PART ONE

CHAPTER ONE

I'd Rather Be Rich

This book is about wealth mobility. It is about how some people get rich while others stay poor. In particular, it is about the paths people take during their lives and how these paths influence how well-off they become. In the 1964 movie *I'd Rather Be Rich*, people were typical in their willingness to go to great lengths to get rich. In the movie, the goal was to inherit from a dying grandfather, but people have all manner of ways of trying to hit it big. There is a general sense that being rich is better than not being rich, but wealth – and the processes that lead to wealth ownership – may be even more important than most people realize.

Wealth is the things people own, including their homes, savings, investments, real estate, businesses, and vehicles. It is usually measured as net worth, the sum of assets less the sum of debts. Owning wealth has many advantages, from the obvious financial freedom it provides to the even more enduring social and political privileges and power accessible to the wealthy. These advantages and the elusive nature of true wealth make questions about who is rich and why broadly appealing. Dramatic economic changes in recent years, accompanied by rising wealth inequality, have created renewed interest in wealth. These changes have also generated speculation about new patterns in the ways people become wealthy. The visibility of Internet millionaires created speculation that there may be an increasing number of entrepreneurs among the wealthy, and the subsequent devaluation of technology stocks and the bankruptcy of scores of dot-com companies raised questions about the role the sectoral shifts play in wealth ownership. Through all this, an increasingly skewed wealth distribution has raised questions, at least in some corners, about why there continue to be people who accumulate little even during periods of unprecedented economic growth.

While basic facts about wealth ownership and inequality are no mystery, we still know very little about who is wealthy and why. That is, we still know very little about wealth accumulation and wealth mobility. Wealth accumulation is the way people acquire assets and debts during their lives. Wealth mobility refers to changes in relative positions within the distribution of wealth. That is, if all people were sorted according to how much wealth they have, mobility refers to how a person's position in this list changes over time. Clearly, wealth accumulation is central to these changes. Those who accumulate assets quickly are going to move upward more rapidly. Of course, wealth mobility is also related to wealth distribution. Given that wealth ownership is highly concentrated and that it has become more concentrated during the time I will be considering here, moving into the upper positions in the distribution is difficult.

Researchers have shown that there is considerable concentration of wealth ownership and have estimated trends in the growth of wealth owned by households. There are also estimates of the role that macroeconomic and demographic trends played in shaping recent changes in wealth ownership. Yet the processes by which people accumulate wealth, the way their wealth ownership changes over their lives, and the way their positions in the distribution change over time have received little attention. This book explores wealth by investigating some of the most basic questions about wealth mobility, such as: How much mobility is there? Has the nature of mobility changed over time? Who is rich? Are most wealthy people entrepreneurs, did they inherit their wealth, or did they become wealthy in some other way? And what behaviors and processes in middle- and working class families propel some people out of these classes while others remain poor throughout their lives?

The starting point for this book is the notion that understanding wealth and the processes that create wealth are not only interesting but also of critical importance to understanding the way people sort themselves socially and economically. That is, understanding wealth ownership is central to understanding inequality. The approach used here directs attention primarily toward the paths people take during their lives in order to understand how these paths shape the distribution of wealth. From this perspective, life paths include the starting point as well as many of the key points of change people encounter during their lives. Being born into a wealthy family, of course, makes it easier to be wealthy as an adult. But decisions about education, work, marriage, children, and saving also matter, and these interact with each other in complex ways to create trajectories. The paths people take are also a product of circumstances and influences that individuals do not directly control but that impede or enhance these trajectories. To understand why people occupy certain positions in a distribution, it is necessary to understand how these processes interact. The objective of this book is to explore the life paths that underlie wealth mobility in order to better understand both the wealthy and those who never become wealthy.

Wealth and Well-Being: Are the Rich Really Better Off?

There is growing evidence that having wealth, at least some wealth, is critically important to well-being. *Wealth* is the value of the property that people own. It is *net worth* or total assets less total debts. For most families, this includes tangible assets such as the family home and vehicles. Other families also own vacation homes, other real estate, and business assets. In addition, assets include financial wealth such as checking and savings accounts, stocks, bonds, mutual funds, Certificates of Deposit, and other financial assets. Debts or liabilities include mortgages on the family home, other mortgages, consumer debt, student loans, car loans, home equity loans, and other debt to institutional lenders or informal lenders such as family members. *Financial wealth* is the value of liquid assets, such as stocks and bonds, but does not include housing wealth or the value of business assets or investment in real estate. Wealth is different from income. *Income* is a flow of money over time, such as wages and salaries from work, government transfer payments, or interest and dividends earned on investments. Unlike income, wealth is not used directly to buy necessities such as food and clothing; rather, wealth is the total amount of property owned at a point in time.

Studies of inequality and the distribution of financial well-being tend to focus on income and how income changes over time. However, wealth may be an even more important indicator of well-being because it provides both direct financial benefits and other advantages. The family home, for example, provides shelter and other current services to the owner. At the same time, home ownership can be one of the most beneficial investments a family can make. Wealth also provides a financial cushion that can alleviate the impact of an emergency. For those without savings, a medical emergency, the unemployment of a primary income earner, or a family breakup can be devastating. Wealth can be used to directly generate more wealth if it is invested and allowed to accumulate. It can also be used to indirectly generate more wealth if it is used as collateral for loans for further investments, such as in the purchase of a home or business. Wealth can be used to purchase luxuries, and it can be used to buy physical protection and a safe and pleasant living environment. In the extreme, wealth can also buy leisure when its owner is able to decide whether to work or not. When family savings provide sufficient current income, income earned from wages and salaries is unnecessary.

Wealth ownership may also generate political and social influence. In a representative democracy, the distribution of political influence is often related to the distribution of wealth, and wealth carries with it social connections that can be used in important ways. Wealth expands educational and occupational opportunities for the current owner, and because wealth can be passed from one generation to the next, it often expands educational and occupational advantages intergenerationally. Of course, the truly rich may attract media attention, solicitations for donations, and other unwanted recognition. Wealth also invites security threats, may be socially isolating, and can dampen motivation. Yet the benefits of wealth ownership generally outweigh the disadvantages, and most agree that the rich are generally better off as a result of their asset ownership.

The Allure of Wealth: Why Does Wealth Fascinate Us?

The rich have perhaps always been fascinating, and dramatic changes in economic conditions in recent years created even more interest in wealth and the wealthy. Social registers and other written accounts of the lives of the wealthy captivated attention in earlier eras much like magazines and television shows that offer a glimpse into the lives of the rich do today. During the 1990s, changing economic conditions drew even more attention to wealth accumulation. Spectacular stock market booms, sustained economic growth, low inflation, low unemployment, and decreased fear of historic international rivals combined to create economic conditions that matched or surpassed numerous historic records. A subsequent economic slowdown reminded investors that good economic times must eventually become more normal. Before the downturn, however, there were important changes in the amount of wealth owned by households, changes in who owned it, and changes in how it was distributed. The magnitude of these changes generated new interest in who gets rich and how.

Expanding Interest in Wealth

The total wealth owned by American households began to grow in the 1960s, and it continued to expand through the 1990s. Total household assets increased more than four times during that period, from about $8 trillion in 1960 to more than $33 trillion in 1994 (all estimates are in year 2000 dollars unless otherwise noted). By the end of 1999, total household assets were valued at more than $50 trillion, decreasing to just more than $45 trillion at the end of the first quarter of 2001. Figure 1.1 illustrates the extent of growth of assets and liabilities held by households during the late 1990s and shows that changes in net worth reflected changes in assets more than they reflected changes in liabilities. During the 1980s and 1990s, fluctuating real estate prices increased the importance of housing assets in the portfolios of American households. There were bigger shifts, however, in the role of financial assets in the portfolio, particularly stock assets.

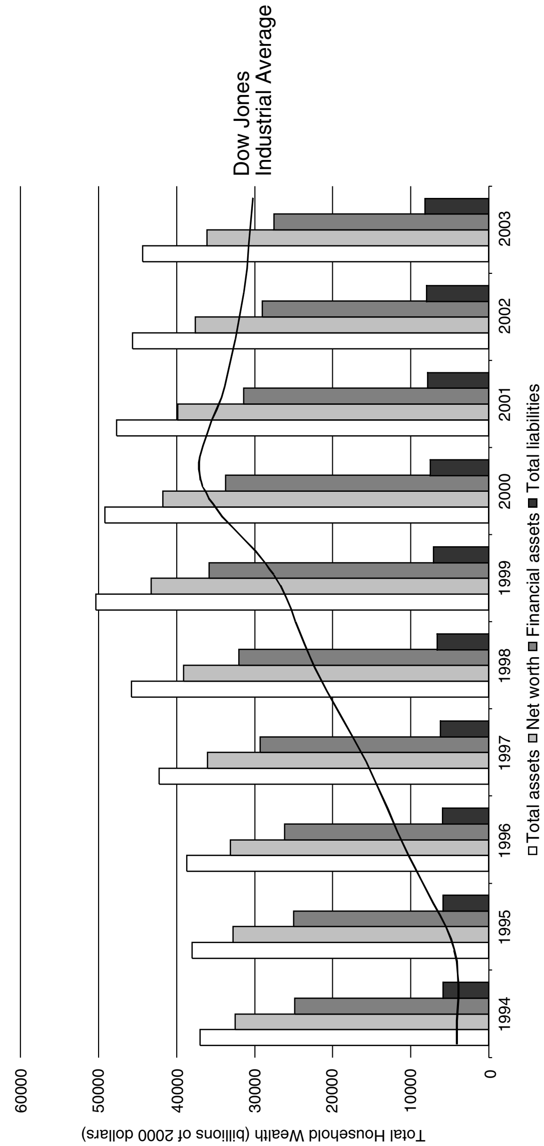

Figure 1.1. Trends in household wealth: Wealth owned by all U.S. households, 1994–2003. *Note:* Wealth values are from the Federal Reserve Board's *Balance Sheets of the U.S. Economy* converted to 2000 dollars using the Consumer Price Index (Federal Reserve System 2001). Dow Jones Industrial Average ranges from $3,700 in 1994 to a high of $11,400 in 2000 (scale not indicated on graph). Values for this figure are included in the Appendix.

Indeed, changing stock market values had a relatively large effect on household wealth throughout the 1990s and beyond 2000. During the 1970s and early 1980s, the stock market was relatively stable, and middle-class families were relatively unlikely to own stocks. This changed in the late 1980s and 1990s, when stock market booms, combined with increased availability of stock mutual funds, made stock ownership both more common and more lucrative for families. The trend line imposed over Figure 1.1 indicates the Dow Jones Industrial Average during the period included in the graph. During the later years included there, many households watched their portfolios expand enormously. Decreasing stock values between 2000 and 2003, however, also accounted for much of the decline in household assets at the end of the period pictured in the figure. As the economy slowed, many of the same households were forced to watch the value of their portfolios diminish almost overnight. More recently, increases in stock values are once again increasing household wealth, a testament to the importance of aggregate trends in outcomes at the household level.

Figure 1.2 focuses on changes in the composition of household wealth ownership that occurred between 1994 and 2003. The figure illustrates the percentage of total household assets that was accounted for by real estate, corporate equities, and mutual fund shares during that period. Between 1994 and 1999, the relative importance of housing wealth declined while the importance of corporate equities and mutual funds increased. These trends reflected inflated stock prices and a growing propensity for households to own corporate equities and (to a lesser degree) mutual funds, rather than changes in the propensity of households to own homes. Corporate equities and mutual funds became an increasingly significant portion of American household portfolios during the 1990s. At the same time, saving and investing increased during the mid-1990s because favorable economic conditions made investing more appealing, because baby boomers had begun to increase their saving for retirement around that time, and because changes to financial instruments created new opportunities for families to save. The introduction of Individual Retirement Accounts, for example, allowed some Americans

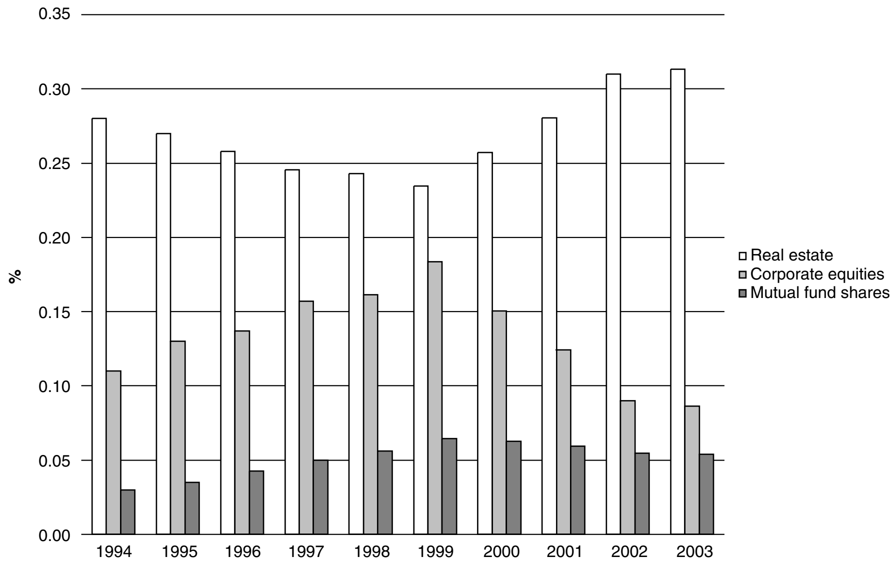

Figure 1.2. The relative importance of real estate and stock in family portfolios. *Note*: Estimates are from the Federal Reserve Board's *Balance Sheets of the U.S. Economy* (Federal Reserve System 2001). Corporate equities are at market value. Mutual fund values are based on the market values of equities held and the book value of other assets held by mutual funds. Real estate includes vacant land and vacant homes for sale. Estimates for 1994–2002 are for end of the year; values for 2003 are for the first quarter.

to save for retirement, tax-free, in ways in which they were not able to in the past. Similarly, while mutual funds have been around for decades, they also became easier to use during the 1990s, and more people accordingly began to save at least a small amount in mutual funds. Technological and other changes, such as the ability to invest easily on the Internet, also changed the way people save. In particular, during the 1990s, it became relatively common to buy stocks, bonds, mutual funds, Certificates of Deposit, and other financial assets online.

Beginning in 2000, the relative importance of real estate in total household wealth increased while the importance of stock ownership declined. This trend reflected declining stock values, evident in Figure 1.1. However, it also reflected increasing home ownership rates and the ability of families to pay off mortgages resulting

Table 1.1. *Household Wealth*

	1989	1992	1995	1998	2001
Net worth					
Mean	239,110	247,340	228,75	283,230	325,180
Median	60,700	51,300	50,220	63,600	65,690
% WITH ZERO OR NEGATIVE	18	18	19	18	17
Financial wealth					
Mean	190,800	188,300	175,540	222,400	254,900
Median	14,200	12,300	11,100	18,650	19,800
% WITH ZERO OR NEGATIVE	27	28	29	26	25

Note: Estimates from the Surveys of Consumer Finances. All monetary values are in 2000 dollars.

from declining mortgage interest rates. In the late 1990s and early 2000s, the proportion of families owning their primary residence increased by 1.5 percent to nearly 68 percent, and mortgage interest rates reached historic lows (Aizcorbe, Kennickell, and Moore 2001). As a result, more families owned homes, and home equity increased, contributing to a relative increase in the importance of real estate in the household portfolio.

Consistent with these patterns, wealth ownership at the level of families fluctuated quite a bit, with those at the upper ends of the wealth distribution enjoying most of the gains. In the early 1960s, mean net worth was about $116,000 (in 2000 dollars), but it has been consistently greater than $170,000 since the early 1980s. Similarly, financial wealth increased from about $92,000 to more than $134,000 between the 1960s and the late 1990s. Table 1.1 summarizes trends in wealth ownership between 1989 and 2001. Changing stock and housing values caused mean net worth to fluctuate somewhat dramatically over that time, particularly at the upper levels of the distribution. Median net worth (the central value in the distribution) varied less in response to stock market changes and is perhaps a better indicator of the true average household wealth. What is perhaps most noticeable from these estimates is that while net worth fluctuated, the percentage of the population that owned no wealth remained high throughout this period. In each year included in the table, at least 17 percent of households had no net worth, and at least