NEW AMERICA FOUNDATION
ASSET BUILDING PROGRAM

March 2005

2005
FEDERAL ASSETS POLICY REPORT AND OUTLOOK

Reid Cramer, Leslie Parrish, and Ray Boshara

Introduction

The purpose of this annual report is to summarize and take stock of the current state of federal policy through an asset-building lens, especially as it affects the asset base of the poor.

In his Second Inaugural Address, President Bush reaffirmed his commitment to promoting an "Ownership Society" and unambiguously connected asset building policy to the most cherished ideals of the nation. He proclaimed:

> In America's ideal of freedom, citizens find the dignity and security of economic independence, instead of laboring on the edge of subsistence. This is the broader definition of liberty that motivated the Homestead Act, the Social Security Act, and the G.I. Bill of Rights. And now we will extend this vision by reforming great institutions to serve the needs of our time. To give every American a stake in the promise and future of our country, we will bring the highest standards to our schools, and build an ownership society.

Through his promotion of an ownership society, the President has placed asset building issues on the table. While budget and other pressures make it unlikely that any significant advancement will be made in most policy efforts that target the poor, there is a possibility that asset building may prove to be one of the few areas where some progress could be made.

This report is divided into three sections. The first is a review of policy developments of the past year related to asset building[1]; the second is a description and analysis of the President's budget proposals for Fiscal Year 2006 from an assets perspective; and the third is a preview of the assets policy issues that may be considered in Congress during 2005. Further details on the policies and proposals discussed in this report can be found at www.AssetBuilding.org.

While not intended to be a definitive list, the report identifies almost $389 billion in resources related to savings, asset building, and wealth creation that are included in the Bush Administration's FY 2006 Budget. The overwhelming majority of these resources, $365 billion, are catalogued as tax expenditures, while almost $23.8 billion of discretionary spending is proposed, up from $18 billion last year. The increase in the discretionary asset building budget reflects a larger request within the Department of Education's budget, which includes a one-time request to pay off the $4.3 billion shortfall within the Pell Grant program.

---

[1] Asset Building refers to public policy and private sector efforts to enable persons with limited financial resources to accumulate and preserve long-term, productive assets—savings, investments, a home, post-secondary education and training, a small business, and a nest-egg for retirement.

Federal Assets Policy Report and Outlook – 2005 Highlights

2004 Review

* The Ownership Society emerges as a major theme in President Bush's re-election campaign.
* Bi-partisan introduction of the ASPIRE Act, a bill to create a universal and progressive system of children's savings accounts.

President's Budget Proposals FY 2006

* Proposes to create three new savings vehicles: LSAs, RSAs, and ERSAs.
* IDA Tax Credit to create 900,000 accounts over ten years.
* Level funding of $25 million for the Assets for Independence Act (AFIA).
* Proposal to allow taxpayers to split refunds into more than one account by 2007.
* Allows the Savers Credit (which encourages retirement savings by the poor) to expire in 2006.

2005 Preview – What's on the Agenda in Congress This Year

* Possible Congressional action on Administration's proposal to create private accounts within Social Security.
* Re-introduction of the ASPIRE Act to create a universal system of children's savings accounts.

I. 2004 IN REVIEW

Savings Accounts

Despite the Administration's embrace of the ownership society theme during the presidential campaign, their proposal to create three new savings vehicles did not gain much traction in Congress. Many financial services firms lobbied to remove the income caps for Roth IRAs (and rename them Retirement Savings Accounts, or RSAs), an idea that generated some interest in Congress. Less attention was paid to the proposals to establish Lifetime Savings Accounts (LSAs) or Employee Retirement Savings Accounts (ERSAs).[2]

The Administration's proposal to create an Individual Development Account (IDA) tax credit that would provide a match for savings by low- and moderate-income accountholders again passed the Senate this year, but was not considered in the House. The Senate, once again, substantially scaled-back the Administration's proposal authorizing tax credits to support up to 900,000 accounts by limiting the tax credits to 300,000 accounts. The smaller-scale Assets for Independence Demonstration Program, also aimed at expanding IDAs, did receive an additional $24.9 million in funding, but it was not reauthorized as scheduled. Consequently several changes to the program supported by advocates in the field have not yet been enacted, such as greater flexibility in the use of public funds. These two IDA proposals will likely be re-visited in 2005, with the Administration maintaining its support for enough tax credits to create up to 900,000 accounts.

In addition to matched savings opportunities through IDAs, a proposal to expand the existing Saver's Credit, which provides a non-refundable 50% tax credit to lower-income families saving for retirement, was offered last year but did not make much headway. The key features of this proposal intended to improve its effectiveness as a savings incentive would be to make it refundable so that it fully benefits the targeted low-income population and make it a permanent feature of the tax code. It remains scheduled in the President's budget to sunset in 2006.

Finally, a universal children's savings account proposal was introduced by bi-partisan sponsors in the House and Senate in July of 2004. The America Saving for Personal Investment, Retirement, and Education Act (The ASPIRE Act) would provide every newborn with a "KIDS Account" endowed with $500. An additional contribution of up to $500 would be available for low- and moderate-income families as well as matched savings incentives for similar families. Contributions could be made until the child reaches adulthood, when the account could be used for a post-secondary education or a first home, or saved for retirement. The original co-sponsors, Senators Rick Santorum (R-PA) and Jon Corzine (D-NJ) along with Representatives Harold Ford, Jr. (D-TN),

[2] Details of the LSA, RSA, and ERSA proposals are provided in Section II.

Patrick Kennedy (D-RI), Thomas Petri (R-WI), and Phil English (R-PA), plan to re-introduce the bill in the 109^{th} Congress this spring.

Post-Secondary Education

With the reauthorization of the Higher Education Act still pending, a variety of bills related to improving financial aid and addressing college costs and tuition increases were introduced over the past year. After holding a series of hearings in early 2004 on ideas to regulate college cost increases by cutting off aid to schools that repeatedly raise tuition levels, the Republican leadership in the House backed down from this approach after receiving assurances from colleges that they were trying to contain costs. By the end of 2004, policymakers were no longer calling for withholding aid from schools with rapidly rising tuition, but instead proposing measures to allow families to gauge the actual costs of various institutions in a readily comparable manner. This proposal, along with calls for a simpler financial aid form and greater outreach to lower-income populations regarding financial aid, seeks to assist families through better access to information.

The structure of loan and grant programs was also a frequent topic of discussion, as policymakers sought to find cost savings to generate greater funding for Pell Grants. Currently, most student loans are executed through both the Direct Loan program, with the government as the lender, and the Federal Financial Education Loan (FFEL) program, where the government pays a subsidy to a financial institution which provides the student loan. Because the FFEL program is far more costly for the government, Congressman Thomas Petri (R-WI) has proposed allowing colleges that use the direct loan program access to some of the savings by increasing their Pell Grant funds. Other proposals focusing on Pell Grants included calls to make that aid available year-round to offer students greater flexibility and a $1,000 in extra Pell Grant awards for students completing “rigorous” coursework in high school and committing to attending college full-time. None of these were enacted.

Homeownership

In the past year, the homeownership rate reached an all time high, with nearly 70 percent of American families owning their own home. The minority homeownership rate rose to historic levels as well, but continues to lag significantly as only 51 percent of minority households are homeowners. The Administration has drawn attention to this disparity and has set two key performance targets to monitor progress. These include the addition of 5.5 million new minority homeowners by 2010 and an increase in the supply of affordable homes by 7 million units over the next ten years.

Two major legislative proposals were advanced in Congress to help lower-income families afford homeownership, but did not become law in 2004. The Zero Downpayment Act, which was highlighted in the Administration’s previous budget, would have authorized the FHA to provide a zero downpayment loan option, which homebuyers could use in return for a slightly higher interest rate and homeownership counseling. A proposal to make mortgage insurance premiums tax deductible for homeowners who buy a home with less than a 20 percent downpayment made headway in both the House and the Senate, but did not pass. This deduction, which would be phased out for families making over $100,000, has been proposed again this year.

Small Business

While the Program for Investment in Microentrepreneurs (PRIME), which helps lower-income business owners, and the Small Business Administration’s Microloan program, which offers financing as well as training and technical assistance to disadvantaged entrepreneurs, are very small programs in relation to the federal budget, the Bush Administration has consistently called for their elimination. Congress, however, has continued to at least modestly fund these and other programs which help the smallest businesses.

Financial Education, Predatory Lending, and Financial Services

The need for financial education was embraced by both parties this year. The Financial Literacy and Education Commission was convened by the Treasury Department as authorized by the Fair and Accurate Credit Transaction Act of 2003 (FACT Act). The purpose of the commission is to improve financial literacy and promote financial education. Initial steps were taken during 2004 to begin coordinating the presentation of educational materials from across the spectrum of federal agencies that deal with financial issues and markets. Additional proposals were made in Congress throughout the year to support financial education through competitive grants, and links with TANF, community organizations, homeownership counseling, and other efforts.

Regarding efforts to regulate predatory lending, Representative Brad Miller (D-NC) introduced a promising proposal, modeled after North Carolina's recently enacted predatory lending law. This bill would impose restrictions and limitations on high-cost mortgages, revise the permissible fees and charges on certain loans made, prohibit unfair or deceptive practices by mortgage brokers and creditors, and provide for public education and counseling about predatory lenders. Others, such as Representative Bob Ney (R-OH), have proposed legislation that would pre-empt strong state predatory lending laws. Neither of these efforts succeeded.

Perhaps most alarming to many community development activists are regulatory proposals coming from the agencies that regulate financial institutions, such as the Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), Federal Deposit Insurance Corporation (FDIC), and the Federal Reserve to streamline Community Reinvestment Act exams for financial institutions with assets between $250-500 million. Some policymakers, lead by former Senator John Edwards (D-NC), introduced legislation to curtail these proposals and many activists have used the public comment period to strenuously oppose these changes, which they fear will weaken incentives to invest in underserved communities.

II. DESCRIPTION AND ANALYSIS OF THE BUSH ADMINISTRATION’S FY 2006 BUDGET PROPOSALS

During the Presidential campaign, President Bush described his vision of an ownership society as a way to frame many of his policy proposals. As articulated by the Administration, this framework aims to help people accumulate savings and exercise more control of those savings in decisions about homeownership, health insurance, and retirement. While some of these proposals are new, many have been proposed in previous White House budgets and a few are being debated now in Congress.

One of the unifying themes of the 2006 Budget is “Promoting Economic Opportunity and Ownership.” The general case for asset building is made explicit.

> A key element of the Administration's policy is to promote ownership in America. The Administration has promoted and will continue to support policies that allow individuals to take greater control over their lives through private ownership. When families have assets, they have a foundation of stability to help them through difficult periods. A family that saves, owns a home, or invests through a retirement, health, or education fund is building toward a brighter future and contributing to our economy’s long-term economic health…In all these proposals, personal ownership is the common feature, because it is the best way to achieve financial independence and prosperity. (The President’s 2006 Budget, page 16-17)

Beyond the rhetoric, the President’s Budget is designed to signal the Administration’s public policy priorities. Although it also includes an accounting of the nation’s finances, at its core it is a set of proposals that reflects an argument for how the government should spend its limited resources. These proposals are sent to Congress for their consideration before funding is appropriated. In accordance with the constitutional distribution of checks and balances, the President proposes and Congress disposes. The main volume of the Budget typically describes the priorities of each executive branch agency in narrative form, with particular attention given to new initiatives, and is augmented by a voluminous Appendix which provides detailed budget requests at the account level.

Since federal policy has many levers, it is important to distinguish between the different types of policies and programs. Accordingly, this analysis will identify (a) new initiatives, (b) funding for existing programs, and (c) tax expenditures as a means of describing the Administration’s budget from an assets perspective. The cost estimates and appropriation budget requests are included in accompanying tables.

While this report focuses on programs related to asset building, the budget proposals of the Bush Administration which may threaten aspects of the social safety net deserve scrutiny as well. The elimination or diminishment of social protections, such as the provision of affordable housing and child care, necessarily weakens asset building prospects.

A. New Initiatives and Proposals

Savings Policy

The President's savings policy proposals were reintroduced in the same form as last year, but with a greater emphasis on the promotion of savings.

> For generations, the tax code has encouraged Americans to spend first and save second. These proposals would level the incentives to save and consume, thereby promoting a culture of saving in America that is essential to future prosperity. (The President's 2006 Budget, page 12)

The Budget proposes creating two new consolidated savings accounts: *Retirement Savings Accounts (RSAs)* and *Lifetime Savings Accounts (LSAs)*. Both accounts would have contribution limits of $5,000 per year per person, but would have no income or age restrictions, a radical and unprecedented proposal. Collectively, these accounts would alter the tax-treatment of savings because contributions would be after-tax, but earnings and withdrawals would be tax-free. For LSAs, withdrawals could be for any purpose at any time, while with RSAs, withdrawals would be tax-free after age 58 or in the event of death or disability. Individuals will be able to convert existing tax-preferred savings into these new accounts in order to consolidate and simplify their savings arrangements, provided applicable taxes are paid. Existing Roth IRAs would be unaffected but renamed RSAs, while traditional IRAs could be converted to an RSA once taxes are paid. RSAs would remove all eligibility rules related to age, pension coverage, or maximum income; eliminate minimum distribution rules while the account owner is alive; and allow conversions of traditional and nondeductible IRAs into the new back-loaded saving vehicles without regard to income.

The Budget also proposes to create *Employer Retirement Savings Accounts (ERSAs)* to promote and simplify employer sponsored retirement plans. The proposal would consolidate 401(k), SIMPLE 401(k), 403(b), and 457 employer-based defined contribution accounts into a single type of plan established by any employer. 401(k)s would be unaffected but renamed ERSAs. 403(b)s and other plans (SEP-IRAs, SIMPLE IRAs, 457 plans) would continue, but may not accept any further contributions after 2005. Contributions would be limited to $14,000 per year (rising to $15,000 by 2006) and, like existing employer-based accounts, would be immediately tax deductible.

The Budget proposes creating an *Individual Development Account (IDA) Tax Credit* to help lower-income individuals save. This proposal would provide dollar-for-dollar matching contributions of up to $500 a year targeted to lower-income individuals through a 100 percent credit to sponsoring financial institutions. Taxpayers would be eligible to establish and contribute to an IDA if their modified Adjusted Gross Income in the preceding taxable year did not exceed $20,000 for single, $30,000 for heads of household, and $40,000 for married taxpayers filing jointly. The credit would apply to contributions made to the first 900,000 accounts opened after December 31, 2006 and before January 1, 2014.

The Budget is silent on the *Savers Credit*, which is scheduled to expire in 2006—which means that the Administration is proposing its elimination. The Savers Credit is presently an incentive for lower-income taxpayers to save through a nonrefundable credit of up to 50 percent on contributions to existing retirement products, such as IRAs and 401(k)s. While this credit can certainly be strengthened into a more powerful tool to encourage savings for low-income people, namely by making it refundable, eliminating it takes away a potentially viable platform to create progressive savings incentives for retirement security.

Without the Savers Credit or any other alternative policy to promote progressive savings, on balance, the proposed accounts create incentives that are regressive, could reduce saving among the most vulnerable populations, and would exacerbate the already bleak long-term budget outlook. Instead of creating a new set of incentives that promote tax sheltering and asset shifting, it would be more effective to target incentives for people who currently don't save enough, especially low-income people shut out of the current system of tax benefits.[3]

Social Security

The Budget did not include any specific proposal for Social Security reform. There was no discussion of benefit reductions, transition costs, or investment choices. With the following statement the Administration signaled its commitment to promote diverting a portion of a worker's payroll taxes into retirement savings accounts: **"**Personal Retirement Accounts under Social Security will provide a better way for Americans to save for their own retirement, using a portion of their payroll taxes." (The President's 2006 Budget, page 16)

Split Refunds

The Administration reiterated its commitment from last year's Budget to amend the tax filing process to allow all taxpayers to channel their tax refunds into more than one account. This year they added a target date, the 2007 tax filing season. Split refunds represent a significant step in establishing the infrastructure to promote asset building because savings rates are strongly influenced, not just by tax incentives, but by the administrative ease of savings programs. The ability to automatically divide a refund into "money to spend" and "money to save" directly on tax returns may help families overcome much of the reluctance they may have in directing their entire refund into tax-preferred savings accounts, like IRAs, that are subject to restrictions on withdrawals. While the split refund concept is more of a reform than a program initiative, a recent pilot project has confirmed that it holds much promise. When taxpayers were offered this opportunity at a demonstration site in Oklahoma, about one-third wanted to participate, and of those that did, they deposited on average almost half of their expected refunds into savings accounts. The Earned Income Tax Credit (EITC) is the source of tax refunds for many low-income families, and the split refund proposal offers an opportunity to convert this asset into savings. If offered to all taxpayers, the ability to split refunds right on the tax form can create a prime opportunity for tax preparers to more easily enable their clients to save a portion of their refund and to educate them about the tax benefits of savings.

Homeownership

In an effort to promote homeownership opportunities, the Administration is re-proposing several initiatives that were introduced last year but not voted on by Congress. These include two financing mechanisms offered by FHA. The first is the FHA Zero Downpayment program, which allows first-time homebuyers with good credit to receive 100 percent financing of their home purchase and closing costs. The second is the Payment Incentives program that allows borrowers with weaker credit histories the ability to access a mortgage at a higher rate that will be gradually reduce over time with timely payments.

Also, the Administration proposes again to create a new Single Family Homeownership Tax Credit that is modeled on the Low-Income Housing Tax Credit which allocates tax credit authority to the states on a per capita basis. Under this plan, builders of affordable housing for middle-income purchasers would receive a tax credit awarded by state housing finance agencies if the projects are located in census tracts with median income equal to 80 percent or less of area median income. The credit may not exceed 50 percent of the cost of constructing or rehabilitating the home. The developer of the property would be eligible to claim the credits over a five year period after selling the property to a qualified buyer. Eligible homebuyers would be required to have incomes equal to 80 percent or less of area median income. In total the credit, if passed, will provide $2.5 billion over 5 years.

The budgetary effects of these new programs are summarized in Table 1 below:

---

[3] For an alternative set of proposals to promote ownership and asset building, See Boshara, Ray, Reid Cramer, and Leslie Parrish (2005). *Policy Options to Promote an Ownership Society for All Americans*. Washington, D.C.: New America Foundation. Available on AssetBuilding.org.

Table 1
New Tax-based Programs to Build Assets - Effect of Budget Proposals on Receipts
(in millions of dollars)

	2006	2007	2008	2009	2010	2006-15
Expand Tax-Free Savings Opportunities[4]	3,709	7,151	4,069	1,693	199	1,461
Consolidate Employer-based Savings Accounts	-224	-335	-357	-382	-411	-14,816
Establish Individual Development Accounts	---	-134	-286	-326	-300	-1,763
Provide Tax Credit for Developers of Affordable Single-Family Housing	-7	-84	-342	-815	-1,425	-17,370

Source: Office of Management and Budget, Executive Office of the President. Budget of the U.S. Government, Fiscal Year 2006, Analytical Perspectives. Table 17-3.

B. Funding Requests for Existing Programs

Education

With the reauthorization of the Higher Education Act still underway and the continuing need for increased Pell Grant resources, the FY 2006 Budget calls for some wide-ranging changes to funding for post-secondary financial aid and college readiness programs. The Bush Administration has proposed to increase the maximum Pell Grant award by $100 each year, from $4,050 in 2005 to $4,550 in 2010. Several other changes to the program include eliminating the "tuition sensitivity" provision, which provides less aid to students attending low-cost schools; allowing Pell Grants to be used year-round; offering an enhanced Pell Grant of up to $1,000 for a limited number of students (36,000) enrolled in rigorous high school courses; and limiting eligibility for Pell Grants to sixteen semesters, or a total of eight years. To help offset the costs of increasing Pell Grants, some programs were eliminated, including both the LEAP (Leveraging Educational Assistance and Partnerships) program that provides grants to states for needy students and Perkins loans, which offer low-interest loans for students demonstrating financial need. In addition, student loan reforms, including a new requirement that graduates that consolidate loans must do so at a variable—rather than a fixed—interest rate, will also free up some funds for other priorities.

The FY 2006 Budget includes several new programs and newly restructured initiatives. A proposal for Presidential Math and Sciences Grants would give approximately 20,000 low-income students studying math and/or science an award of up to $5,000 in addition to the Pell Grant. In addition, a newly created Community College Access Grants Fund would offer incentives to encourage dual enrollment programs that allow high school students to earn college credits and have credits from community colleges more easily transfer to four-year institutions. Finally, college readiness program, such as TRIO and GEAR UP which serve prospective first-generation low-income students, have been restructured, with parts of TRIO and all of GEAR UP absorbed into a larger High School Intervention initiative, which would provide flexible funding for states to carry out readiness programs for at-risk youth.

[4] In the short term, the creation of LSAs and RSAs generates revenue because there will be federal taxes and penalties associated with the shifting of savings into these accounts. These gains do not represent any improvement in the government's overall revenue stream, however, and the back-loading of savings incentives will have much greater costs in the out-years.

Housing and Urban Development
Perhaps the Administration's most significant budget initiative affecting HUD was its proposal to consolidate the Community Development Block Grant program (CDBG) and other economic development programs within the Department of Commerce—at a greatly reduced level. Historically, these funds have supported a wide range of affordable housing and community development activities, many linked directly and indirectly to asset building. While the Administration has requested $3.7 billion in funding for the new program at Commerce, HUD's community development activities (including CDBG) were funded at over $5.3 billion for 2005. It is unclear how Congress will respond to this proposal.

The Administration's budget proposals continue to reflect its preference for homeownership activities over community development and affordable rental housing. In support of the Administration's goal to increase the rate of minority homeownership, the Budget requests a significant increase for the *American Dream Downpayment* Initiative, authorized in 2003. This effort is designed to expand homeownership opportunities to 40,000 low-income, first-time homebuyers by providing downpayment assistance. It is funded at $200 million as a set-aside within the HOME program, a significantly higher request than what Congress appropriated for the program last year. The HOME Investment Partnership program continues to be one of the main funding streams for states and localities to expand the supply of affordable housing, and includes both rental assistance and homeownership projects.

SHOP is another homeownership program designated as a Presidential initiative. SHOP funds assist low-income homebuyers who contribute "sweat equity" toward the construction of their homes. The funds will leverage other resources to produce at least 1,500 new homeownership units. It had been funded as a set-aside within the Community Development Block Grant program, which the Administration has proposed transferring to the Department of Commerce. This year the SHOP funding request is $30 million.

Housing Counseling provides comprehensive counseling services to prospective homebuyers. The program had been funded as a set aside within the HOME program but is now being proposed as a stand alone account, with a funding request of $40 million.

Family Self Sufficiency is an important asset building vehicle which allows participating families in assisted housing to set aside money into an escrow account that would otherwise go to rent increases. The administration is proposing to provide funding for FSS coordinators out of a revised budget structure which is impairing the effectiveness of the program. Currently, funding for FSS is provided through four separate HUD accounts as there is separate funding for the escrow accounts and program coordinators in both public housing and the voucher programs. Three out of four of these accounts experienced significant funding problems in 2004. Although these problems need to be addressed, the Administration's recent evaluation of the program found it to be well designed but in need of greater participation by the housing authorities.

Health and Human Services
Individual Development Accounts, supported by the *Asset for Independence Demonstration Program*, were supported by a budget request of $25 million, the same level requested in the 2005 budget. Although the program was not reauthorized when it expired in 2004, it continues to receive support for the Administration and funding from Congress, even though its overall resources are modest. A review of the program's performance to date, presented in the Budget, identifies strong management practices but also a need to develop grantee-supported performance measures that will help demonstrate program effectiveness and improved efficiencies.

The Office of Refugee Resettlement (ORR) in HHS has been the second largest funder of IDAs in the country. Since 1999 approximately $66 million has supported over 13,000 IDA accounts; there have been over 7,100 matched withdrawals to date. While there is no specific budget line to support refugee IDA programs, it has been funded through the ORR discretionary budget. Unfortunately, this budget item has been reduced in recent years and no IDA program announcement has been issued since FY 2003. This has led to 16 IDA projects closing operations, and 33 more programs are expected to close-out by September of this year. From initial reports, the ORR IDA program has shown success in enabling low-income refugees to save and acquire assets to enter the economic mainstream.

Treasury
Support for the *Community Development Financial Institutions Fund* has almost completely eroded under the Bush Administration. Requested funding has declined in each of the last three years, and this year's request proposes to eliminate all loans, grants, and technical assistance to community development financial institutions across the country made under this program. Funding at $8 million is proposed to administer the New Markets Tax Credit and the portfolio of existing loans and grants.

Labor
The Budget includes $137 million to run the Employee Benefits Security Administration, the agency responsible for safeguarding workers retirement savings. More significant is the current state of the Pension Benefit Guaranty Corporation (PBGC), the entity that insures the defined-benefit pensions of 44 million workers against employer bankruptcy or other failures. At the close of 2004, PBGC had liabilities that exceeded its assets by over $23 billion, double what it had been the previous year. The Administration outlined a strategy to stabilize the defined-benefit system and committed to introducing a legislative proposal to amend the authorizing legislation.

Small Business Administration
The Bush Administration proposes once again to terminate the Microloan program and eliminate the Program for Investment in Microentrepreneurs (PRIME), both of which aim to assist low-income and minority persons start small businesses. Last year Congress responded to these proposals by funding PRIME and Microloan technical assistance at previously funded levels. The President's proposal justifies the termination of the Microloan Program with the claim that it is excessively expensive relative to alternative loan programs, such as a 7(a) program, which is SBA's primary loan program expected to support a loan volume of over $16 billion through guaranteed loans in 2006

Table 2
Funding Levels of Selected Discretionary (Spending) Programs to Build Assets
(in millions of dollars)

	Actual 2004	Estimated 2005	Requested 2006
Department of Education			
Pell Grants – Discretionary	12,006	12,365	13,199
Pell - Increase Max Award by $100	--	--	420
Pell - Retire Funding Shortfall	--	--	4,301
Pell - Enhanced Pell Grant for State Scholars	--	--	33
Supplemental Educational Opportunity Grants	771	779	779
Work-Study	999	990	990
Leveraging Educational Assistance and Partnerships	66	66	--
Presidential Math and Science Scholars	--	--	100
Community College Access Grants	--	--	125
TRIO	--	837	369
GEAR UP	298	306	--
High School Intervention	--	--	1,240
Department of Housing and Urban Development			
Self-Help Homeownership program (SHOP)	25	52	30
Housing Counseling	40	38	40
American Dream Downpayment Fund	87	50	200
Family Self-Sufficiency – Voucher Program	48	46	55
HOME Investment Partnership Program	1,859	1,788	1,730
Department of Health and Human Services			
Assets for Independence Demonstration Program	25	25	25
Department of Treasury			
Community Development Financial Institutions	63	56	8
Department of Labor			
Employee Benefits Security Administration	124	131	137
Small Business Administration			
Microloan program, loan levels	23	10	0
Microloan program, technical assistance	15	15	0
Program for Investment in Microentrepreneurs	5	5	0
TOTAL	**16,454**	**17,559**	**23,831**

Source: Office of Management and Budget, Executive Office of the President. Budget of the U.S. Government, Fiscal Year 2006.

C. <u>Tax Expenditure Programs</u>

Beyond proposals to spend money, the budget includes an analysis of the tax code. Tax expenditure programs in the form of tax deductions, tax credits, preferential tax rates, tax deferrals, or income exclusions are a primary vehicle for achieving many federal policy objectives. Collectively, they subsidize a broad range of activities, including many asset building investments such as mortgage payments, business investments, retirement savings, and educational expenditures. As calculated by the government, the value of these asset building tax expenditure programs exceeds $365 billion on an annual basis, and thus deserves scrutiny.

There are several methods for estimating the value of tax expenditures; the two most common measures are revenue losses attributed to provisions in the tax code and budget outlay equivalent. The difference between the two is that “revenue losses” count money that would otherwise come in to the Treasury without the change to the tax law and “outlays” are money actually spent by the government. These estimates will vary slightly from one another depending upon the specific activity and tax treatment. In the case of some refundable tax credit programs, such as the Earned Income Tax Credit, outlays and revenue losses are quite different, so it is important to consider both.

The theory behind using tax expenditures as a policy vehicle is that it works best when the benefits or incentives are related to income and are intended to be widely available. While tax expenditure programs may subsidize worthy activities and generate sizeable social and economic returns, they are not accessible to a large number of citizens that would benefit from them the most. Many lower-income households do not have large enough tax liabilities to take advantage of these tax expenditure programs. Not surprisingly, 90 percent of the benefits in the two largest tax expenditure categories (homeownership and retirement) reach households with incomes above $50,000 a year.[5] All told, the federal government offers over $156 billion a year in support of homeownership and over $117 billion to subsidize retirement savings.

Table 3 below identifies the tax expenditures included in the Federal Budget related to asset building. Some are familiar and easy to understand, while others are obscure and more complicated. For the purpose of this presentation, tax advantages that can be claimed by businesses are not included, even if they help subsidize employee training.

[5] U.S. Congress Joint Committee on Taxation (2003). Estimate of Federal Tax Expenditures for Fiscal Years 2004-2008.

Table 3
Value of Select Asset Building Tax Expenditures:
Fiscal Year 2006
(in millions of dollars)

Housing	
Deductibility of Mortgage Interest on Owner Occupied Housing	76,030
Deductibility of Property Tax	14,830
Capital Gains Exclusion on Home Sales	36,270
Exclusion of Net Imputed Rental Income on Owner-Occupied Housing	29,720
Subtotal Housing	*156,850*
Investment: Commerce	
Capital Gains	28,370
Capital Gains Exclusion of Small Corporation Stock	250
Step-up Basis of Capital Gains at Death	28,760
Carryover Basis of Capital Gains on Gifts	290
Exclusion of Interest on Life Insurance Savings	24,070
Subtotal Commerce	*81,740*
Education	
HOPE Tax Credit	3,220
Lifetime Learning Credit	2,080
Education Individual Retirement Account	190
Deductibility of Student Loan Interest	800
Deductibility of Higher Education Expenses	1,840
State Prepaid Tuition Plans	650
Subtotal Education	*8,780*
Retirement: Income Security	
Net Exclusion of Pension Contributions: Employer Plans	51,050
Net Exclusion of Pension Contributions: 401 (k) Plans	48,140
Net Exclusion of Pension Contributions: IRAs	7,310
Net Exclusion of Pension Contributions: Savers Credit	1,170
Net Exclusion of Pension Contributions: Keough Plans	9,980
Subtotal Income Security	*117,650*
TOTAL	**365,020**

Source: Office of Management and Budget, Executive Office of the President. Budget of the U.S. Government, Fiscal Year 2006, Analytical Perspectives. Table 19-1.

III. 2005 PREVIEW

At the onset of the 109th Congress, the President made it clear that he intends to expend some of his political capital to support a revamping of the Social Security program. If the Administration's proposals to create private accounts and reduce benefits are stymied, alternative means to promote savings and retirement security may receive more attention. This could mean that a range of asset building ideas come on the table, including some that use account-based structures along with progressive savings incentives. Conversely, political stalemate over Social Security may block meaningful consideration of related policy issues. Given Republican control of Congress and the White House, each of the initiatives included in the Budget should generate some reaction in Congress. Further, in a general sense there is a growing level of interest across the ideological spectrum in efforts to promote savings and asset building.

In February 2005, a bi-partisan group of legislators, supported by the New America Foundation's Asset Building Program, launched a Savings and Ownership Caucus in both the House and the Senate. Each caucus will serve as a vehicle to explore, debate, and advance policies to build savings and assets for all Americans, and low-income Americans in particular. In the Senate, the Caucus will be chaired by Rick Santorum (R-PA) and Kent Conrad (D-

ND) and in the House by Jim Cooper (D-TN), Phil English (R-PA), Harold Ford, Jr. (D-TN) and Thomas Petri (R-WI). Initially, each caucus will create an active working group of members and staff with the goal of developing and advocating innovative federal policies aimed at boosting personal savings, individual ownership of wealth, and financial literacy. One of the first issues to receive the support of caucus members is the proposal to split tax refunds among multiple accounts. The change to the tax filing system has already been supported by the Administration, and the caucus members are coordinating efforts to exert their congressional oversight capacities to ensure that this initiative is implemented in a timely and effective manner. In addition, a bi-partisan Financial and Economic Education Caucus, chaired by Rep. Judy Biggert (R-IL) and Rep. Ruben Hinojosa (D-TX) was launched in the House to help organize legislative efforts and policy initiatives related to financial literacy and economic education.

Social Security Debate
The Administration's proposals to reform the Social Security system by allowing workers to divert a portion of their payroll taxes into private, personal accounts will be one of the primary political debates of 2005. Although not included in the Budget as a formal proposal or initiative, the White House has made this effort their top domestic priority. The Democratic response has initially focused on resisting the carving out of accounts within Social Security. Some members of both parties have expressed interest in creating *add-on* accounts that would supplement the social insurance provided by Social Security. While this may appear as a natural legislative compromise, the political uncertainty surrounding the outcome of the Social Security debate may undermine potential consensus.

Savings Policy
The Administration's proposal to create Retirement Savings Accounts (RSAs), Lifetime Savings Accounts (LSAs), and Employer Retirement Savings Accounts (ERSAs) was not considered actively by Congress last year and are likely to take a back seat again this year to other policy debates, particularly Social Security. Leading Congressional Republicans have continued to express more interest in the RSA proposal than the other two. The Administration has identified two members, Senator Craig Thomas (R-WY) and Representative Sam Johnson (R-TX), to take the lead in promoting these proposals as a legislative package. They have signaled their intention to use the legislation as a means to highlight the goals of making saving for everyday life and retirement easier and more attractive.

Tax Reform
The President's 2006 Budget calls for a "fundamental reform of the Federal income tax system to make it simpler, fairer, and more pro-growth." This pledged was followed up with the convening of The President's Advisory Panel on Federal Tax Reform, which is charged with examining the current system and making policy recommendations. The panel is co-chaired by former Senators Connie Mack and John Breaux and is scheduled to issue a report by July 31, 2005. Given the short time-frame and the President's stated goals, it is expected that the panel will recommend a series of savings incentives for individuals, replacement of depreciation with expensing, lowered taxation of foreign-source income, and permanent repeal of the estate tax. Ways and Means Committee Chairman Bill Thomas (R-CA) has expressed a preference for considering a broad range of proposals, some of which would combine changes to Social Security and the tax code. This would entail a more fundamental reform of the tax code than the Administration currently seeks, and reflects a degree of uncertainty in how tax reform proposals will be considered in Congress.

Savings Accounts Established at Birth
Last year, the introduction of the ASPIRE Act succeeded in raising the profile of children's savings accounts proposals as a means of promoting savings and asset building. The bill's introduction also generated comments from a range of policy experts, financial institutions, program directors, and advocates. Based on this feedback, the congressional sponsors have incorporated a series of refinements into the bill. Reintroduction of the ASPIRE Act is scheduled for April 2005. The primary change concerns the treatment of the KIDS Accounts once the account holder turns 18. The legislation calls for all KIDS Accounts to be treated as Roth IRAs. This approach ensures that contributions to the accounts will not be shut off after 18 years, and the accounts can serve as a life-long savings platform. Contribution rules would be identical to those that apply to Roth IRAs. Accountholders could keep these accounts in the public KIDS Account Fund or roll them out to private Roth providers. The bill will retain both its universal and progressive features: everyone will be given an account at birth and children in

families earning under the national median income will be eligible for a savings match of up to $500 each year until the accountholder turns 18.

The Administration's focus on the Ownership Society will create the ongoing opportunity to focus on policy proposals that help families, and particularly lower-income families, build assets. The ASPIRE Act may receive consideration in these debates as it creates an account-based system outside Social Security that may serve as a compromise solution to the apparent political standoff. Additionally, the ASPIRE Act already has bipartisan support and offers a means of facilitating large-scale financial education and savings activity.

Several other accounts-at-birth proposals have been offered which may receive attention as well. Both Congressmen Jerry Weller (R-IL) and Thomas Petri (R-WI) have separate proposals to create accounts-at-birth systems link to retirement security. Weller's proposal is called the Social Security KidSave Accounts Act, and Petri's is called Social Security Plus Accounts. These plans, along with the ASPIRE Act, reflect some of the primary fault lines in the crafting of different accounts-at-birth schemes, namely whether these accounts are carved-out or added-on to the current Social Security program and whether account resources are tied up until retirement or available to accountholders for other qualified uses.

Individual Development Accounts

Soon after the new Congress convened, Senator Rick Santorum (R-PA) introduced the Family and Community Protection Act of 2005 (S. 6), which is similar to the IDA tax credit proposed in the Savings for Working Families Act. This provision would match contributions to Individual Development Accounts (IDAs) for low-income people saving for a first home purchase, business capitalization or expansion, or post-secondary education or training. Under this program, financial institutions would offer IDA accounts in which participants could deposit up to $1,500 a year. For each dollar the financial institution matches, they would receive a tax credit, up to $500 per IDA account per year, with tax credits available for no more than 300,000 accounts over a 10 year period. To date, there is no companion piece of legislation in the House, but since a similar proposal was included in the Administration's Budget, there is a chance that this proposal could attract more Republican support in the months ahead.

Bankruptcy Reform and Asset Protection

After coming close in recent years, bankruptcy reform legislation is moving closing to enactment in 2005. The Bankruptcy Abuse Prevention and Consumer Act (S. 256) was passed by the Senate in March 2005. The bill would make it more difficult to file for Chapter 7 bankruptcy and would instead require some people to file Chapter 13, which entails at least some level of debt repayment. In an effort to prevent future bankruptcies, the bill also calls for more disclosures on how expensive paying only minimum credit card payments can be through information distributed with bills and through a toll-free telephone number. Generally, the reform measures are supported by those in the credit card industry and opposed by consumer groups. Some of the concerns cited by the legislation's opponents include the undue burden these reforms would place on working families who file for bankruptcy due to medical debt or other financial emergencies, and that the preventative measures do not go far enough to curtail abusive practices by the credit card industry. A companion bill has been introduced in the House (HR 685), and is expected to be considered soon.

Higher Education Act Reauthorization

While a flurry of hearings and legislative proposals on the Higher Education Act (HEA) in the last Congressional session sparked some interesting debates and highlighted different policy options, the HEA—which funds the major federal post-secondary financial aid programs—will likely be reauthorized this year. Some potential reforms include a modest increase in the maximum Pell Grant award and other changes to this program, including allowing some students to take advantage of the grant year-round and a repeal of the tuition sensitivity provision. In addition, policymakers have proposed measures to simplify the financial aid application and provide better outreach to low-income families. In return for some of these improvements, Congress will likely seek cost savings through tweaking loan programs, promoting the lower cost direct loan program and only allowing students to consolidate loans at variable, rather than fixed, rates. More controversial issues in which Congressional Republicans and the Bush Administration differ include whether to continue the LEAP program (which offers federal matching grants for state financial aid), and the future of the TRIO and GEAR UP pre-college programs, as well as the Perkins Loan program.

For further information, contact:

Reid Cramer
Research Director, Asset Building Program
cramer@newamerica.net

Leslie Parrish
Senior Research Associate, Asset Building Program
parrish@newamerica.net

Ray Boshara
Director, Asset Building Program
boshara@newamerica.net

New America Foundation
1630 Connecticut Avenue, NW 7th Floor
Washington, DC 20009
202-986-2700 - phone
202-986-3696 - fax
www.newamerica.net and www.assetbuilding.org