Enabling Families to Weather Emergencies and Develop

The Role of Assets

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CONTENTS

ENABLING FAMILIES TO WEATHER EMERGENCIES AND DEVELOP

The Role of Assets

Low-wage jobs can be unstable, leaving families struggling to cope with employment gaps and financial emergencies that can strike without warning. Such means-tested social programs as Temporary Assistance for Needy Families (TANF) and Food Stamps and such social insurance programs as Unemployment Insurance can help families weather hard times, but not all families are eligible for these benefits. For example, only 22 percent of low-income families with an unemployed worker for some part of 2006 received unemployment insurance benefits. Further, these program benefits may not cover families' rent, utilities, and food. One potential solution to this problem is asset building: savings and assets can help low-income families weather unexpected employment gaps or pay unexpected medical and car-repair bills, as well as realize such long-term goals as owning a home or financing retirement. This essay discusses low-income families' needs for assets and examines promising policies aimed at addressing them.

Asset Holdings of Low-Income Working Families

Most low-income working families have too few assets to weather emergencies. Over three-quarters of low-income working families are "asset poor"—without enough assets to finance consumption for three months at the federal income poverty level.[1] Yet, unemployment spells average two to four months (Caner and Wolff 2004; Vroman 2007). If only financial (i.e., liquid) assets are considered (e.g., savings, 401(k), bonds), then nearly 80 percent of low-income working families are asset poor[2]—highly vulnerable to eviction and other financial vagaries and assaults. The asset picture improves if net worth is considered, but it is still tenuous.[3] In this case, just under half (44.9 percent) of low-income working families are asset poor. While an improvement, this still leaves roughly half of families in precarious financial situations. At the bottom of the asset totem pole, nearly 30 percent of low-income working families have zero or negative net worth. Overall, the median net worth among low-income working families is $6,565 (table 1).

Table 1. Asset Holdings for Low-Income Working Families, 2003

	Ownership percent	*Mean*	*Median Holdings by Income Percentile* 25th	50th	75th
Net worth	73.5%[a]	$73,892	$0	$6,565	$56,350
Bank accounts	56.5%	$5,249	$180	$800	$3,000
Retirement accounts	21.2%	$26,016	$3,000	$10,000	$26,000
Home equity	45.6%	$87,227	$17,000	$45,000	$110,000
Car equity	82.5%	$3,583	$750	$3,700	$6,800

Source: Author tabulations from wave 9 of the 2001 SIPP panel, conducted in 2003.

Note: Low-income working families are families with children whose members worked at some point during the prior 12 months and whose income is less than 200 percent of the federal poverty threshold.

[a] "Ownership percent" for net worth is the percent of low-income working families with positive net worth.

A closer look at low-income working families' asset holdings reveals that the typical family has limited savings and does not own a home or have a retirement account. Many such families have no car. A slim majority (56.5 percent) of low-income working families has a bank account,[4] but often it is too small—$800 is the median—to see a family through even a short employment gap or other financial emergency. These overall numbers mask asset differences by age, race, and family structure. The percentage of low-income working families with bank accounts, for example, differs by nearly 30 percentage points across racial and ethnic groups, from 67 percent for white families to 44 percent for Hispanic families and 38 percent for black families. Earnings among families with bank accounts also differ by demographic group. For family heads from age 30 to 39, the median is $707, rising to $1,460 for those age 50 to 60. Similarly, the median level of bank account savings is $305 for single female-headed families and $1,000 for two-parent families.

Few in this population save for retirement. Only 21.2 percent of low-income working families report having any type of retirement account (table 1). Families headed by older adults are slightly more likely to have one—26 percent versus 17 percent. These accounts have a median value of $10,000— not much when spread out over an individual's expected retirement years but not trivial as a defense against the unforeseen either. The value of families' retirement savings varies by age, from roughly $6,000 for 30- to 39-year-olds to $23,000 for 50- to 60-year-olds. Low retirement savings rates may reflect lack of an employer-sponsored retirement savings plan[5] or the diversion of funds to more pressing needs. Also, fear of penalties for early withdrawals for bill-paying or other unauthorized uses of these funds may discourage saving for retirement. As Beverly, Schneider, and Tufano (2005) document, the most common savings goal among a sample of low-income tax filers in Tulsa, Oklahoma, was "general precautionary"—or rainy day—savings. Further, many of the tax benefits that better-off families enjoy for saving for retirement elude low-income families because their tax bills are relatively low.

Homeownership is more prevalent than retirement savings among low-income working families. Nearly half (45.6 percent) own a home, and the median value of home equity for these homeowners is $45,000 (table 1). Homeownership among low-income working families differs substantially by race and ethnicity. While 56 percent of white families own a home, only 38 percent of Hispanic and 25 percent of black families do so. For the U.S. population, homeownership rates increased steadily between 1994 and 2004 but have since decreased with the current housing crisis. In 2007, homeownership rates fell below 2003 rates.[6]

Most (82.5 percent) low-income working families own a car, with a median value of $3,700 (table 1). While only a small minority of families do not have a vehicle, a vehicle can be necessary to get and keep jobs. This disadvantage has become more pronounced as many jobs have moved from cities to suburbs, where public transportation is more limited and less reliable.[7]

The Government's Role in Asset Building

Double-edged swords, federal and state government programs and policies can both promote and discourage families' asset building. Such means-tested transfer programs as TANF and Food Stamps can discourage precautionary savings by providing families with benefits—basically, a consumption floor during economic emergencies. Asset tests associated with means-tested transfer programs can also discourage asset building: since only families with assets below a set threshold are eligible, it is tempting to spend down or keep financial assets below that line.[8] The federal government historically set strict asset limits for means-tested program eligibility but relaxed them somewhat over the last decade, in part due to concerns that they discouraged savings.[9]

While liberalizing asset tests, federal and state governments also started promoting asset-building among low-income families by supporting Individual Development Account (IDA) programs. Targeted at low-income families, these accounts allow participants to save for such specific approved purposes as higher education, homeownership, and business start-ups. IDA programs provide matching funds when families' savings are withdrawn to spend on one of these preset goals. These programs have demonstrated that low-income families can and will save when provided with financial literacy (a mandatory component of the program) and given financial incentives (see McKernan, Ratcliffe, and Nam 2007; Mills et al. 2006; Schreiner and Sherraden 2007; and Stegman and Faris 2005, among others). That said, spending on IDA programs represents just a tiny fraction (about one-tenth of 1 percent) of all federal spending aimed at promoting savings.

The federal government subsidizes asset building mainly through the tax code. Taxpayers can deduct interest paid on mortgages and can shelter significant amounts of savings for retirement. Of the roughly $367 billion spent on asset-building policies in fiscal year 2005, more than 99 percent of the dollars dedicated took the form of tax breaks. Direct outlays for programs such as IDAs accounted for only 1 percent (Woo and Buchholz 2007).[10] This subsidy structure primarily benefits high-income families since they have higher income tax liabilities. Conversely, many low-income families pay little or no income tax so miss out. Interest deductions, as one example, are available only to those who itemize their deductions, which further excludes low- and moderate-income taxpayers. In fact, in fiscal year 2005, less than 3 percent of the benefits from federal asset-building programs went to the bottom 60 percent of income households. The top 20 percent, in contrast, received nearly 90 percent of the benefits (Woo and Buchholz 2007). In general, federal spending supports long-term asset development—such as retirement savings and homeownership—and most low-income working families do not hold long-term assets.

Homeownership—most notably through subsidies to largely middle- and upper-income homeowners—has long enjoyed federal support. The major subsidies are the mortgage interest tax deduction, the property tax deduction, the exclusion of the net rental value due to equity, and the capital gains tax exclusion. But some policies primarily help low- and moderate-income families. The Community Reinvestment Act gives banks and thrifts responsibility for helping meet the credit needs of low- and moderate-income borrowers in their business areas. The Depository Institutions Deregulatory and Monetary Control Act of 1980 effectively abolished usury laws (restrictions on interest rates) on first-lien mortgages. Along with technological advances, such as credit scoring, and the influence of capital markets, these policies opened up the subprime market and provided mortgage credit to higher risk low- and moderate-income borrowers (Gramlich 2007). Between 1994 and 2005, homeownership rates for African-American and Latino homebuyers rose impressively—from 42 to 49 percent for blacks and from 42 to 50 percent for Hispanics (Gramlich 2007). But this new subprime market grew without the regulation applied to the prime market, and these gains are now being eroded by forced home sales and foreclosures.

The Consequences of Low Asset Holdings

Low asset holdings translate into difficulty meeting basic needs, lost opportunities for economic mobility, and missed chances to invest in children's development and human capital. Paltry assets can also mean shortfalls that can destabilize or delay retirement.

Without assets to draw on during emergencies, families must rely more on public supports and other outside help and struggle to meet basic needs. Many low-asset families have to resort to expensive short-term loans to survive a financial emergency. Once a vicious cycle of indebtedness takes hold, long-term asset goals evaporate. Conversely, with an asset cushion, families can enter into a virtuous circle of asset accumulation—paying down debts, saving more, earning a credit rating, and, as but one example, afford a down payment on a home (Nam, Huang, and Sherraden forthcoming).

Having fewer assets also means missing out on the many benefits that come with long-term asset development, whether from owning a home or a small business or from education and retirement. Homeownership and a good education can be springboards into the middle class and better child outcomes. For example, the empirical literature suggests that children in families who own their own homes reach higher educational levels and are less likely to become pregnant as teenagers (Lerman and McKernan forthcoming), most likely because homeownership increases residential stability. As for shorter-term benefits, a home or retirement savings can provide families leverage to borrow during emergencies by tapping into home equity lines of credit or retirement funds. Asset-holding and the increased job stability that goes hand in hand with a better education can boost credit ratings, which in turn can open up additional options for borrowing in an emergency and at lower interest rates.

The Most Promising Policy Options

Which asset-related policies would help low-income working families the most? First, families with few assets need access to small loans, preferably with a savings component, to help them weather bad patches. Then, they need to get a financial toehold to build the savings needed to avoid expensive short-term loans and to purchase a reliable car if one is needed to get to work. With emergency savings secured, families can move on to building assets for longer-term development, such as homeownership. Many asset policy proposals focus solely on longer-term development, pitting it against shorter-term financial goals, such as weathering a financial emergency. Our proposals try to resolve that counterproductive tension.

Increase Competition for and Regulation of Small Loans

If low-income working families have too few assets to weather emergencies, where do they turn for help? One third of low-income families without savings accounts report that they would use a payday lender or pawn something to pay a large bill in an emergency.[11] Payday lenders, pawnbrokers, and auto-title lenders all tender small loans intended to carry borrowers through temporary cash shortages. Payday lenders, for example, provide short-term loans to working people with bank accounts. The typical payday loan is for roughly $250–$300 for two weeks, with fees of $15–$20 per $100 borrowed (Flannery and Samolyk 2005). Pawnbrokers and auto-title lenders also provide short-term loans but use collateral (such as jewelry or a car title) to secure them. Pawnbroker loans are typically a one-month loan under $100 (National Pawnbrokers Association 2008), and the typical auto-title loan is a one-month loan between $600 and $2,500 (South Carolina Appleseed Legal Justice Center 2004). Occasional use of such short-term loans can help families repair a car needed for commuting or pay for an unexpected medical need, but habitual use or reliance on short-term loans for extended periods can trigger a spiral of debt that hinders future asset building.

To better protect families using small loans, we recommend regulating small loans more strictly, developing new types of longer-term small loans, and encouraging the mainstream financial sector to offer small loans with a savings component.

Increase Regulation of Small Loans

Regulate standard, clear, and timely disclosures of the total loan cost so consumers know their full obligation and can easily compare what various lenders charge for loans.[12] Stricter regulation coupled with standard and improved disclosures for consumers will increase competition within the alternative financial sector.[13] And full disclosures, along with licensing, reporting, and examination requirements, could enhance the industry's image and make the small loan business more appealing to both mainstream and alternative entrants.[14]

The case for regulating fees or interest rates on small loans is less clear and warrants further research and consideration. Does regulating prices charged make fewer small, short-term loans available? Where will families who need these loans turn if they cannot get them? Flannery and Samolyk (2005) find that "fixed operating costs and loan loss rates do justify a large part of the high APRs [annualized rates of interest] charged on payday advance loans" (p. 1) and undermine APR-based claims of "excess" profits. If profits are not excessive, then regulating prices will limit availability. If profits are excessive, then the policies proposed here—regulating disclosures; requiring licensing, reporting, and examinations; and creating incentives for financial institutions to provide small loan services—should increase competition and drive prices down.

Develop a Longer-Term Loan Product

A longer-term loan product for habitual users—those who rely on short-term loans frequently or for long periods—is needed. Regulating disclosures and creating incentives for traditional financial institutions to provide small loans would create this product de facto. Sources such as Tele-Trak—which maintains records of people's payday advances—or other centralized information can identify habitual users so they could be offered more affordable longer-term products and such services as financial counseling.

Create Incentives for Traditional Financial Institutions to Provide Small Loans with Piggyback Savings

Financial institutions may shy away from the research and product development needed to provide small loans, especially given the alternative financial sector's unsavory image. The Federal Deposit Insurance Corporation's (FDIC's) Pilot Project for Affordable Small-Dollar Loans proposes to demonstrate how small loans can increase the business of banks that reach out to underserved communities and develop new customers for mainstream banking services (Krimminger and Thompson 2007). In addition, the FDIC uses the Community Reinvestment Act as an incentive for lenders to provide small loans, preferably with a savings element. Lenders that pick up the gauntlet warrant favorable consideration for providing credit that responds to diverse community needs and for providing community development services. Governmental incentives like these that harness the market and expand access to financial services for low-income families are consistent with Barr's general recommendation in his 2004 article "Banking the Poor."

Examples of mainstream small loan programs include (1) the North Carolina State Employees' Credit Union's Salary Advance Loan Program (SALO), (2) Citibank's revolving lines of credit, and (3) the "Better Choice" program initiated in 2006 by the Pennsylvania Credit Union Association (Krimminger and Thompson 2007). SALO provides loans up to $500 with an interest rate of 18 percent and no fees. The loan plus accrued interest must be repaid by an automatic debit from the borrower's account on his or her next pay date. Application and underwriting requirements are minimal. A family need only have a checking account, use direct deposit, and not be in bankruptcy. Under SALO's savings component, every time a loan is made, 5 percent of the advance is deposited into an interest-accumulating savings account. The savings partially securitize the loan and encourage saving. SALO also has a partnership with a credit-counseling service, BALANCE, that offers financial education. BALANCE helps families restructure debt, budget, and develop money-management skills. Any borrower receiving more than three consecutive payday loans is referred to BALANCE.[15] So far, SALO has served nearly 100,000 customers, saving them $145 million over the cost of typical payday loans. And through the savings component, SALO program users have cumulatively put away more than $13.2 million (State Employees' Credit Union 2008).

Overall, our recommended policies should make small short-term loan options more transparent and less costly but still available for consumers with few other alternatives. We do not recommend eliminating these loans, which could be replaced by alternatives that make families even worse off.

Costs: The reforms suggested here for increasing competition and regulation of small loans are regulatory and market-based and do not require a costly new government subsidy program. The increased federal regulation called for will require additional resources to enforce, but licensing, reporting, and lender scrutiny need not require federal government financing. Indeed, a tradition in the banking world is for regulated financial institutions to pay examination costs. Increased federal regulation of nonbanks, such as small loan providers, would level the playing field between banks and nonbanks while increasing consumer protection.

Incentivize Savings for Low-Income Families

Incentivized savings can help low-income working families get a toehold in the financial world and increase financial literacy. Incentivized savings accounts—such as children's savings accounts and IDAs—could bank low-income working families who would not otherwise have accounts, enhance financial education, and encourage asset building.[16] Children's accounts are subsidized savings accounts given to children at birth, typically with an initial deposit from the government. Children's accounts have been proposed in the United States and implemented in the United Kingdom, Singapore, and Korea. The proposed America Saving for Personal Investment, Retirement, and Education Act (ASPIRE Act) in the United States would provide every child with a $500 account at birth and an additional $500 if he or she lives in a low-income family (New America Foundation 2007). IDAs are matched savings accounts strictly for home purchase and repair, postsecondary education, microenterprise, and retirement.

As financial education tools, incentivized accounts allow families and children to see first hand the value of compound interest (Butrica et al. 2008). That alone may improve financial acumen, but combined with some financial training through schools or as currently mandated in IDA programs, these accounts could be even more effective. Research suggests that fewer than 10 hours of such training is optimal (Schreiner and Sherraden 2007).

Incentivized savings accounts encourage asset building by matching family savings deposited into accounts. Such matched savings may be an important way to redirect some of the substantial savings-promoting tax subsidies that currently go mostly to high-income families.

Create and Match Savings in Children's Accounts

Our children's account proposal has five key elements:

- Children's accounts would be provided to all children at birth, with an initial government deposit of $500. Unlike restricting accounts to children in low-income families, this universal approach gives financial institutions a stronger incentive to offer savings accounts with small balances.
- Families, friends, and charities would be permitted to contribute private donations to the accounts, but such donations would not receive any tax advantages.
- Low-income families would be encouraged to save through a dollar-for-dollar government match on the first $1,000 contributed.
- Children's account funds need not be used until the child turns 18; they can then be used for any purpose. Unrestricted use after age 18 will reduce administrative costs below those with proposals (such as the ASPIRE Act) that restrict use to college expenses, home-buying, or retirement and will also enable

new adult account holders to use funds to weather such exigencies as a financial setback or unemployment spell.

- Children's account government grants and the interest they earn receive tax preference only for low-income families. Simulations of the differential effects of key children's accounts features suggest that making these accounts nontaxable for all benefits higher-income families much more than low-income families (Butrica et al. 2008).

Our proposal for children's accounts resembles that proposed by the ASPIRE Act (New America Foundation 2007) and the Aspen Institute (2005), and all three proposals are modeled to some extent after the United Kingdom's children's accounts. The Child Trust Fund provides each child born in the United Kingdom after September 2002 with £250 and another £250 if he or she lives in a lower-income family (Cramer 2006). Our proposal differs from the others, however, in making children's accounts tax free only for low-income families, not all families. Another difference is that we do not recommend giving low-income families an additional $500 at birth since doing so would too often benefit higher-income families who just happened to have low incomes the year their child was born (Butrica et al. 2008).

Costs: Estimated costs for the ASPIRE Act and Aspen Institute proposals range from $2.1 to $3.25 billion in the first year and from $26.6 to $37.5 billion over 10 years (Aspen Institute 2007, 18; Cramer 2006, 36). These estimates are likely an upper bound for our proposal because only low-income families would get tax preference on government grants and interest earned.

Expand Incentivized Accounts through an EITC Savers Bonus

How can the benefits of incentivized savings accounts be extended to more than families with newborn children, and what is the best way to scale up current IDA programs? We recommend matching federal earned income tax credit (EITC) dollars that are deposited into longer-term savings accounts or used to buy U.S. savings bonds. In both cases, the federal government match would automatically go into the longer-term savings product and could not take the form of a higher tax refund that could be spent.[17] The EITC refund provides an important opportunity for low-income families to save. As a refundable income tax credit, it both reduces a person's tax liability and allows refunds larger than the income tax liability. Recognizing this as an opportunity for families to save, in 2007 the federal government began allowing taxpayers to deposit their refund directly into up to three accounts, thus allowing families to decide how much to save before they gain access to the money.[18]

To give low-income families incentives to save their federal EITC and continue to build other assets,

- the EITC would be matched dollar for dollar by the government up to $200 a year when deposited directly into specified types of longer-term savings accounts (e.g., IDAs, children's accounts, IRAs, 529 plans);[19]

- the EITC would be matched dollar for dollar when used to buy a U.S. savings bond. The bond option allows those who do not have savings vehicles with the routing and account number necessary for direct deposit—or access to a commercial firm that allows people to open savings vehicles when they file their taxes—to take advantage of the match. While it is not currently possible to purchase a U.S. saving bond directly from a tax refund, it was between 1962 and 1968; and

- families would continue to have immediate access to their IDA, so they can use it to withstand an emergency, but they receive no match for funds withdrawn early. Savings bonds must be held for at least one year.[20]

Expanding incentivized savings accounts through universal children's accounts and a matched EITC refund would bring the benefits of these accounts to more low-income working families and reduce the cost of the accounts. Experimental and nonexperimental research on Individual Development Accounts has shown that IDA programs increase asset accumulation (Schreiner et al. 2005; U.S. Department of Health and Human

Services 2004; Stegman and Faris 2005; Mills et al. 2006) and that matching savings deposits seems to attract and hold participants (Sherraden 2007). However, today's community-based IDA programs are costly to run (Sherraden 2007). Moving incentivized savings programs out of community-based organizations and into a government-based model (as proposed in the ASPIRE Act) or a private financial sector–based model with government oversight (as proposed in the Aspen Institute's Child Accounts proposal of 2007) will reduce costs.

Costs: The EITC match is expected to cost between $1.5 billion and $3.0 billion a year. The lower bound estimate assumes that one-third of EITC recipients take the full match, while the upper bound assumes two-thirds do.[21] The cost of the proposed EITC match could be offset by the saver's credit, which is a tax credit that promotes retirement savings and costs the federal government over $900 million dollars a year.[22] The saver's credit is not refundable so provides little incentive for many low-income families to save. Further, the credit is given in the form of a tax refund that could be spent on anything upon receipt, so it does not create further incentives to save.

Support Car Ownership

Access to a reliable automobile can be important for finding and keeping a job. Many employers are located outside city centers, beyond the reach of good or even any public transportation. Indeed, two-thirds of new jobs are located in the suburbs (Waller 2005a). Although most low-income working families (82 percent) own a car, roughly 2 million do not. Cars can make it easier for low-income families to cope with emergencies, allowing workers easier access to more employers (to, say, fill out more applications), consider employers not located near public transportation, and work late-night shifts. Indeed, research suggests that car ownership may boost employment and earnings (Lucas and Nicholson 2003 and Ong 2002 as cited in Waller 2005b).[23] True, new cars quickly depreciate and older cars can cost a lot to maintain. Even gas, insurance, and run-of-the-mill repairs can strain household finances. Yet, given the tough commutes carless families can have, the benefits of car ownership can far outweigh the costs.

Many low-income families consider a car a necessity (to get to work and medical appointments or to buy groceries) and turn to subprime auto loans to finance its purchase. These loans have high annual interest rates and high default rates, so providing less burdensome auto-financing alternatives can lead to better credit scores and increase the likelihood that low-income families become integrated into the formal financial sector.

We recommend two proposals to support car ownership: (1) allowing IDAs and other incentivized accounts to be used for vehicle purchase and upkeep and (2) setting up a national grants program to help low-income families purchase and maintain vehicles. These proposals can be implemented separately or together, and both channel benefits directly to low-income families, instead of spreading them out across families in all income brackets.

Allow IDAs and Other Incentivized Accounts to Be Used for Vehicle Ownership

IDA programs mostly support long-term asset development, such as homeownership, business start-up, and higher education. In today's economy and work environment, vehicle ownership and maintenance belong on this list too. In 2007, the House of Representatives introduced a bill, Creating Access to Rides Act (H.R. 3599), that would allow IDAs established under the Assets for Independence Act to be used to purchase or maintain an automobile or to purchase automobile insurance. Our proposal differs by disallowing matched IDA savings to be spent on automobile insurance and capping the amount that can be withdrawn and matched at $3,000 to discourage low-income families from overspending on cars. With an average match rate of roughly two to one for IDA programs (Nam, Ratcliffe, and McKernan forthcoming), a $3,000 withdrawal would provide low-income families with roughly $9,000 to purchase or put a down payment on an automobile.

This proposal affords low-income families a new way to save for and obtain a reliable automobile without turning to the expensive and risky subprime loan market—vital for families with little to spare for a down payment or with a poor or sparse credit history. Subprime loans can have annual interest rates of 25 to 30 percent, and more than half of them default (Adams, Einav, and Levin 2007). By avoiding the subprime loan market and using savings from incentivized accounts to purchase an automobile or make a sizable down payment, low-income families can put themselves in a better financial position. Our proposal also encourages them to open an incentivized account and begin saving, giving them a financial foothold that may lead to further savings for longer-run objectives.

Costs: If families simply buy a car instead of purchasing something else on the list of preset program goals, then adding vehicle purchase to the approved list will entail no additional costs. But should, for example, people use savings in incentivized accounts to purchase a vehicle under current law (and thus not receive the match), expanding the list of preset goals to include vehicle purchase will raise program costs by increasing the number of IDA participants who receive the match. Still, since total spending on incentivized accounts is small (about $40 million a year and less than 0.01 percent of federal spending on asset building), potential cost increases due to greater take-up of the match are also relatively small. If expanding preset goals increased program costs by 10 percent, federal spending would rise by only $4.0 million a year.

Set up a National Grants Program to Help Low-Income Families Purchase and Repair Vehicles
We recommend setting up a national grants program that would provide federal funds to create or enlarge car-ownership programs designed to help low-income families purchase and repair cars. The grants would be competitively awarded to states, Indian tribes and tribal organizations, localities, and nonprofits. Program participation would be limited to families with incomes below 200 percent of the federal poverty threshold. These grants could also be used to add a car-ownership component to programs that already serve other needs of low-income families (e.g., employment and training programs). Also, these grants would include an evaluation component. As a first step, we recommend the federal government appropriate $50 million to this program annually for five years. This proposal is similar in design to the national grants program included in the 2007 Creating Access to Rides Act (H.R. 3599): this proposed program is not big enough to help all low-income working families in need of a car, but the required program evaluation should give policymakers the information needed to decide whether and how to support additional or expanded programs.

Most current car-ownership programs are small. Some programs have been set up using TANF funds while others are supported by state and local governments. The elements of these programs differ across programs and include (1) selling and leasing donated cars, (2) providing interest-free or low cost loans, and (3) helping participants with their down payment, insurance and inspection costs, and a maintenance plan. Programs that help low-income families obtain a reliable car and provide assistance with costs for such necessities as insurance and repairs can go a long way toward increasing a family's employment prospects and ability to weather emergencies. By providing low-cost loans and keeping families out of the subprime market, these programs can help families build and improve their credit histories and scores. This, in turn, can help families obtain future loans for cars or such longer-term investments as higher education or a home in the prime loan market.

Costs: The program proposed here would cost $250 million over five years—$50 million in each of the five years—and would be funded out of general revenues. While $250 million is a significant sum, it is tiny relative to the $367 billion spent on asset-building programs in the United States. Minor changes in other asset-building policies would free up funds for this program.

Incentivize and Protect Homeownership

Make Homeownership Tax Subsidies More Progressive
Federal spending on homeownership programs was roughly $116.6 billion in 2005, and 99 percent was in the form of tax subsidies. As discussed above, subsidies provided as tax breaks mostly benefit high-income

families. Sixty percent of the two largest homeownership expenditures—the mortgage interest deduction and deductions for property taxes—for instance, go to households in the top 10 percent by income, while the bottom 50 percent of households gets less than 3 percent (Woo and Buchholz 2007).

The mortgage interest deduction is by far the largest single component of homeownership expenditures, composing more than 60 percent of federal spending on homeownership subsidies ($72.6 billion in 2005). Tax filers can deduct the amount of interest they pay on their home mortgage from their adjusted gross income if they itemize their deductions. Interest paid on mortgages up to $1 million can be deducted from taxable income. Partly because it subsidizes debt instead of assets, this tax benefit has had little effect on homeownership rates, but it provides incentives for the purchase of bigger and more expensive homes (Gale, Gruber, and Stephens-Davidowitz 2007). Low- and moderate-income families benefit less from the mortgage interest deduction because they tend to purchase less expensive homes and are less likely to itemize their deductions (Carasso 2005).

Owning a home is often considered the "American dream," and monthly mortgage payments are a key way families build home equity and increase their wealth. Making the mortgage interest deduction more progressive could promote homeownership among low- and moderate-income families. However, any restructuring must carefully consider the economic consequences on the real estate market (e.g., housing prices) and the ability of current homeowners to meet their payments. Eliminating the mortgage interest deduction, for example, could make it very difficult or impossible for homeowners to make their payments and cripple the housing market. There are clear tensions in any proposal that redirects homeownership subsidies away from upper-income families toward low- and moderate-income families, and any redirection should be phased in over time. While we do not present a specific proposal here, changes in the structure and design of homeownership programs should be seriously considered in the public debate.[24]

Increase Oversight of Nonbanks

Low- and moderate-income families trying to buy homes need better protections than they now receive. These families typically pose greater credit risks than higher-income families do (due to less stable employment and other factors) and so are more likely to finance their home mortgages outside of banks. These alternative lenders originate most subprime loans but receive less federal oversight and supervision than banks—perhaps one reason the current credit crisis originated in the subprime market. What measures will help prevent the next credit debacle and protect low-income working families? We believe the answer is increased regulation of lenders that are not banks.[25]

Commercial banks and thrifts undergo rigorous bank examinations from their regulators—the Office of Controller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, and the Federal Reserve Board. In each bank, teams of examiners study lending records and Home Mortgage Disclosure Act (HMDA) reports, and check for lending discrimination and lender diligence in evaluating borrowers' ability to make mortgage payments. "Nonbanks" (or independents) are regulated by the Federal Trade Commission (FTC) and undergo no bank examinations. In *Subprime Mortgages: American's Latest Boom and Bust*, former governor of the Federal Reserve System Ned Gramlich recommends increased supervision of lenders and brokers to better protect subprime borrowers and avoid the next credit meltdown. Here, we propose aligning federal regulation of nonbank mortgage lenders with current regulations for banks. As Gramlich recommends, examinations for nonbanks could include evaluation of the borrower's ability to pay using the published maximum rate on an adjustable rate mortgage, not the short-term teaser rate. And the safety and soundness provisions already applied to banks could be extended to nonbanks because loans with large implicit payment shocks can trigger widespread defaults and damage financial and housing markets.

Unlike the law-enforcement model currently used by the FTC to regulate nonbanks, rigorous examination brings results and improvements behind the scenes without resort to a federal lawsuit. Examiners can spot red flags (such as loans that do not document the borrower's ability to pay) and raise them before problems grow or multiply. Only in severe cases would it be necessary to sue a lender to resolve consumer protection issues. Examiners would have reason to conduct site visits and exams in all nonbanks. Under the current FTC law-enforcement model, site visits are difficult and the FTC lacks regular and easy access to data. Most lenders have no contact with the FTC, while the few that do fear being singled out and tarred as a warning to other lenders.

Costs: If the Federal Trade Commission continues to be the federal law enforcer for nonbanks, then it needs the resources to undertake meaningful bank examinations. Currently, the roughly 20 attorneys in the FTC's Division of Financial Practices and a few economists in the Bureau of Economics are responsible for enforcing the law (with regional office assistance) for most subprime mortgage lenders, fraud, false advertising, payment systems, and more.[26] On balance, increased federal regulation of nonbanks would level the playing field between banks and nonbanks while increasing consumer protection. And, as noted, regulated financial institutions traditionally shoulder the cost of examinations.

Promote Retirement Savings through Automatic IRAs

Nearly half of U.S. workers do not have an employer-sponsored savings plans, such as 401(k) plans. Employer-sponsored savings plans allow workers to easily save for retirement. Without such plans, workers may find it harder to maneuver the system (say, figure out how to open an individual retirement account, or IRA). Easy access to a retirement savings plan could help workers save for retirement and make the post-earning years more financially secure. This is particularly relevant for low-wage workers because they are less likely than higher-wage workers to have an employer-sponsored retirement plan. Further, retirement savings among low-income working families is very low—only 21 percent have any retirement savings (see table 1).

We recommend that the federal government enact legislation to create automatic IRAs. Automatic IRAs, introduced in 2007 in both the House of Representatives (H.R. 2167) and the Senate (S. 1141), could greatly help low-wage workers save for retirement.[27] With this program, employers that do not offer an employer-provided savings plan would use their payroll system to automatically deposit a portion of employers' earnings into an IRA. The default contribution rate would be 1 percent of earnings, but it could be as high as 8 percent.[28] To compensate employers for the cost of setting up direct deposit into IRAs, they would receive a tax credit.[29] A key program feature is that employees would be "automatically" enrolled in the program. That is, any employee who did not want to participate in the program would have to take steps to opt out. This is an important design feature, as automatic enrollment in 401(k) programs have been found to substantially increase 401(k) participation (Choi et al. 2004; Madrian and Shea 2001).

Automatic IRAs could significantly improve the well-being of low-income families in retirement. Research suggests that after 30 years of contributing 3 percent of earnings to one of these accounts, a low-income person might have $20,000 dollars for retirement (Schmitt and Xanthopoulos 2007). Additional benefits would be improved credit scores and better odds of qualifying for a loan (e.g., a car loan or home mortgage). Although designed for other purposes, these accounts could also help low-income families weather emergencies. While there is a 10-percent penalty on early withdrawals from IRAs, and early withdrawals should be discouraged, these accounts could provide a necessary cushion in an economic crisis. There are, however, potential drawbacks to the proposed program. For example, a low-income family might increase its credit card debt to purchase necessities while saving in an IRA—a net loss given high interest rates on credit card debt. We set the default rate at 1 percent (versus 3 percent in H.R. 2167 and S. 1141) to lessen the potential downsides of the program. On balance, automatic IRAs promise to improve the asset position, credit scores, and long-term economic well-being of low-income families.

Costs: Two costs are associated with this proposal: (1) the employer tax credit and (2) reductions in individual income tax liability. An analysis of automatic IRAs by Schmitt and Xanthopoulos (2007) suggests that the employer tax credit would cost roughly $250 million over 10 years (or an average of $25 million a year). This proposal would also lower federal revenues by reducing individual income tax liability since, under current law, IRA savings are not subject to federal income tax. These reductions occur because families save a portion of earning in a tax-preferred account that is currently available, not because this proposal sets up a new tax preferred savings option. Schmitt and Xanthopoulos estimate that instituting automatic IRAs with a default contribution rate of 3 percent of earnings would reduce federal revenue by $2.5 to $5 billion over 10 years (or an average of $250 to $500 million each year). Because our proposal has a lower default rate (1 percent versus 3 percent), the Schmitt and Xanthopoulos estimates are upper-bound estimates of the federal tax revenue losses that would result from our proposal.

The Short- and Long-Term Benefits for Families and Children

This essay proposes five complementary types of asset policies that enable families to weather emergencies and promote their long-term development:

1. Increase regulation of small loans, preferably with a savings component, to help families with few assets weather an emergency.
2. Match children's accounts and EITC savings (when deposited into longer-term savings accounts, such as IDAs, or when used to buy U.S. savings bonds) to incentivize savings, help low-income working families get a toehold in the financial world, and increase financial literacy.
3. Allow incentivized savings accounts to be used for vehicle ownership and set up a national grants program to expand ownership of reliable vehicles.
4. Modify the mortgage interest tax deduction and increase oversight of "nonbanks" so low-income working families receive some of the same incentives and protections that higher-income families receive when buying a home.
5. Promote retirement savings through automatic IRAs to provide low-income working families with easy access to a retirement savings mechanism and thus a more secure retirement.

Not all the proposals presented here require additional federal funds. Relying on a longstanding banking tradition, our proposals to intensify competition for and regulation of small loans and to increase oversight of nonbanks call on loan providers to pay for the increased oversight costs. This same tradition justifies our nongovernment financing design.

Our proposals to incentivize savings for low-income families are our most costly recommendations—totaling $4.2 to $6.8 billion a year. Children's accounts are estimated to cost an average of $2.7 to $3.8 billion a year over 10 years, and the EITC savers bonus is estimated to cost $1.5 to $3.0 billion a year.

Promoting retirement savings through automatic IRAs is the next most expensive proposal, costing an estimated average of $275 to $525 million a year over 10 years. Most of this funding ($250 to $500 million a year) takes the form of reduced tax revenues due to increased savings in tax-preferred accounts (i.e., IRAs). The revenue reductions occur because automatic IRAs make it easier for individuals to save in these existing tax preferred accounts, not because our proposal sets up a new tax-preferred savings option.

Proposed spending on car ownership programs is more modest. Allowing IDAs to be used for vehicle ownership would cost an estimated $4 million a year, while the national grants program to help low-income families purchase and repair a vehicle costs $50 million a year. Taken together, the two proposals total $4.5 million to $7.4 billion a year and could be offset by eliminating or modifying current policies that do little to encourage asset building, such as the saver's credit or the mortgage interest-tax deduction. Our proposals are modest even without offsetting the cost when compared with the roughly $400 billion currently spent on asset-building policies.

These proposed policies aimed at asset building have both short-term and long-term benefits. The policies that focus on weathering emergencies (such as those for small loans and automobiles) help tide families over when they need a short-term loan to pay for an unexpected medical bill or car repair, but also help families in the long run by improving financial security, improving credit history, moving families into the mainstream financial market, and improving long-term job stability and success. The policies designed to promote longer-term financial security—mainly through homeownership and retirement savings—could be springboards into the middle class and better child outcomes. In addition, these assets provide low-income working families with additional options to borrow in emergencies, from home equity lines of credit, retirement funds, and as a result of the better credit ratings that are associated with holding assets. By focusing on both families' short-term needs and long-term development, these policies could improve low-income working families' immediate prospects and long-term well-being.

NOTES

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[1] This commonly used asset poverty definition does not capture asset poverty from an assets-for-development perspective, where the amount needed to own a home or another measure may be more relevant (Nam, Huang, and Sherraden forthcoming).

[2] Unless otherwise noted, the data presented in this section (including table 1) capture assets held in 2003 and are based on the authors' tabulations from wave 9 of the 2001 Survey of Income and Program Participation (SIPP) panel. The numbers reported are for low-income working families, defined as families with children under age 18 whose members worked at some time during the prior 12 months and whose income is less than 200 percent of the federal poverty threshold.

[3] Net worth includes families' net financial assets (e.g., savings, 401(k), bonds) as well as their net nonfinancial assets (e.g., vehicle, business, and home equity).

[4] This 2003 Survey of Income and Program Participation estimate for low-income working families is low relative to the 2004 Survey of Consumer Finances, which reports that 75 percent of bottom-quintile families have a transaction account, such as a checking or savings account (Bucks, Kennickel, and Moore 2006).

[5] As discussed below, nearly half of U.S. workers do not have an employer-sponsored retirement savings plan, such as a 401(k) plan.

[6] U.S. Census Bureau, "Housing Vacancies and Homeownership" (CPS/HVS) Annual Statistics 2007 Table 20, http://www.census.gov/hhes/www/housing/hvs/annual07/ann07t20.html.

[7] The asset holdings of the low-income working families are generally low when compared with all families. Data from the 2004 Survey of Consumer Finances show that when considering all families, 91.3 percent have a transaction account, 49.7 percent have a retirement account, 69.1 percent own a home, and 86.3 percent own a vehicle (Bucks et al. 2006).

[8] See O'Brien (forthcoming) for a qualitative analysis of asset limits and welfare recipients' savings behavior.

[9] The 1996 federal welfare reform legislation gave states the authority to create TANF asset limits, eliminating the federal asset limits that existed under the Aid to Families with Dependent Children program, which were only $1,000 for liquid assets and $1,500 for vehicle assets. This change led to increases in TANF asset limits. Between 1993 and 2003, for example, unrestricted asset limits more than doubled in real terms (from $1,139 to $2,587, in 2000 dollars) and 25 states implemented policies to exempt at least one vehicle when determining program eligibility (McKernan, Ratcliffe, and Nam 2007). More recently, the federal government took steps to liberalize the Food Stamp Program asset limits in the Farm Security and Rural Investment Act of 2002 (the Farm Bill).

[10] The president's fiscal year 2009 budget proposes to spend over $400 billion on asset-building policies (Cramer, O'Brien, and Lopez-Fernandini 2008).

[11] Urban Institute tabulations of families earning less than $30,000 from the Making Connections Survey. The Making Connections Cross-Site Survey is a product of the Annie E. Casey Foundation. For more information, see "Making Connections FAQ" at http://www.aecf.org/MajorInitiatives/MakingConnections/FAQs.aspx.

[12] The total cost of lending should be disclosed as one or two numbers, in a standardized form, totaling all fees for a loan of the stated duration. One total cost could be stated for a set loan amount of two-week duration, another for the same loan amount for a one-month duration, and so on. Stating the fee as a dollar amount instead of or in addition to the annual percentage rate (APR) may be easier for consumers to understand on short-term loans.

[13] Research suggests that disclosure laws can improve outcomes. McKernan, Lacko, and Hastak (2003) find that disclosing the total cost of rent-to-own transactions makes consumers less likely to purchase through rent-to-own, and Lacko and Pappalardo (2007) demonstrate that disclosures can significantly improve consumer understanding of loan terms.

[14] The Federal Deposit Insurance Corporation (FDIC) provides guidelines for payday lending examination requirements. See FDIC, "Guidelines for Payday Lending," http://www.fdic.gov/regulations/safety/payday/.

[15] "State Employees Credit Union–Salary Advance Program (SALO)," http://www.ncua.gov/PALS/BP/PALSDocs/66310-46,113,116,135.htm.

[16] Incentivized savings accounts, such as IDAs and children's accounts, were first proposed by Sherraden (1991).

[17] The New America Foundation formally proposed an EITC savers bonus in 2006 (Boshara et al. 2006; Boshara, Cramer, and O'Brien 2007) and has provided congressional testimony on the bonus (http://waysandmeans.house.gov/hearings.asp?formmode=view&id=6063). The Foundation's proposal allows the tax filer to receive the bonus directly (although states that the bonus would ideally be deposited directly into the savings product). Our proposal, on the other hand, requires the bonus be automatically directed to the longer-term savings product.

One potential issue with our proposal is that recipients could withdraw matched funds after they are deposited into the longer-term savings products. Stricter withdrawal penalties on these matched dollars can be considered, although the administrative costs could be substantial.

[18] The EITC match would need to be available to those who receive their refund over the course of the year as well as to those who choose to receive it once a year.

[19] The EITC savers bonus proposed by the New America Foundation allows a dollar-for-dollar match up to $500 (Boshara et al. 2007).

[20] If the bond is redeemed before five years, there is a penalty—the three most recent months of interest are forfeited.

[21] These estimates assume 22.5 million families receive the EITC. In 2006, 22.4 million tax filers received the EITC. See IRS, "Earned Income Tax Credit Statistics," http://www.irs.gov/individuals/article/0,,id=177571,00.html.

[22] IRS, "Plan Now to Get Full Benefit of Saver's Credit; Tax Break Helps Low-and Moderate-Income Workers Save for Retirement," http://www.irs.gov/newsroom/article/0,,id=175591,00.html.

[23] There are no experimental studies of the effects of car ownership on employment and earnings.

[24] For specific proposals, see Carasso, Steuerle, and Bell (2005) and Gale and colleagues (2007).

[25] Increased regulation of nonbanks is consistent with President Bush's Working Group on Financial Markets recent policy proposal that federal and state regulators strengthen oversight of all mortgage originators (Paulson 2008).

[26] Resources are the largest obstacle to FTC examinations, but additional authority could be helpful. The FTC's consumer protection mission will provide examiners with the legal backdrop necessary, but additional language supporting "site visits" and "examinations" is recommended.

[27] Automatic IRAs were first proposed by Mark Iwry (Retirement Security Project) and David John (Heritage Foundation).

[28] That is, without action 1 percent of employees' earnings would be automatically deposited into an IRA.

[29] To provide consistency across retirement savings vehicles, the employer tax credit could be expanded to include new and existing employers that set up an employer-sponsored retirement plan, such as a 401(k) or 403(b) plan.

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COMMENT ON “ENABLING FAMILIES TO WEATHER EMERGENCIES AND DEVELOP”

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The McKernan-Ratcliffe paper considers the role of assets and debts in enabling low-income families to cope with financial exigencies. As the authors note, means-tested social welfare programs have not proven adequate to deal with most of the difficulties faced by these families. For example, only 22 percent of families with a low-income unemployed worker received any Unemployment Insurance benefit in 2006. In addition, the actual benefits received were in most cases inadequate to pay for the basic expenses of the family. The paper proposes asset policies to deal with financial emergencies. Such asset policies can also help families achieve long-term goals such as buying a house and providing for retirement.

Almost all the policy proposals presented in the paper are excellent, and I am in agreement with them. However, as a general point, I think the authors should emphasize asset building more and debt policy less. With adequate financial savings, the need for short-term loans becomes much smaller. I think the general emphasis should be on providing *refundable tax credits* to low-income families as opposed to deductions since, as the authors note, the tax benefits from deductions for low-income families are rather minimal. These could be modeled after the earned income tax credit (EITC). In addition, these credits could be earmarked for specialized savings accounts like Individual Development Accounts (IDAs). For example, in the 2008 presidential campaign, Barack Obama has proposed refundable tax credits in lieu of a deduction in the case of mortgage interest and property taxes. As the McKernan and Ratcliffe note, more than 99 percent of the dollars spent by the federal government to subsidize asset building are in the form of tax expenditures and less than 1 percent in direct outlays such as IDAs.

I very much agree with the idea of further promoting IDAs and introducing children’s accounts as in the United Kingdom. However, I think that children’s accounts should remain tax free for all families as in Britain. It is hard to predict the socioeconomic status of children when they become adults. Also, having a universal benefit like social security will make the program easier to adopt politically. I also agree with the proposal for the federal government to match EITC dollars that are deposited in savings accounts or used to buy U.S. savings bonds. I think this idea will enhance savings among low-income families.

With regard to car ownership, I agree with McKernan and Ratcliffe that IDAs should be liberalized to allow car ownership. But I do not understand why the authors wish to exclude car insurance, since this is a major cost of car ownership and its cost may also limit the extent of car ownership among low-income families. As McKernan and Ratcliffe note, because of the approximately two to one match rate for an IDA withdrawal, the cap of $3,000 for the withdrawal translates into about a $9,000 limit for a car purchase. This seems sufficient to buy a decent car.

I am also in agreement that mortgage loans from nonbanks should be subjected to the same rigorous bank examinations and oversight as those from commercial banks, which are currently regulated. Defaults on subprime mortgages are now reaching epidemic proportions, as are foreclosures on homes. Mortgages should be issued to prospective homebuyers only after a determination that the borrower can adequately repay the debt (I believe that most European countries have this regulation).

I also think that McKernan and Ratcliffe should stress the negative home equity problem that is now occurring. Many low-income homeowners now have outstanding mortgage loans that are greater than their house values. (Some estimates are as high as 10 percent of all outstanding mortgages.) This feature has very negative effects on the ability of the family to sell its home (so-called "short sales"), since many banks and lending institutions will not approve such sales, particularly when there are multiple loans on the property.

I also support a push for universal individual retirement accounts (IRAs). As the authors note, only 21 percent of low-income working families have any retirement savings. Further, the median value of these accounts was only $10,000 in 2003—hardly enough to support their consumption for a single year! McKernan and Ratcliffe call for only the creation of automatic IRAs. The default option is that employee would be automatically enrolled in an IRA but the employee would still have the option of dropping out. As the authors note, studies have found that making the default option automatic enrollment in the system substantially increases participation. However, I would argue for a stronger provision that IRA enrollment be made mandatory (just like Social Security). Also, in the case when the employer does not provide any other retirement program I would make some kind of employer match (somewhere between 1 and 3 percent of the worker's earnings) a mandatory part of this program. I think this feature is important because, as the authors report, an employee contributing 3 percent of his (or her) earnings would accumulate only $20,000 after 30 years. This is barely equal to 200 percent of the federal poverty level for a two-person family.

With regard to the advantages of asset ownership, the authors might note the work of Conley (1999), who found that wealth affected household behavior over and above income. This is particularly the case when accounting for behavioral differences between races. In particular, Conley argued that it was impossible to understand the persistence of racial inequality in the United States without examining black/white differences in wealth ownership. Conley set out to establish the need to go beyond the standard socioeconomic status indicators (education, occupation and income) in order to understand the causes of black/white inequality. He showed, for example, that the socioeconomic status indicators by themselves do not adequately explain differences in educational performance between black and white students; when wealth is included as an explanatory factor, much of the remaining gap in educational performance is accounted for.

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WHEN TRADITIONAL ASSET BUILDING IS NOT ENOUGH

A Comment on "Enabling Families to Weather Emergencies and Develop"

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McKernan and Ratcliffe's paper highlights the need to change budget priorities and focus more on helping low-income families gain assets. The authors' engaging analysis is particularly important for policymakers as well as policy analysts, contributing to what we know about asset building among the low income, consequences of the problem, and potential policy solutions. Their cost-benefits analysis is particularly effective because often policy development and implementation-enforcement are a compromise between budget priorities and values, without rigorous evaluation. This is a thoughtful, practical proposal of how to extend traditional asset policies to low-income households.

While ambitious along traditional lines, McKernan and Ratcliffe's policy agenda proposes minimal moral imperatives but some pragmatic policies that have a chance of being supported in this political climate (though would still be considered by some to be too proactive and interventionist). Research and practice suggest that this is not enough to pull low-income households out of debt and into asset stability. By focusing on increasing savings levels and vehicle ownership among low-income families, McKernan and Ratcliffe do not sufficiently address the consumption needs and constraints, and savings limitations on low-income people. They also do not disaggregate their policy analyses or prescriptions by race or gender. The low income are not a homogeneous group, though most face similar constraints. McKernan and Ratcliffe's policy menu, therefore, is missing additional strategies, such as collective ownership, to remedy such challenges as income and savings constraints, institutional racism, and racial and gender discrimination.

Some Considerations about the Savings Strategy

On the face of it, saving and maintaining a positive credit rating are good strategies for anyone. No matter how supportive the savings products or how large the matches or long the tax deferral, however, it is unrealistic to expect people to take food out of their children's mouths in order to start a savings account. Conventional wisdom assumes that low-income people do not save enough because they waste money and make the wrong consumption decisions. This ignores the reality that savings rates are not very different across classes and black-white savings rates are the same when income is controlled. In addition, the rising costs of basic necessities and stagnating wages and income transfers (FRAC 2008) render saving a serious challenge. Recent analyses such as Gorbachev (2007) reveal that consumption costs for housing, food, and utilities are disproportionately higher for those with the lowest incomes and have been increasing.

To help low-income people build assets, one strategy is to first increase their disposable income by reducing the costs of necessities such as housing, energy, and food. This could be done through public subsidies or consumer cooperatives (energy and utility cooperatives, co-op grocery stores and pharmacies, cooperative farms, and housing cooperatives). Increasing household income is another way to increase disposable income, through, for example, living wages or a guaranteed family income. While some jurisdictions such as Baltimore, Maryland, have passed living wage ordinances, raising income is a difficult policy around which to form consensus. In sum, connections between income generation and cost-saving strategies and the ability to save and invest should not be ignored.

Portfolio Span

One weakness in the McKernan and Ratcliffe proposals is the lack of attention to portfolio composition and span in the process of wealth accumulation. Research on the composition of wealth portfolios finds that the wealth of the richest in the United States is diverse and its span wide. The wealthy are rich more because of business equity, the net worth of their stocks and bonds, and real estate equity than because of the equity in their own home. "Families who hold more complex portfolios tend to be wealthier than other families" (Chiteji, Gouskova, and Stafford 2006, 201). The median white family holds four elements in its wealth portfolio compared with two elements in the median black family's portfolio (200). We also know that low-income whites have more assets and higher levels of homeownership (as well as more inheritance) than people of color (Leigh 2006). While women do not do as well as men, the span of their portfolio is better than for African Americans (Chiteji et al. 2006, table 8.2). On the other hand, never-married women have the fewest assets and most family responsibilities, with African American women owning the least assets (Chang 2006). These statistics are not broken down by income, but the trend is obvious. Policies need to be tailored by race and gender, not just by class, particularly because the causes and consequences of asset poverty differ by race and gender.

An understanding of portfolio span is particularly important for wealth accumulation—growth, not just stability of assets. While realistically we care first about helping low-income people acquire an asset, if our ultimate aim is wealth accumulation and the elimination of asset poverty, a savings account or two will not be enough. We also need strategies to help low-income families, families of color, and women own (or at least benefit from) a variety of assets.[1]

McKernan and Ratcliffe do a good job discussing the tension between short- and long-term asset goals, but they do not explain well enough the need to divide savings between liquid assets that tend to be short term and can be used for emergencies, and illiquid assets that provide long-term stability and can be collateral for a loan. The asset/savings goal is to put the family in a position to take care of itself in an emergency and acquire an investment (house, business, etc.). Then the family only has to borrow as a last resort or when it will create more investment income and assets for the family.

Think Community

It is difficult to imagine a complex wealth portfolio of low-income families. How can they manage such a feat with no disposable income, precarious economic condition, and susceptibility to economic and health shocks that reduce their income and savings further? While one strategy is to promote policies that facilitate the provision of a comprehensive social safety net, another approach is to examine the collective assets of a community and think about structures and mechanisms where pooled resources give people some economic stability, relative independence, and asset ownership, as well as the ability to help one another. Joint ownership is a stepping stone to individual/household wealth and an end in itself.

The most traditional collective asset is the credit union. Community development financial institutions (CDFIs) and credit unions (CUs) are regulated financial institutions with track records of serving the underserved and low-income communities. As opposed to payday lenders, check cashing companies, and big banks, CUs, for example, provide quality financial services and products at an affordable price, and they are user friendly, community owned, and democratically governed. CUs and CDFIs also recirculate dollars—their savings and loans come from the community and are used in the community where they originate. Lower fees also mean more disposable income and ability to save for members. McKernan and Ratcliffe use credit unions as examples of financial institutions that provide small loans with savings but do not emphasize their importance as a major alternative financial services agency for low-income people, and as engines of asset building for low-income households. CUs and CDFIs are forms of community wealth and community-based mechanisms for asset building that public policies could support and expand.

Members of a community can also own land, housing, and enterprises jointly and run businesses together with democratic structures. Cooperative housing reduces the costs of home ownership and maintenance. For low-income people, limited equity housing cooperatives and market-rate housing cooperatives serve the same purposes as condominiums but keep the housing affordable and combine small amounts of pooled resources with grants and loans. In this period of mortgage and housing crisis, with housing values down and interest rates declining, this could be the right time to institute responsible policies that increase low-income homeownership through co-op housing and use of credit unions as the mortgage lender.

Worker-owned businesses, particularly worker cooperatives, which use employees' pooled equity combined with loans (and sometimes grants for start-up), allow workers to own and often manage their own business, participate in democratic governance (one member one vote) and decide about work rules, business practices, and surplus distribution (profit sharing). These are also effective ways to provide low-income people with equity, for a small amount of investment (payable in installments) and reduced risk.

The cooperative-joint ownership strategy extends to all kinds of assets including car and stock ownership. Gordon Nembhard (2002, 2004) provides examples. More policies and strategies to support cooperative institutions and joint ownership would help low-income families accumulate wealth through realistic, meaningful, and sustainable practices.

Note

[1] For more about the variety of assets see Leigh (2006), and about the benefits of a complex portfolio see Chiteji and colleagues (2006).

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