

COMMENT ON “ENABLING FAMILIES TO WEATHER EMERGENCIES AND DEVELOP”

Edward N. Wolff
New York University

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.

Reference

Conley, Dalton. 1999. *Being Black, Living in the Red: Race, Wealth and Social Policy in America*. Berkeley and Los Angeles: University of California Press.