

A New Safety Net for Low-Income Families

Number 7



America's low-income working families are struggling to get by, too often making impossible choices among food, housing, and health care because their incomes do not stretch far enough. Government safety nets were reformed in the mid-1990s with the promise that work would pay. But that promise remains unfulfilled for many families. This series of essays explores the challenges these vulnerable households face and suggests ways to protect them and help them thrive—urgent goals with far-reaching benefits for our children, our families, and our economic future.

Enabling Families to Weather Emergencies and Develop—Summary

Signe-Mary McKernan and Caroline Ratcliffe

Low-wage jobs can be unstable, leaving families struggling to cope with employment gaps and financial emergencies that can strike without warning. To make matters worse, low-income working families typically have few assets to get them through these hard times. Government social programs can help but may be inadequate or unavailable for some households. One potential solution is asset-building: savings or assets can help low-income families weather a sudden job loss or health crisis and realize such long-term goals as owning a home or financing retirement.

LOW-INCOME FAMILIES ARE “ASSET POOR”

About 8 in 10 low-income working families are “asset poor,” meaning they don’t have enough assets or savings to live on for three months at the federal poverty level. A slim majority (57 percent) has a bank account, but the median value is \$800—too small to see a family through even a short employment gap. Nearly half (46 percent) own a home, with a median equity value of \$45,000, and only 21 percent have a retirement account. Most (83 percent) own a car, with a median equity value of \$3,700, but the few who don’t are at a significant disadvantage getting or keeping a job.

With few assets to draw on during emergencies, many families turn to expensive short-term loans that can lead to a cycle of debt. They lose out on opportunities to invest in education for themselves or their chil-

dren and can’t move up the income ladder to better economic security.

The majority of federal spending to promote savings goes toward tax breaks that most low-income families will never see. Federal policy actually discourages savings among low-income families by using asset tests for means-tested transfer program eligibility, such as Food Stamps.

RECOMMENDATIONS

We propose policies to help low-income working families gain access to small loans for immediate needs if they lack savings, build savings, and reach long-term financial goals, such as homeownership and retirement security.

- *Increase regulation for small loans:* One-third of low-income families without a savings account report that they would use a payday lender or pawn something to pay for an emergency. To better protect families, we recommend regulating small loans more strictly, developing a longer-term small loan for frequent borrowers, and encouraging mainstream banks to offer small loans with a savings component.
- *Encourage savings:* We propose creating subsidized savings accounts for children, with an initial government deposit of \$500. The accounts would be tax free and provide a dollar-for-dollar match only for low-income families. We also recommend matching federal earned income tax credit dollars that are deposited into longer-term savings accounts or used to buy U.S. savings bonds. Matched savings redirects some of the savings-promoting tax subsidies that go mostly to high-income households.

- *Support car ownership:* Individual Development Accounts promote savings by matching funds for certain goals, such as education and homeownership. We recommend adding car ownership to the approved list. We also suggest setting up a national grants program to create or expand programs helping low-income families purchase and repair cars. These changes can help protect families from subprime auto loans and help them build and improve their credit histories.
- *Promote and protect homeownership:* Make homeownership tax subsidies more progressive so they reach more low- and moderate-income families. And to protect families using subprime loans, require alternative “nonbank” lenders to follow the same regulations as banks do.
- *Create automatic Individual Retirement Accounts:* Nearly half of U.S. workers don’t have an employer-sponsored retirement plan. For them, we recommend

legislation to create automatic IRAs; workers would be enrolled unless they specifically opt out, raising the level of participation. Employers would deposit a portion of each employee’s earnings into an IRA. To compensate them for the administrative costs, employers would receive a tax credit.

Not all these proposals require additional federal funds. In cases where the recommendations call for new spending, we have identified offsets by eliminating or re-focusing tax deductions that favor high-income families.

OUTCOME

These five complementary recommendations can help families weather emergencies and build assets for long-term financial security. By addressing both short-term needs and long-term development, these policies could improve low-income working families’ immediate prospects and continued well-being.

ASSET HOLDINGS FOR LOW-INCOME WORKING FAMILIES, 2003

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.

	OWNERSHIP PERCENT	MEAN VALUE	MEDIAN HOLDINGS BY INCOME PERCENTILE		
			25th	50th	75th
Net worth	73.5%	\$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

For the full report, see “Enabling Families to Weather Emergencies and Develop: The Role of Assets” by Signe-Mary McKernan and Caroline Ratcliffe.

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