

EXECUTIVE SUMMARY

Although research on the determinants of saving and asset accumulation is extensive, it remains inadequate for policy purposes. Most theories of saving point to individual characteristics to explain low levels of wealth. Relatively few studies offer research that could inform policy for increasing wealth. This report examines the following question: What factors determine financial asset building? More specifically, this report:

- summarizes existing theories of saving and asset accumulation;
- presents a conceptual framework for the determinants of asset building; and
- reviews empirical evidence that supports or challenges this framework, and suggests directions for future research.

Theories of the Determinants of Saving and Asset Accumulation

Existing theories of the determinants of saving and asset accumulation may be classified into three categories: (1) neoclassical economic, (2) psychological and sociological, and (3) behavioral economic. Neoclassical economic models assume that individuals are rational beings who respond in predictable ways to changes in incentives. Many economic models also assume that individuals have perfect knowledge and access to perfect markets. Early models put primary emphasis on income and age (or stage in the life cycle) as predictors of saving and asset accumulation. More recent models have emphasized the desire to leave a bequest, the desire for precautionary savings, and, most recently, the effects of public policy on precautionary saving. The most recent models are an important advance because they are more explicitly policy-oriented and because they suggest a possible policy pathway for increasing wealth.

Psychological and sociological theories consider additional determinants of saving, including personality characteristics, aspirations, expectations, and peer and family influences. Although these factors may help explain low levels of wealth in the low-income population, they offer few clear policy recommendations for increasing wealth.

The behavioral economic theory of saving is rooted in neoclassical economic theory but rejects the assumption that people are rational and all-knowing. Behavioral theorists have identified a number of common human characteristics that shape financial behavior, including lack of self-control, limited cognitive abilities, inertia, the tendency to interpret default options as “advice,” and the tendency to use mental accounting techniques. The number of empirical studies examining behavioral propositions is growing rapidly, and most of these studies provide support for behavioral theory. Behavioral theory has sometimes stopped, however, with this emphasis on individual deficiencies. To inform policy, theory could move beyond this focus on individuals to emphasize institutions that can encourage saving and asset accumulation by accounting for, and perhaps even taking advantage of, individual tendencies. These institutions are the focus of the conceptual framework described below.

Conceptual Framework for the Determinants of Asset Building

The conceptual framework offered in this report flows from an emerging institutional theory of saving and asset accumulation. In this framework, both individual and institutional constructs affect saving and investment, which in turn lead to asset accumulation (see Exhibit ES-1). The framework also acknowledges inter-household sources of asset accumulation through *inter vivos* transfers and inheritances, but these are not the focus.

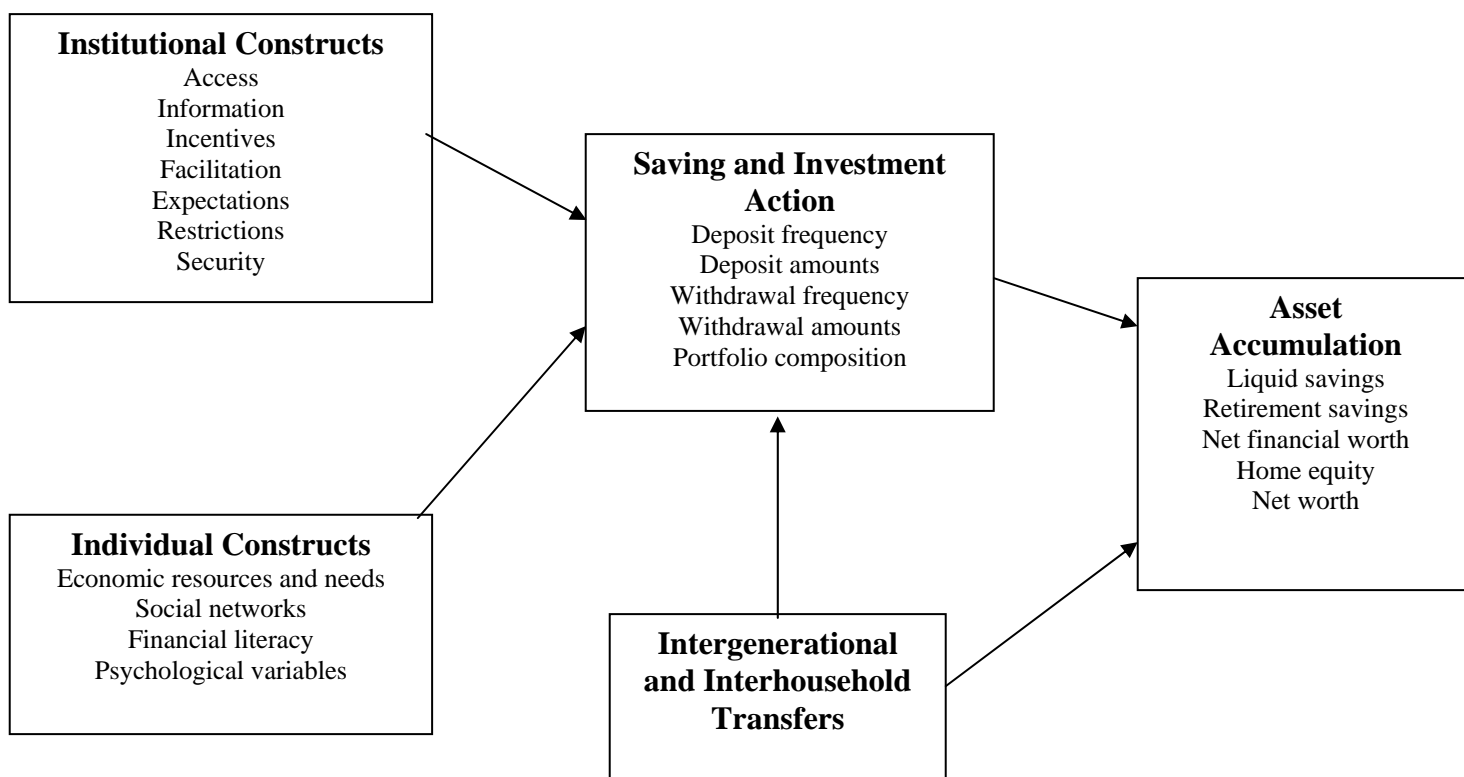
This conceptual framework includes individual constructs: economic resources and needs, informal support for saving, financial knowledge, and psychological variables, such as future orientation and saving-related attitudes. These individual constructs (and probably others not yet identified) are relevant because individual choices can affect asset accumulation and because knowledge of individuals can lead to the design of institutions that more effectively encourage saving and asset accumulation. However, this framework places less emphasis on individuals than do the major economic, psychological, and behavioral perspectives on saving.

The framework emphasizes institutional constructs that shape saving behavior and outcomes. The term *institutions* refers to purposefully-created policies, programs, products, and services that shape opportunities, constraints, and consequences. From an institutional perspective, saving and asset accumulation are in large part the result of structured mechanisms. For the non-poor, these mechanisms include deductions for home mortgage interest and property taxes, exclusions for employment-sponsored pension contributions and earnings, tax deferments for Individual Retirement Accounts (IRAs) and Keogh Plans, and employer contributions and tax deferments for employee pension plans. Low- and moderate-income households, with little existing savings, do not have the same access or receive the same incentives from institutions that promote and subsidize asset accumulation (Howard 1997; Seidman 2001; Sherraden 1991).

The aspects of institutions designed to promote saving and asset accumulation may be organized according to seven constructs: (1) access, (2) information, (3) incentives, (4) facilitation, (5) expectations, (6) restrictions, and (7) security. Each of the constructs has direct policy relevance. Access refers to eligibility and practicality. Information includes both general financial information and information that is specific to a particular financial product or program. Incentives include subsidies and rates of return. Facilitation refers to any form of assistance in saving, especially making saving “automatic.” Expectations are implicit or explicit suggestions about desirable saving, investment, or asset accumulation. Restrictions are rules that restrict access to or use of assets. And security is freedom from unreasonable risk in saving and asset holding. Each of these constructs is expected to shape saving and investment action and, as a result, to affect asset accumulation.

In the “real world,” these constructs tend to exist in “bundles” rather than in isolation. These bundles, supported through public policy, tend to be delivered through employment settings and settings and through the tax system. A 401(k) plan with an employer match, for

Exhibit ES- 1. Determinants of Saving and Investment Action and Asset Accumulation



example, provides several institutional supports for saving, especially incentives, facilitation, restrictions, and information. For the most part, those who have jobs with benefits, those who are homeowners, and those who are “investors” have access to these bundles of institutional supports. Low-income households benefit much less from these bundles than others. There are some asset-building policies and programs targeted specifically to low-income households, but these initiatives are small and, overall, provide much less support for saving and asset accumulation than the programs that largely benefit middle- and upper-income households.

Empirical Evidence on Determinants of Asset Building

Effects of Individual Constructs on Saving and Investment Action

There have been few direct tests of the hypotheses proposed here regarding individual constructs. This may indicate that the most important individual constructs have not been identified, or it may indicate that the suggested propositions are not tested because they are perceived to be truisms. The latter is more likely the case at least for the propositions that (1) economic resources and needs and (2) financial knowledge affect saving and asset accumulation. The clearest empirical evidence related to these individual-level propositions shows that the average

American has very low financial literacy, that retirement and precautionary saving motives are the most common motives, and that saving is difficult when economic resources are limited. This evidence is descriptive and may only indirectly relate to the propositions offered here. There is some very limited evidence that informal support affects saving and asset building.

Effects of Institutional Constructs on Saving and Investment Action

The most-researched institutional construct is incentives. There is some evidence that matches increase participation in saving programs, and even more evidence that matches increase contributions to these programs. Evidence is mixed regarding the effect of matches on net saving (across all saving vehicles); contributions to incentivized saving programs are probably a mix of new savings and shifted assets. With regard to saving disincentives, evidence suggests that income transfer programs such as Temporary Assistance for Needy Families and Supplemental Security Income may reduce asset accumulation by low-income households. Recent studies examining increases in asset limits associated with welfare reform have some inconsistent results, so it is not yet clear whether loosening asset restrictions will increase saving by low-income households. (For example see McKernan, Ratcliffe, and Nam 2007.)

The importance of access is suggested by the fact that those who are not offered a retirement savings program in the workplace tend to have very little retirement savings, but beyond this, the construct of access has not been well specified and investigated. There is a fair amount of evidence on financial education (one method of providing financial information). A number of studies suggest that financial education improves financial outcomes, but many of these studies are vulnerable to selection bias and social desirability bias. A growing body of evidence, including the results of two rigorous studies, supports the hypothesis that facilitation shapes saving action. With regard to restrictions, it is clear that some people choose restrictions and believe restrictions help them protect their savings. Low participation rates in IRAs, 401(k)s, and 529 college savings plans seems to suggest, however, that many are not comfortable with restrictions, at least as currently structured. Evidence regarding expectations is limited and mixed. In the United States, there is very little direct evidence related to security, though security is known to be an important factor in less developed countries.

Suggestions for Future Research

The summary of empirical evidence provided in this report reveals a number of gaps in knowledge. Of special interest are gaps that limit ability to design programs and policies that facilitate saving and asset building in low-income households. Some research questions that may provide additional policy-relevant knowledge include the following:

- Under what conditions is homeownership a good asset-building strategy for low-income households? What are effective strategies for helping potential homeowners make wise choices about ownership?

- Does health insurance coverage facilitate saving and asset building for low-income households?
- Does financial education change financial knowledge, attitudes, and behaviors in ways that lead to increased saving and asset accumulation in low-income households? Does well-targeted financial information that is delivered automatically to individuals produce these outcomes?
- What match structure (i.e., match rate and match cap) maximizes participation in incentivized saving programs? What match structure maximizes contributions? What match structure maximizes net saving (across all saving vehicles)? Do these findings vary by income or education level?
- Does relaxing the asset limits in income transfer programs lead to increased saving and asset holding?
- Under what circumstances do people want restrictions? Under what circumstances do they want liquidity? Do these patterns vary by income or education?

Some of the most promising avenues for future research would require new policy interventions, not just new or improved data sources. New interventions would be indicated in at least two scenarios: where there is no existing initiative with the institutional characteristic, or bundle of characteristics, of interest; and where researchers want to examine rigorously how actual behavior responds to varying institutional characteristics, and no existing program has systematically varying institutional characteristics.

An important line of experimental or quasi-experimental research would involve match structure. This research focus is promising because existing studies suggest that people (across the income spectrum) respond to financial incentives, but these studies do not identify “optimal” match structures. Like questions about match structure, questions about the demand for restrictions and liquidity would be best answered with an experiment or quasi-experiment designed around a new intervention. Questions about financial education and financial information could be answered with new interventions, or research plans might be carefully designed around existing interventions. In lieu of interventions with impact assessments, some insights could be gained from carefully constructed survey questions that ask individuals how they feel about, and whether they would save in, saving products with different restrictions.

In short, data requirements to answer research questions identified here vary substantially, but some of these research pursuits would require a large investment. For the purpose of designing programs and policies that facilitate asset building in low-income households, there is a particular imperative for research using low-income samples.

Conclusions

The assumption of this work is that better theory can build knowledge that will inform and improve policy. From this perspective, institutional features can be *purposefully created and put in place* by public policy. This is not a social scientific perspective that seeks only to understand social forces and behaviors, but rather it is an applied agenda that seeks to inform policy design and implementation. While a fully developed and integrated institutional theory of saving and assets does not yet exist, the identification of institutional constructs and related empirical evidence informs policy development and also lays the groundwork for future research.