by the College Board, which would enable a Pell-eligible family to receive a child's Pell Grant earlier in life as a deposit to a 529 account.

[24] Signe-Mary McKernan, Caroline Ratcliffe, and Katie Vinopal (2009), "Do Assets Help Families Cope with Adverse Events?" Brief 10 (Washington: The Urban Institute, November), www.urban.org/UploadedPDF/411994_help_family_cope.pdf.

As implied in the recommendations above, there is a great need to diversify the savings and assets of families, especially those below median income. The wealth of these families has been concentrated in homeownership, which has contributed to the stability and upward mobility of millions of families over time--but which, especially when not acquired responsibly, or because of price fluctuations, ended up being a risky asset for too many families. Homeownership, as mentioned earlier, clearly carries both potential risks and rewards that must be carefully weighed. It is wise, therefore, for families to have access to a range of savings products--short- and longer-term, restricted and unrestricted--that lead to as broad a range of financial assets (such as investments and retirement accounts) and productive assets (such as a home, land, post-secondary education, reliable car, or small business) as possible. As Federal Reserve Board Vice Chair Janet Yellen has said, "In light of this experience [with collapsing housing prices], it makes sense to think about the development of wealth-building vehicles for low- and moderate-income households that have some of the desirable qualities of homeownership as an investment, but perhaps have less of the risk. Such instruments should be simple and transparent and might include a savings commitment component. Although households will likely need to take on some risk in order to accumulate wealth, the risk should not have the potential to destroy a household's financial security. Continued research in this area is badly needed."[25]

[25] Janet Yellen (2011), "Housing Market Developments and Their Effects on Low- and Moderate-Income Neighborhoods," speech delivered the 2011 Federal Reserve Bank of Cleveland Policy Summit, June 9, www.federalreserve.gov/newsevents/speech/yellen20110609a.htm.

Conclusion

Mr. Chairman, I commend you for convening this hearing today to look at high levels of household debt, consumer protection, and rebuilding the middle class. We know that household debt is both weighing down millions of families and stifling economic growth. Thankfully, we have compelling evidence, some of it presented here, suggesting that rebuilding balance sheets and net worth will help hard-hit families and the broader economy move forward. I hope to make a modest contribution to this critical challenge, and I would be pleased to answer any questions that you might have.