



Observations and Thoughts

From the
2012 J.P. MORGAN RETIREMENT SYMPOSIUM:
CONVERGING FORCES

The American culture of money –

The changing ways in which Americans interact with their money and the impact on the economy and retirement

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The U.S. savings culture has evolved in a way that is starkly different than cultures in Asia or Europe. These political, social and behavioral dynamics continue to have an impact on Americans' view of money and our ability to save, invest and secure a comfortable retirement.

A HISTORICAL OVERVIEW AND THOUGHTS FROM SHELDON GARON

Savings initiatives driven by government-sponsored institutions and campaigns helped build strong savings cultures in East Asia and Continental Europe. While high savings rates in Japan and the rest of East Asia are widely recognized, Continental Europe also has a long history of successful savings behavior. Beginning in the early 1800s, savings banks and later postal savings banks, which first appeared around 1860, began to proliferate across Europe and beyond. These institutions were targeted at working and middle class people and would accept “small savings” and pay interest. Postal savings banks, in addition to being easily accessible in the local post office, also had the benefit of offering state guarantees. School savings banks were launched in the 1800s, targeting young children as the savers of tomorrow. Children would make weekly deposits on Monday mornings in their classrooms, and the funds would be gathered and deposited on their behalf at the local savings or post office bank.

War savings campaigns were launched and popular in Europe and Asia at the advent of

WWI and later during WWII. These campaigns encouraged people to save to help finance the war effort, emphasizing the importance not of individual savings and austerity, but of national survival. Postwar savings campaigns continued to be popular as many of these nations, damaged and war-torn, began the rebuilding process. In Japan, savings campaigns and initiatives continued for decades after the war. Similarly, even today countries such as France and Germany continue to promote “small savings” accounts and financial education through targeted programs, postal savings, and easily accessible local banks.

In the U.S., savings banks were not nearly as widely spread. While some could be found on the East Coast and in major cities, large portions of the Western and Southern U.S. did not have access to banks. Postal banks in the U.S. only lasted from 1910 to 1966, while school savings banks existed in some districts, but failed to reach most American children.

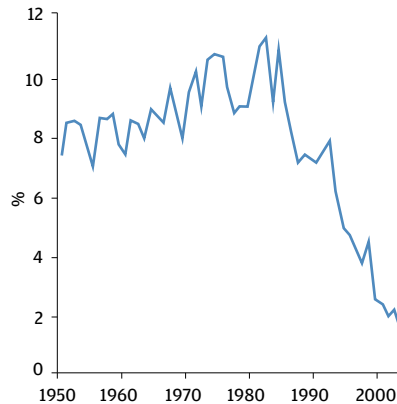
WWII marked the first time that the U.S. government actively promoted small saving at a national level. This occurred in the form of U.S. Savings Bonds, and with the

introduction of the FDIC and similar guarantees for the savings and loans, small savers' accounts in the accessible S&Ls and other small banks rapidly expanded after 1945. However, following the war, America's savings patterns began again to diverge from those in other countries. With thriving productivity, a strong American economy, full employment and no war damage requiring investment in rebuilding, policymakers chose to promote consumer spending – not saving and investment – as the engine of economic growth.

Generally, Americans were not bad savers, averaging between 7% to 11% from 1946 to the 1990s when savings fell sharply. During the post-WWII period, there were a number of factors that contributed to the sharp divergence in American savings habits from those of other countries. In addition to consumption-oriented messaging, home ownership began to be widely promoted as a way to save on a disciplined basis and build a “nest egg.” Many Americans took advantage of the favorable tax treatment of mortgage interest and 25- to 30-year amortized mortgages. For the first several postwar decades, Americans managed both to finance homes and save money. But something snapped in the 1980s. Home equity loans exploded after the 1986 tax reform made interest on them deductible. This led to the rapid expansion of debt as millions of homeowners tapped into home equity credit lines. In addition, deregulation of the credit card industry in the 1980s ushered in a period where middle class, lower-income households and sub-prime borrowers were given access to more credit,

POSTWAR U.S. SAVINGS RATES

Personal Saving
(As a percent of disposable personal income)



Source: U.S. Bureau of Economic Analysis

which ultimately led to a sharp rise in personal debt levels – all against a backdrop of rising income inequality.

In the U.S. today, some 25% of lower-income households lack any savings or checking account, and millions more struggle to maintain accounts in the face of high bank fees. From a public policy perspective, we should look at global best practices and consider revisiting programs such as postal savings banks and other approaches to promoting small savings so as to offer banking access to a broader number of people.

Teaching to save early is important, and the U.S. significantly lags behind other developed nations. In France and Germany,

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THE AMERICAN CULTURE OF MONEY – THE CHANGING WAYS IN WHICH AMERICANS INTERACT WITH THEIR MONEY AND THE IMPACT ON THE ECONOMY AND RETIREMENT

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banks and governments are proactive about encouraging children to begin saving early. By the time children are eight or nine, parents are often approached by their bank about opening savings accounts. In contrast, in the U.S. young people cannot legally withdraw money from their own accounts until they are 18. Financial education should also go beyond saving to include budgeting, credit, investment and other aspects of financial literacy.

VIEWS AND PERSPECTIVES FROM RAY BOSHARA

The household balance sheet effect is a relatively new conceptual framework and financial measurement for the Federal Reserve System. It looks beyond earnings and income and includes all assets, such as savings, debts, investments or other holdings. It is a measure that assesses a household's ability to move forward economically and to contribute to the growth of the economy.

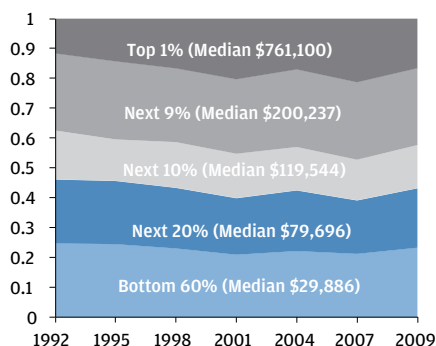
We need to appreciate the current transformative moment. There are striking similarities between today and the Progressive Era, which lasted roughly 30 years from 1880 through 1910. Similar to then, today we face growing inequality, double-digit unemployment, a health care system in crisis, rising fundamentalism, a large and well-organized elderly lobby, important technological changes, stunning progress in science, massive consolidation among corporations, a large number of unbanked Americans, widespread and nefarious lending

practices and new sources of energy leading to mounting environmental concerns. In the earlier period, Progressives responded by creating regulatory regimes for Wall Street and the banking sector that prevented any need for a massive taxpayer bailout. They also created the Federal Reserve system, instituted the progressive income tax system, sponsored the Pure Food and Drugs Act, stopped predatory lending, adopted new sources of cleaner energy and instilled values of thrift, conservatism and public service – all while leaving no legacy of public debt. Ultimately, they accomplished a great deal. So the question is whether we can achieve as much. I'm optimistic about getting there again with a vision for inclusive growth.

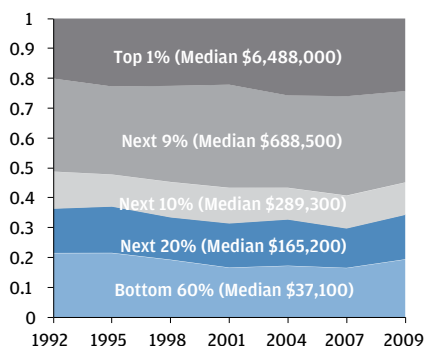
Income is not likely to grow evenly or significantly. So what will replace the American consumer as the engine of economic growth? No one is quite sure, but a key principle of the book *Why Nations Fail*, by Daron Acemoglu and James Robinson, is the premise that both inclusive economic and political institutions are necessary, with ownership in capital-building opportunities often required for achieving inclusive growth. Today, an entire section of the population is not contributing to or sharing in economic growth. We need to find ways to establish more inclusive banking and other economic institutions to enable the bottom half to fully participate in the economy. The 20th century saw the democratization of credit; the challenge in the 21st century will be the democratization of capital. Without this, we cannot get the balance sheet, or our nation's economic growth, right.

BUT WE'VE GOT A LONG WAY TO GO: THE DISTRIBUTION OF INCOME VS. WEALTH

Income



Net Worth by Income Grouping



Source: Federal Reserve, Survey of Consumer Finances. Note: Medians are as of 2009.

Wealth inequality dwarfs income inequality. The real issue is that the bottom half have so little wealth comparatively. One in three Americans has less than \$10,000 in net worth, and one in six has zero or negative net worth. The fact that so few have ownership is one of the fundamental challenges of our time, not inequality per se. Wealth-building institutions, including financial firms, U.S. government policies, employers and the income tax system and code, contributed to wealth inequality by encouraging higher income households to build wealth while not reaching those with lower incomes.

Some \$400 billion to \$500 billion of savings has accrued to the wealthiest families, largely through the tax code. Families making \$50,000+ per year receive more than 90% of the benefit of these tax savings and wealth accumulation gets more generous

as wealth increases. Institutions in America, rather than building wealth from the bottom up, are redistributing it up the ladder. Tax provisions, such as mortgage deductions and those favoring 401(k) savings, have inadvertently helped the people who would save and build wealth anyway.

The banking landscape is very bleak for the bottom half. They need more access to quality banking institutions – 26% are unbanked, underbanked or unhappily banked. This population segment does not have access to the same institutions we do. For example, if you have an employer 401(k) plan, everything is done for you – direct access to a savings vehicle, easy payroll deductions, a selection of investment options and financial literacy information are all easily accessible. In sharp contrast, lower-income people face a wealth-depleting environment of check-cashing

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stores, payday loan providers and aggressive lenders with above-market interest rates. Our challenge is to create more wealth building for the entire population. We need to make the business case for helping the bottom half save and make it easier to serve this population, perhaps through technological advances. By doing so, we'll allocate capital more fairly and help the economy grow at the same time.

The importance of saving early cannot be overemphasized. Studies show that children with savings accounts are seven times more likely to go to college than those without them – and this is true even when you hold constant parental education and academic achievement. Some examples of innovative approaches include the now discontinued Child Trust Fund that was established in the U.K. in 2002. The program, which was in effect for nearly eight years, put aside 250 British pounds at birth for every child and an additional 250 British pounds for low-income children. At age seven, another 250 pounds was put in for all low-income children in the program. The funds were then available at age 18. Studies of the Child Trust Fund showed savings by families at all income levels. Other interesting programs include K2C, a program in San Francisco that establishes a college savings account for every kindergartner, as well as SEED for Oklahoma kids, which sets up a 529 plan at birth for 1,300 Oklahoma children and compares the path of those to 1,300 children who do not have an established 529.

Think small and think big when it comes to establishing policies that will help the bottom half and distribute wealth more equitably. There are small tweaks to the tax system that would help people save more, including tax form 8888 that helps individuals save by letting filers split their tax refunds into as many as three savings-oriented accounts, which could include an IRA or an account with Savings Bonds. We should also think big by considering the tax provisions that expire at the end of this year, which will put billions of dollars on the table that might potentially be reallocated to help the bottom half save and build wealth. A savings account at birth, like the Child Trust Fund in the U.K., would also be a great idea.

In the U.S., no financial products exist in which children can easily save or invest for the long term. We must address this issue in order to promote early saving. If we cannot afford a subsidized savings account at birth for every child, then one avenue of progress may be through a proposal for a new children's Roth IRA – a "Roth at Birth" – which was recently recommended by the President's Advisory Council on Financial Capability. The earlier you educate children, the better and the more ingrained good savings behaviors will be. In particular, studies show that connecting account ownership and financial education results in better financial outcomes. So it's critical that every child own and contribute to a savings account earmarked for his or her future.