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BORROWING TO
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SERIES



In the Red or In the Black?

Understanding the
Relationship
Between Household
Debt and Assets

José A. García

About Dēmos

Dēmos is a non-partisan public policy research and advocacy organization. Headquartered in New York City, Dēmos works with advocates and policymakers around the country in pursuit of four overarching goals: a more equitable economy; a vibrant and inclusive democracy; an empowered public sector that works for the common good; and responsible U.S. engagement in an interdependent world.

The **Economic Opportunity Program** addresses the economic insecurity and inequality that characterize American society today. We offer fresh analysis and bold policy ideas to provide new opportunities for low-income individuals, young adults, and financially-strapped families to achieve economic security.

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Borrowing to Make Ends Meet - Series Information

In the Red or In the Black? Understanding the Relationship Between Household Debt and Assets is the fifth report in a new Dēmos publication series that examines trends in household indebtedness and its impact on economic security. The first report in the series, *A House of Cards*, chronicles the housing boom and the subsequent refinancing wave. The second report, *Borrowing to Stay Healthy*, examines how medical expenses impact household credit card debt. The third report, *Who Pays: The Winners and Losers of Credit Card Deregulation*, uncovered how over the last 20 years credit issuers have shifted the burden of higher fees and penalties to those who can least afford them—reaping billions in profits along the way. The fourth report, *Borrowing to Make Ends Meet: The Rapid Growth of Credit Card Debt in America* exposes disturbing trends in sky-rocketing credit card debt and also provides detailed data based on age, race and income demographics.

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S E R I E S



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Acknowledgements

This report was edited by Timothy Rusch, Tamara Draut and Gennady Kolker. Design and layout by Aaron Brown and Cory Isaacson.

The authors wish to thank the Ford Foundation for their ongoing support of this work.

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Introduction

Since the mid-20th century, asset accumulation has been the foundation of a stable middle class, providing families with long-term economic security that spans from one generation to the next. For several decades, this growth in assets created a root system that fostered economic mobility, making it possible for households to meet their immediate economic needs as well as accumulate the resources necessary to send a child to college, weather an emergency, and retire in comfort. But that security is withering in the wake of rising household debt.

Families today are devoting more of their incomes to servicing debt—from higher-than-ever student loan balances, to gas and groceries charged to credit cards, to mounting medical bills. In many cases, families are also using their assets—and rapidly depleting them—to cover the cost of rising debt. While growing evidence shows that the household economy is becoming more unstable, there is little known about the erosion of the asset root system that helped build and sustain America's middle class. In order to better understand the relationship between debt and household assets, this paper will explore the impact of credit card and educational debt on financial assets and home equity among low- and middle-income households, including a specific focus on age and race.

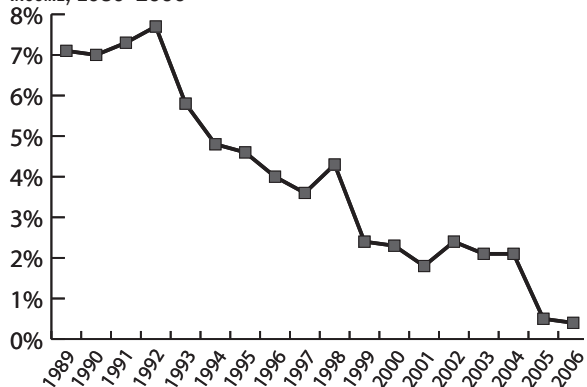
ASSETS AND THE FAMILY ECONOMY TODAY

Assets assist families with both their long- and short-term financial needs, whether laying the groundwork for future finances—such as college and retirement—or coping with unexpected economic shocks, like short-term unemployment or increases in the monthly cost of living. In today's household economy, savings, often the first asset families turn to when they are short on cash, are being used up faster than they are being replaced. With savings quickly diminishing, fewer households can be described as economically buoyant, defined as being able to meet three months of their living expenses if they were to suffer a loss of income.

As more income is dedicated to servicing debt, household savings have steadily declined to a personal savings rate of .04 percent in 2006 (Chart 1).¹ For low-income households, the presence of debt poses steep challenges to the goal of building some type of savings. For example, many families that are participating in Individual Development Account (IDA) programs, which provide low-income families with a dollar match for the money saved in order to fund asset-building expenses (such as a future home purchase or college tuition) are finding that economic shocks hinder savings. In fact, two-thirds of participants withdraw one-third of their matchable IDA balance to pay bills and other necessities.² As families continue to deplete assets in order to deal with unexpected financial circumstances, economic policies have done little to address the precipitous decline in savings—and the shift toward fewer liquid assets—in American households.

To manage rising debt and meet increases in basic costs, between 2001 and 2006 many households had to borrow against or cash out the equity in their homes. During the refinancing boom of the same period, between 2001 and 2006, nearly \$1.2 trillion of

CHART 1: PERSONAL SAVINGS AS A PERCENTAGE OF DISPOSABLE PERSONAL INCOME, 1989–2006



Source: U.S. Department of Commerce, Bureau of Economic Analysis, Table 2.1

home equity was cashed out.³ According to a survey conducted by the Federal Reserve, half of all families that cash out home equity use it to pay expenses such as credit card debt.⁴ As a result of the refinancing boom and, in some locations, a decline in home values due to the subprime meltdown, home equity has fallen to a record low of 50.4 percent.⁵

ASSETS AND A FOUNDATION OF PUBLIC INVESTMENTS

To understand the impact of debt on a family's assets—and overall financial well-being—we should begin with understanding the history of America's middle class. To build assets, families need to have enough income to pay for their cost-of-living expenses and

have enough left over for investments in *transformative assets*—assets such as a home or higher education, which facilitate economic mobility. The foundation for a prosperous and strong middle class in America began with policies that provided direct assistance to help families build assets and accumulate wealth. Public investments such as the GI Bill and the Higher Education Act fueled a rapid rise in educational attainment. Meanwhile, homeownership increased as government programs enabled more people to obtain home loans, made mortgage interest tax deductible, promoted suburban housing development, and enacted reforms targeting discriminatory lending practices.

It is important to note, however, that the post-World War II policy efforts that developed an infrastructure of opportunity did little to benefit Latino and African-American families. While these policies created a larger and stronger middle class, African-American and Latino families had great difficulty entering and remaining in that middle class. Anti-discrimination efforts came late to the process of constructing the middle class and have been incomplete in their achievement. While public policies such as The Fair Housing Act of 1968, the Equal Credit Opportunity Act of 1974, and the Community Reinvestment Act were aimed at ending discrimination in lending, the legacy of redlining persists. The racial wealth gap today is defined by households of color continuing to have lower levels of asset accumulation while paying more for credit than similarly situated white households.

Now, more than six decades since the policy investments of the post-war era, public investment has failed to keep pace with the changing economic landscape.

In the past 20 years alone, the cost of living has increased by nearly 90 percent due largely to the rising costs of housing, health care and transportation (cost increases of 81 percent, 74 percent, and 47 percent, respectively).⁶ As the cost of living has increased, income has remained stagnant. The typical American family has experienced a steady decline in inflation-adjusted earnings since 2001, and between 2000 and 2004 all income percentiles experienced a general decrease in real income. However, the group hit hard-

est by the decline was families in the lowest 20th percentile—those that experienced a decrease of 1.5 percent (Chart 3).⁷ Meanwhile, key family safety nets, such as health insurance, have decreased the level of coverage and require more Americans to reach into their pockets to cover health care necessities. The outcome of these economic obstacles has been an increasing reliance on high-cost debt to close the gap between income and basic expenses.

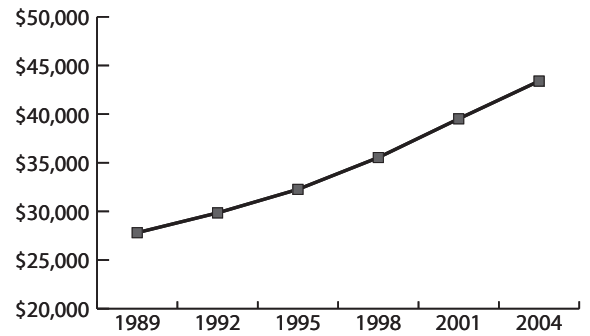
RISING DEBT

There is little doubt that America's low- to middle-income families are experiencing greater financial strain than they have in previous decades. To deal with rising costs, many households are turning to credit cards. According to a national household survey commissioned by Dēmos in 2005, the average credit card debt of low- and middle-income indebted households in America was \$8,650 (with a median of \$5,000).⁸ One-third of households had credit card debt over \$10,000, while another third reported credit card debt lower than \$2,500. In the aggregate, credit card debt grew nationally from \$692 billion to \$876 billion between 2000 and 2006, nearly three times the \$238 billion of debt in 1989 (2006 dollars).⁹ Households are also accumulating greater amounts of student loan debt, which reached an average of \$19,100 in 2004, more than doubling the average figure in 1993.¹⁰ For young households, this growing debt appears to have a cascading effect, reducing their capacity to save and build wealth. Financially strapped households are also increasing their mortgage debt, draining \$1.2 trillion in home equity over the last six years.

Rising credit card balances, student loans and cash-out refinancing have pushed both the household debt-to-income and debt-to-assets ratios to record levels. From 2001 to 2004, the debt-to-asset ratio—the percentage of debt owed for every dollar held in assets—rose 2.9 percentage points, from 12.1 to 15 percent.¹¹

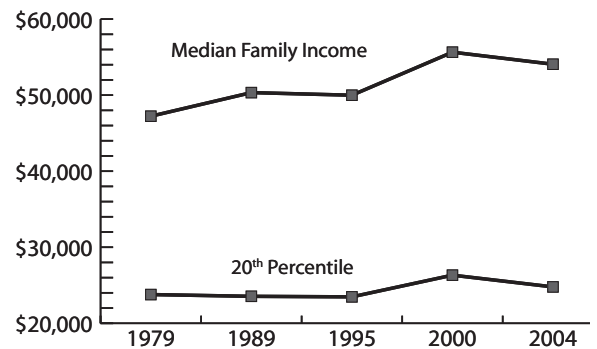
To get a clear picture of a family's average expenditures on debt and monthly necessities—and therefore project how well a family can save—the Financial Obligation Ratio (FOR) is instructive. The ratio provides a clearer picture of the amount of income used to pay debt because it includes rental payments and car lease payments, which are not reflected in the debt-to-asset ratio. In the years between 1980

CHART 2: AVERAGE ANNUAL EXPENDITURES (2004 DOLLARS)



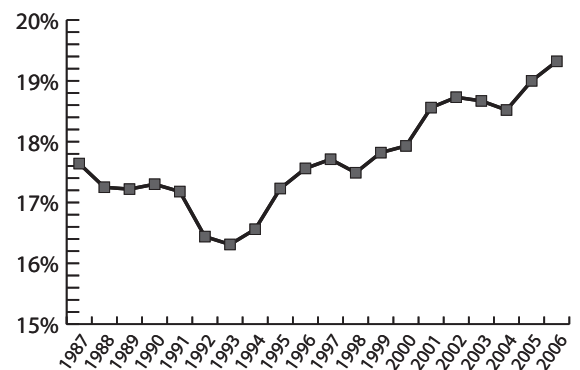
Source: U.S. Bureau of Labor Statistics, Consumer Expenditures in 2004, April 2006.

CHART 3: MEDIAN FAMILY INCOME, 1979 – 2004 (2004 DOLLARS)



Source: *The State of Working America 2006/2007*

CHART 4: FINANCIAL OBLIGATION RATIO



Source: Dēmos' calculations of Federal Reserve's Household Debt Service and Financial Obligations Ratios

and 2006, as consumer debt increased, there was a steady increase in the Financial Obligation Ratio, from 15 percent of income to 19 percent (see Chart 4). Today, families are paying an average of 27 percent more of their monthly income to deal with monthly debt and other essential bills than they did two decades ago.

Methodology

This report examines trends in debt and asset accumulation as well as the relationship between debt and assets in 2004 by household, race/ethnicity, and age. The data analyzed in this report was drawn from the Survey of Consumer Finances (SCF), a triennial survey of the assets and liabilities of American families sponsored by the Board of Governors of the Federal Reserve System with the cooperation of the U.S. Department of the Treasury. The recommended SCF weights were used to ensure that the data reflects the general population.

The sample selected for the analysis is low- to middle-income households. We eliminated families that have more than \$369,000 in financial assets (the highest 10 percent of families with financial assets), or incomes greater than \$120,000. This comprised 85 percent of the total Survey of Consumer Finance sample. The SCF's definition of "family" is close to the Census Bureau's definition of "household," which includes married couples and single individuals. The terms "households" and "families" are used interchangeably throughout the report.

We have created the term *economic buoyancy*, which refers to the availability of net financial assets to sustain a household for at least three months without income. For the educational loan section of the report, we have isolated our analysis to families under age 34 that have at least one year of post-secondary education.

Household Assets

Assets are durable possessions owned, such as a house or savings. However, assets can also refer to intangible things like a higher education. In general, household assets can be defined as those purchases or investments that assist families in attaining and maintaining financial security. Traditionally, homes and cars have been considered *non-financial assets* and checking and savings accounts, stocks, bonds, certificates of deposit and other financial products are understood as *financial assets* due to their quick liquidity. In this section, we will explore the nature of household assets between 2001 and 2004, focusing on the ability of low- and middle-income households to weather economic difficulties with financial assets.

According to the 2001 and 2004 Survey of Consumer Finances, total assets increased for most families between survey years.

- ▷ Families that had any assets experienced an increase of 10.3 percent, from a median of \$156,800 to \$172,900.¹²

- ▷ Median home values increased 22 percent, from \$131,000 to \$160,000.¹³ The increase in home value helped to defray the impact of decreasing financial assets, which fell by 6.9 percent from \$29,800 in 2001 to \$23,800 in 2004.¹⁴

The household survey data from 2004 does not capture the effects of declining home values and rising foreclosures that have resulted over the last year. The following data therefore may provide a more optimistic portrait of household assets than is currently the case.

- ▷ In 2004, 65 percent of low- and middle-income household homeowners had a median home value of \$132,000 (\$173,408 mean) with a median home equity valued at \$69,000 (\$103,999 mean).
- ▷ Home equity accounted for 60 percent of the value of their homes in 2004.¹⁵

Because the biggest source of wealth for most Americans is home equity, it is important to measure wealth in two ways: net worth, which provides a measurement of total assets, including home values, minus debts; and liquid assets—the amount of money households can quickly tap, such as that found in savings, certificates of deposit, and in other forms.

- ▷ In 2004, the median net worth of low- to middle-income households was \$57,170 (\$143,676 mean).
- ▷ Also in 2004, 89 percent of households had some form of liquid assets, with a median value of \$1,850 (\$8,264 mean).

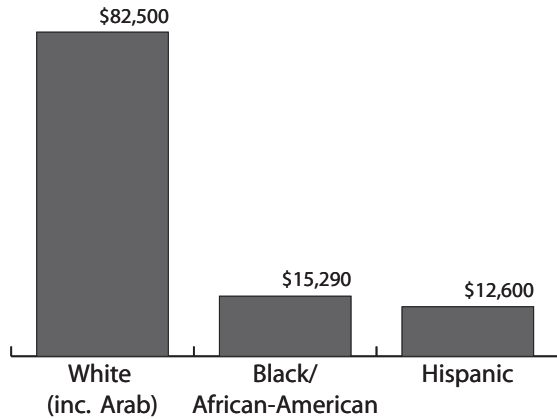
With low liquid assets, most American households do not have enough savings built up to weather short-term drops in income or unexpected expenses. **Three out of four low- to middle-income Americans are not economically buoyant—they do not have enough net financial assets to replace three months of income.**

RACE

African-American and Latino households have considerably less wealth and savings than white households, a legacy of exclusionary public policy that helped white households accumulate both financial and social capital in the post-war decades. As a result of decades of redlining, households of color are less likely to have the kinds of assets and savings that provide economic security and allow for the intergenerational transfer of wealth. In the short-term, their limited financial assets and disproportionately lower homeownership rates result in a greater reliance on high-cost debt—payday loans, auto title loans and credit cards—to weather economic emergencies or deal with unexpected expenses.¹⁶

- ▷ **White low- and middle-income households have a net worth that is five times higher than that of African Americans and six times higher than Latinos.** In 2004, while low- and middle-income whites had a median net worth of \$82,500 (\$169,283 mean), African Americans had a median net worth of \$15,290 (\$67,860 mean), and Latinos had a median net worth of \$12,600 (\$70,788 mean).

CHART 5: NET WORTH OF LOW- AND MIDDLE-INCOME FAMILIES, BY RACE, 2004



Source: Dēmos' calculations of the 2004 Survey of Consumer Finances

- ▷ In 2004, 25 percent of African-American and Latino households did not have liquid assets, compared to only 7 percent of low- and middle-income white households. For those with assets, whites had a \$2,600 median (\$9,988 mean) in liquid assets while African Americans and Latinos had median liquid assets of \$500 (\$3,658 and \$3,121 mean, respectively)—a 420 percent difference.
- ▷ Between 2001 and 2004, the debt-to-asset ratio rose 2.9 percentage points, from 12.1 percent to 15 percent.
- ▷ In 2004, white households had a median of 15 cents of debt for every dollar of assets, while black and Latino households had a median of 23 and 24 cents of debt for every dollar of assets, respectively.

- ▷ The data showed continuing gaps in homeownership: 48.7 percent of African Americans and 45.9 percent of Latinos owned their homes, compared to 71.6 percent of white households.

AGE

Historically asset accumulation has been closely associated with life cycle changes, accelerating as income grows over the course of a lifetime. Indeed, younger households have less savings and assets than their older counterparts. While more debt is expected among younger households and greater asset accumulation is assumed for middle-aged and older households, today households across the age spectrum face new challenges to their economic security, as detailed in the following section. Rising student loan debt is impacting young adults' ability to build wealth and savings, while many older Americans are more likely now than in previous years to still be paying off their mortgage in retirement.

- ▷ In 2004, the median net worth for households aged 18–24 was \$3,600 (\$27,121 mean).
- ▷ Eighty-three percent of households aged 18–24 had some form of liquid assets, with a median value of \$660 (\$3,178 mean), comprising 11 percent of their total asset portfolio.
- ▷ Middle-aged households, those aged 35–44, had a median net worth of \$44,640 (\$109,138 mean).
- ▷ Among households aged 35–44, liquid assets comprised 9 percent of their total asset portfolio, with a median of \$1,600 (\$6,532 mean).
- ▷ Home equity accounted for 48 percent of total assets among middle-aged households, with a median value of \$80,000 (\$117,106 mean).

As expected, older Americans had the highest net worth of all age groups and the highest rates of home equity as a percentage of home value.

- ▷ Those aged 65 and older had a median net worth of \$137,180 (\$220,712 mean).
- ▷ Among households over 65, home equity accounted for 53 percent of their total assets, with a median value of \$97,000 (\$130,799 mean). Their median home equity was equal to 80 percent of their home value.

Household Debt

In examining debt, economists and personal finance experts often make a distinction between “good” and “bad” debt. Good debt is often defined as debt that is an investment in something that will last a lifetime. Student loans and mortgages are typically considered good debt. Credit card debt is universally considered bad debt since it comes at a much higher cost and is traditionally viewed as debt used to support non-essential spending. But over the last decade, the demarcation between good debt and bad debt has softened. As we detail in this section, young households with student loan debt have less savings and lower home equity than those young households without debt, raising questions about whether student loans should be considered solely good debt. And as research indicates, credit card debt balances are rapidly climbing among low-to middle-income households as they struggle to pay for medical bills, to replace income during a job loss, and to finance unexpected but essential expenses such as car repairs.¹⁷ As the data indicate, households with credit card debt, on average, have substantially lower savings and net worth than those without. These differences are particularly pronounced among households of color. While we cannot untangle causality between credit card debt and savings (e.g. Does credit card debt accumulate in the absence of savings? Or does the accumulation of credit card debt impede savings accumulation?), it is clear that the economic portrait of households with credit card debt is substantially weaker than those without.

Credit Card Debt and Household Assets

The Survey of Consumer Finances data shows that households with credit card debt—across income, race and age—have lower levels of financial assets and home equity.

- ▷ In 2004, households *without* credit card debt held a median of \$44,150 in financial assets (\$79,151 mean)—close to five times more than the median of \$7,800 (\$32,421 mean) in financial assets held by households with credit card debt.
- ▷ Households with credit card debt are less likely to be economically buoyant (that is, able to replace three months of income with savings): Only 15 percent of credit card indebted households were economically buoyant, compared with 48 percent of those *without* credit card debt.
- ▷ Families *without* credit card debt had median home equity representing 70 percent of their median home value, while those with credit card debt had a median home equity that was 49 percent of their median home value.

TABLE 1: FINANCIAL ASSETS AND HOME EQUITY, BY PRESENCE OF CREDIT CARD DEBT, 2004

	Financial Assets	Percent of Households that are Economically Buoyant	Median Home Equity as a Percent of Home Value
Households without Credit Card Debt	\$44,150	48%	70%
Households with Credit Card Debt	\$7,800	15%	49%

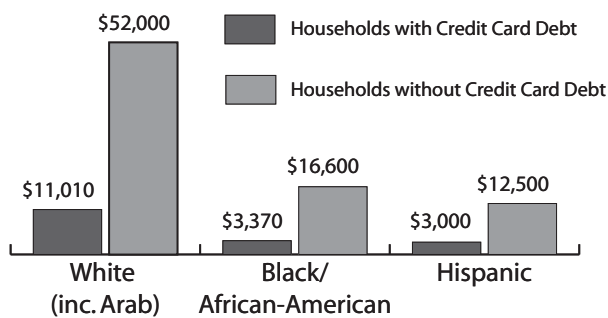
Source: Dēmos' calculations of the 2004 Survey of Consumer Finances

RACE

Households of all races with credit card debt have fewer financial assets than similar households that do not have credit card debt. However, previous research conducted by Dēmos found that households of color are more likely than white households to be paying an interest rate higher than 20 percent on their credit cards.¹⁸ In addition, these households are more likely to report being late on or missing a payment, which often results in additional fees and higher interest rate charges.

- ▷ In 2004, African Americans *without* credit card debt had median financial assets of \$16,000 (\$45,993 mean), compared to \$3,370 (\$20,653 mean) for those with credit card debt—a 374 percent difference.
- ▷ Latino households *without* credit card debt had median financial assets of \$12,500 (\$32,901 mean) compared to \$3,000 (\$11,838 mean) for those with credit card debt—a 316 percent difference.

CHART 6. MEDIAN FINANCIAL ASSETS BY RACE/ETHNICITY AND PRESENCE OF CREDIT CARD DEBT, 2004



Source: Dēmos' calculations of the 2004 Survey of Consumer Finances

- ▷ White households *without* credit card debt had median financial assets of \$52,000 (\$84,936 mean) compared to \$11,010 (\$84,936 mean) for those with credit card debt—a 372 percent difference.

The data show that households of all races with credit card debt are less likely to be economically buoyant than households without credit card debt, though the difference is greater among white households.

- ▷ In 2004, among white households with credit card debt, only 17 percent were economically buoyant, compared to 53 percent of white households that did not have credit card debt.
- ▷ Among African-American households with credit card debt, only 11 percent were economically buoyant, compared to 32 percent of African-American households that did not have credit card debt.

- ▷ Among Latino households with credit card debt, only 6 percent were economically buoyant, compared to 15 percent of Latino families without such debt.

African-American and white households with credit card debt have less home equity.

- ▷ White households *without* credit card debt had a median home equity that equaled 70 percent of their home value, compared to 49 percent for those households with credit card debt.
- ▷ For African-American households *without* credit card debt, median home equity was 68 percent of their home value, compared to 50 percent for those households with credit card debt.
- ▷ For Latino households *without* credit card debt, median home equity was 29 percent of their home value, compared to 30 percent for those with credit card debt.

AGE

Typically, older Americans tend to be more financially stable, free from mortgage payments and other types of debt obligations more common among young and middle-aged households. This portrait has begun to shift in recent years, with more seniors still paying off mortgages after the age of 65 and carrying increasing amounts of credit card debt. Between 1989 and 2004, older households experienced a 194 percent increase in average credit card debt, from \$1,669 to \$4,906.¹⁹

In general, older Americans with credit card debt have far fewer assets than those older households without such debt and also have less equity in their homes.

- ▷ In 2004, older Americans *without* credit card debt had median financial assets of \$68,500 (\$98,542 mean), compared to \$10,000 (\$42,711 mean) among those with credit card debt.
- ▷ Older Americans *without* credit card debt had median home equity equal to 92 percent of their home value, compared to 77 percent among those households with credit card debt.

Education Debt and Household Assets

Since the early 1990s, the percentage of college students who take out student loans to pay for their education has risen from less than half of all students to nearly two-thirds.²⁰ Not only are more students graduating with debt, they are graduating with higher amounts of debt: The average student loan debt for students graduating from public universities grew from \$8,000 in 1993 to \$17,250 in 2004.²¹ Students from low-income households, particularly those who receive Pell grants, are much more likely to have student loan debt than other students. Among Pell grant recipients who earned their degree in 2004, 88.5 percent had student loans, compared to just over half (51.7 percent) of non-Pell recipients.²²

With the average student loan monthly payment now topping \$200, it is important to examine how the presence of student loan debt may influence the ability of young households to accumulate savings and build wealth. In this section, we focus the data on households aged 18 to 34 with some level of post-secondary education, comparing the financial assets and home equity of households in this age group based on whether they have student loan debt. Overall, young households with education debt have less financial assets and lower home equity than young households without this debt burden.

- ▷ In 2004, 43 percent of households under 34 with some level of post-secondary education had educational loans, with a median debt of \$9,000 (\$16,204 mean).
- ▷ Households aged 18–34 carrying education-related debt had median financial assets that were 28 percent lower than those households without such debt (Table 2).

TABLE 2: FINANCIAL ASSETS AND HOME EQUITY, BY PRESENCE OF EDUCATION DEBT, 2004

	Median Financial Assets	Percent of Households that are Economically Buoyant	Median Home Equity as a Percent of Home Value
Households aged 18–34 without Education Debt	\$5,720	22%	38%
Households aged 18–34 with Education Debt	\$4,100	6%	20%

Source: Dêmos' calculations of the 2004 Survey of Consumer Finances

- ▷ Only 6 percent of young adult households with education debt were economically buoyant compared to 22 percent of those without education debt.
- ▷ Young homeowners that did not have education loans had greater home equity—38 percent of median home value, compared to 20 percent among young homeowners with education debt.

The reality that young households with education loans have fewer financial assets and are nearly four times as likely to not be able to replace three months of income than young households without education debt calls into question whether this type of debt should continue to be considered purely “good debt.” While workers with a college degree will earn more over their lifetimes than those without, it does appear that student loans slow the accumulation of savings and wealth.

RACE

White, Latino and African-American households under age 34 are about equally likely to be carrying education debt, though the median amount of that debt is highest for white households and lowest for African-American households.

- ▷ In 2004, nearly half (47 percent) of white households aged 18–34 had education debt, with a median of \$12,001 (\$17,606 mean).
- ▷ Forty-four percent of young Latino households had education debt, with a median of \$10,095 (\$23,744 mean).

- ▷ Forty-four percent of African-American households had education debt, with a median of \$8,201 (\$15,217).
- ▷ Young white households *without* education loans had 56 percent greater financial assets than those with such debt, with a median of \$7,950 (\$30,016 mean) among those without education loans, compared to a median of \$5,100 (\$15,064 mean) among white households with education loans.
- ▷ Young African-American households *without* education loans had 12 percent greater financial assets than those with such debt, with a median of \$2,800 (\$14,221 mean) among those without education loans, compared to a median of \$2,500 (\$12,576 mean) among African-American households with education loans.
- ▷ Unlike white and African-American households, young Latino households *with* education debt had 47 percent greater financial assets than those without such debt, with a median of \$2,941 (\$9,671 mean) among those with education loans, compared to a median of \$2,000 (\$8,566 mean) among those without.

Both white and African-American households with education debt are less likely to be economically buoyant than those without such debt:

- ▷ In 2004, only 4 percent of African-American households with education debt were economically buoyant, compared to 15 percent of those without education debt.
- ▷ Six percent of white households with education debt were economically buoyant, compared to 21 percent of those that did not have education debt.
- ▷ Among Latino households, the trend is reversed: 20 percent of Latino households with educational debt were economically buoyant, compared to only 12 percent of those without education debt.

The impact of education debt on Latino and African-American households yielded two interesting findings that warrant further research. First, Latino households with education debt had higher financial assets than their counterparts without such debt. Second, among African-American households, the difference in median financial assets based on the presence of education debt was less pronounced than it was for young white households. Both of these trends may be related to family income prior to taking on the education debt, as Latino and African Americans who pursue higher education may be concentrated among families with higher incomes, whereas young white households who enter college come from a more economically diverse pool.

Policy Recommendations

The data in this report indicate that the presence of debt, particularly credit card debt and education debt, is impacting household economic security in a variety of ways. First, those households with these types of debt have fewer financial assets on average and less home equity. In addition, these indebted households are less likely to be economically buoyant; in other words, they are unable to replace three months of income should some-

one in the household lose a job. Unfortunately, this research cannot answer the question of whether or not these indebted households start out with fewer financial assets to begin with, which may explain the presence of credit card and education debt, or whether these households end up with fewer assets due to the accumulation of these types of debts.

The portrait drawn in this report does point to the need for a comprehensive set of policies that can help low- and middle-income households increase their savings and reduce their debt.

BUILDING ASSETS AND REDUCING DEBT

The United States currently does not have a comprehensive savings and asset-building policy, but rather a scattershot set of policies that, when taken together, largely benefit households that need help the least. Even homeownership—the most common source of wealth for families—has become more precarious. In 2006, the National Association of Realtors estimated that 45 percent of first-time homebuyers put \$0 down. Amid declining incomes and inflated home prices, today's young families—the next middle class—are carrying higher mortgage debt than ever and/or finding it difficult to put aside the funds needed to make the all-important life investment of purchasing a home.

The existing patchwork of policies that promote or reward savings and asset-building overwhelmingly benefit households that already have substantial net worth and economic security.

According to analyses by the Corporation for Enterprise Development, while the federal government spent \$367 billion on asset-building policies in 2005, 45 percent of these subsidies went to households with incomes over \$1 million. The largest asset-building expenditure, the home mortgage deduction, is particularly skewed toward the best-off households in America.²³ The bottom half of earners receive 2.9 percent of the tax benefits while the richest 10 percent receive 59 percent. Meanwhile, the bottom 60 percent receive a meager 3 percent of this investment budget. In order to grow and strengthen working families, America needs to embrace a set of principled investments that better target those households for whom a modest subsidy would make a significant difference in building emergency savings and saving for future investments such as college and a down payment on a home. Furthermore, changes must be made to the business practices of the lending industry by addressing abusive and predatory lending practices.

We propose the following framework for future asset-building and debt-reduction policy:

- ▷ **Help Households Save for Emergencies** by enacting policies to promote traditional savings through the creation of universal savings accounts and targeted tax credits that would provide progressively structured credits per the amount saved.
- ▷ **Make Homeownership More Secure** by helping young families save for a down payment and thereby reduce their mortgage debt. *HomeSavers accounts* should be created that provide progressive matches in the form of tax credits.

- ▷ **Expand Individual Development Account** programs to assist low-income families in paying down their debt and build savings that can be used for unexpected expenses or financial emergencies.
- ▷ **Protect Homebuyers from Deceptive and Abusive Mortgage Lending Practices** by establishing strong federal standards that protect consumers throughout the entirety of the mortgage process, including licensure at the federal level for mortgage brokers. Lastly, require that consumers be offered the best possible loan for which they qualify rather than the largest and most costly loan they can be convinced into taking.
- ▷ **Reduce Foreclosures among Subprime Borrowers** by requiring that lenders qualify borrowers based on the fully indexed rate of the loan—not the teaser rate, as is the case with “exploding” adjustable rate mortgages. Additional steps include: encouraging agencies to pursue meaningful enforcement against lenders and brokers whose underwriting practices harm homeowners; requiring that subprime lenders evaluate the borrower’s ability to repay before making a home loan; and outlawing mortgages with pre-payment penalties. Finally, Congress needs to establish a rescue fund to directly help households currently facing foreclosure as a result of aggressive and predatory subprime mortgages with no regard for their ability to repay.
- ▷ **Give Families a Fair Chance to Pay Down Debt by Prohibiting Abusive Credit Card Practices** that allow the lender to change the terms of the account at any time, for any reason; to apply interest rate increases retroactively to existing balances; and to use universal default (see *Dēmos’ Borrowing To Make Ends Meet* report for further detail).

MAKING HIGHER EDUCATION MORE ACCESSIBLE AND AFFORDABLE

Education is one of the keys to income mobility, since the majority of well-paying jobs require at least some college and a 4-year degree is steadily becoming the minimum requirement. Yet, access to higher education has become more elusive and expensive in the last decade. As tuition has soared, rising faster than both inflation and family income, more students have been unable to afford college. At the start of the millennium, over 400,000 college-qualified high school graduates from low- and moderate-income families did not enroll in a 4-year college, and 168,000 did not enroll in any college at all. America needs bold new efforts to increase access to higher education. At the same time, those students who do enroll in and complete college are taking on increasing amounts of student loan debt. Today, two-thirds of college graduates borrow to pay for school and graduate with an average of \$19,200 in student loan debt, which includes private student loans with higher interest and restrictive repayment requirements. Students from lower-income families are more likely to borrow and at higher amounts—making a higher percentage of their income go toward paying debt. Income security and mobility for low- and middle-income Americans will demand that our nation redouble its efforts to making college affordable and accessible. The core of this effort must address the weakening of the federal financial aid system, which over the last two decades has shifted away from a grant-based system to a debt-based system that increasingly relies on private student loans.

- ▷ **Strengthen the Federal Financial Aid System** by enhancing grant aid for low- and middle-income students and providing early and upfront knowledge of the financial aid available to families starting as early as 7th grade. Dêmos has developed a proposal based on these principles—*The Contract for College*—that would dramatically reduce student loan debt and increase college-going rates by providing a guaranteed financial aid package of loans, grants and work-study based on a sliding scale system in which grant-aid would cover from 75 percent of the total cost of attendance for the lowest income students to 40 percent of the cost of attendance for middle-income students.

Conclusion

Debt is impacting the capacity of low- to middle-income households to save, accrue financial assets, and build equity in their homes. As a consequence, these households are less financially secure overall and are more vulnerable to financial collapse due to job loss, major medical illness, or some other catastrophic event. The findings in this report indicate that most low- to middle-income households lack a strong private safety net in the form of assets and savings, and that those households with credit card debt and education debt are in an even weaker financial position. Over the last five years, low- to middle-income households have experienced a decline in household incomes and a substantial increase in the cost of basic necessities such as housing and health care. Rising debt appears to be further eroding their economic security.

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