

Office for Financial Success – Financial Tip of the Week  
 A service of the Personal Financial Planning Department  
 College of Human Environmental Sciences  
 University of Missouri-Columbia  
 (08/14/2009)

**Who’s on first?**

Sometimes we want to know where we stand, when compared to others. Economists call this behavior, with regard to saving and spending our money, the “relative income hypothesis”. (The relative income hypothesis has been credited to J. S. Duesenberry. He wrote about it in his Harvard Ph.D. dissertation: *Income, Saving and the Theory of Consumer Behavior* in 1949.) Simply put, we spend our money to buy things according to the social class to which we perceive we belong. If our income increases, we ratchet up to the next social class and, if our income decreases, we ratchet down to a social class that we perceive to be lower. The trouble is that we generally find people ratcheting up much faster than they ratchet down.

The other day I was reading an insert to the *Journal of Financial Planning* (June 2009) and saw a table on “Income, Assets, and Liabilities by Income Group” compiled from data collected by the US Bureau of Labor Statistics in their annual Consumer Expenditure Study. The data below come from 2007 and may be found in Table 2301 at <http://www.bls.gov/cex>. (There is additional information on the make-up of the families in each group that is represented in Table 2301, such as sources of income, average value of owned housing, average age, how much money each group spends in different expenditure categories, and other data that academics and policymakers find interesting. Perhaps, you will find it of interest.)

Income, Assets, and Liabilities by Income Group

	<\$70,000	\$70,000- \$79,999	\$80,000- \$99,999	\$100,000- \$119,999	\$120,000- \$149,999	\$150,000 and more
Income before taxes	\$32,745	\$74,679	\$88,830	\$108,502	\$132,523	\$243,376
Income after taxes	\$32,137	\$72,129	\$85,638	\$103,496	\$126,792	\$230,849
Average annual expenditure	\$34,109	\$58,005	\$67,640	\$77,838	\$91,864	\$126,443
Net change in total assets	\$4,558	\$12,275	\$10,888	\$11,112	\$32,520	\$54,731
Net change in total debts	\$7,436	\$17,820	\$18,444	\$18,608	\$39,141	\$38,247
Net change in net worth (Net change in total assets less net change in total liabilities)	(\$2,877)	(\$5,544)	(\$7,557)	(\$7,496)	(\$6,621)	\$16,484

As did the *Journal of Financial Planning*, I found it to be instructive and of interest to note the differences in assets and liabilities across income groups. The group with income in the \$80,000 to

\$99,999 range was “the spendthrift” group, adding \$18,444 to their liabilities, while only adding \$10,888 to their assets. This can be seen easily, as the group has a “net change in total assets and liabilities” of a negative \$7,557 – a greater negative than any other group. Unfortunately, only the highest income households, those with average incomes of \$243,376, demonstrated a propensity to save money, as indicated by a change in assets greater than their increase in debts (liabilities). Moreover, the stock market, as indicated by the Standard & Poor’s 500 (adjusted for dividends and stock splits), closed slightly higher in 2007 (1468.36), than in 2006 (1418.30)!

Another thing to point out, as many of our student readers are in this income group, is that those in the lowest income category, under \$70,000, on average, spent more than their after-tax income. Fully 69% of the American population is in this group! Granted, we don’t know if they spent this money due to a financial hardship, to make tuition payments, to make ends meet, or to keep up with some mythical “Jones Family” down the street. All we know is that the average American family, except those with incomes over \$150,000 (representing less than 7% of American households), borrowed more than they saved and the 69% with income below \$70,000 spent more than they earned.

Ask yourself if this behavior is an ingredient to the recipe for *financial success*? On the other hand, is this simply another fact that makes us shake our head and hope that all of us have learned some valuable lessons over the past 10 months? No one has control over how you spend your money other than you and, frankly, it shouldn’t take a world-wide financial crisis to force Americans, all of us, to wake-up and start taking care of business – starting with the finances of our own family.

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