

### THE ASSETS REPORT 2007

#### A Review, Assessment, and Forecast of Federal Assets Policy

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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 families with lower incomes and fewer resources, which is the focus of our work.<sup>2</sup> The report is divided into three sections. The first is a review of policy developments from the past year related to asset building; the second is an examination of the president's budget proposals for fiscal year 2008 from an assets perspective; and the third is a forecast of the assets policy issues that may be considered in Congress during the year or two ahead. A companion report, *The 2007 Assets Agenda*, provides a detailed description of the policy options to broaden savings and asset ownership.

The year begins with a new Democratic majority in both chambers, which has brought renewed attention to poverty and economic opportunity issues, along with a greater focus on curbing predatory lending and certain credit card practices. Heightened attention to the balance sheets, declining incomes, and overall economic prospects of America's low- and moderate-income families could bring added momentum to policies to build savings and wealth among those families. However, while a growing number of Democrats and Republicans support asset-building policies, such policies are still not seen as central to economic security and opportunity debates.

#### The Assets Report 2007 - Highlights

##### 2006 Review

- IRS established split refunds to enable taxpayers to divide refunds into multiple accounts.
- Congress makes the Saver's Credit permanent and indexed for inflation.
- Pension Protection Act of 2006 signed into law, establishing higher 401(k) contribution limits and provisions to support automatic enrollment in retirement plans.
- Children's Savings Account proposals proliferate.
- The Financial Literacy and Education Commission released their *National Strategy* report with few actionable recommendations; Congress enacts no new policy.
- Congress caps interest rates on loans to military families, marking a substantial step in the fight against predatory lending.
- Section 529 College Savings Plans have their tax advantage made permanent; no provisions are added to extend savings incentives to lower-income families.

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<sup>2</sup> "Asset building" refers to public policy and private sector efforts to enable persons 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.

### **President's Budget Proposals FY 2008**

- Over \$407 billion in tax expenditures related to asset building, overwhelmingly accruing to middle- and upper-income households.
- IDA Tax Credit proposal dropped from the president's budget.
- Renewed proposal to consolidate tax-preferred savings accounts into Retirement Savings Accounts, Lifetime Savings Accounts, and Employer Retirement Savings Accounts.
- Administration proposes to exclude Sec. 529 College Savings Plans from financial aid calculations and allow contributions to 529s to qualify for the Saver's Credit.
- Administration proposes to exclude all assets held in retirement and education savings accounts when determining eligibility for benefits in the Food Stamp Program

### **2007 Preview: What's on the Agenda in Congress This Year**

- Congressional agenda shaped by new Democratic majorities in both the House and the Senate, leading to hearings and possible legislation on issues related to poverty and economic insecurity.
- Increased policy debate on issues related to debt, including credit cards, sub-prime and predatory lending, medical debt, foreclosure, and bankruptcy.
- Continued interest in Children's Savings Account proposals.
- Growing awareness and potential legislative action on raising assets limits, particularly in the Food Stamp Program.
- Potential for a renewed discussion of retirement security in the context of Social Security reform.

Where asset-building policies *could* play a more prominent role is in efforts to boost personal and national savings, financial education, and retirement security. Last year was the second consecutive year that Americans had a negative personal savings rate—a trend not seen since the Great Depression.<sup>3</sup> Combined with rising consumer debt and an increase in bankruptcies and foreclosures among low- and even middle-income Americans, policy efforts to improve savings and asset holdings could gain prominence among policymakers.

Significant policy efforts, requiring billions of dollars of new spending, are likely to be tempered if not dismissed due to persistent budget deficits and large international commitments. Among the first actions of the new Congress was to reinstate a set of budget rules previously used to restrain spending. These rules reflect the political reality that Democrats appear to be eager to assume the mantle of fiscal responsibility. Accordingly, the assets field is likely to continue to pursue a “two track” strategy—aggressively pursuing low-cost policies and regulations to boost savings and asset ownership (such as split refunds and auto 401(k)s) while laying the foundation for enacting larger, bolder policies (such as establishing savings accounts at birth for all newborns) should the right political moment arise.

That moment could arrive within the next few years, given the onset of a historic presidential campaign in which bold, new ideas are being proposed and debated. A growing number of leading presidential candidates have embraced a wide range of asset-building ideas, signaling an auspicious future for the maturing asset building field.

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<sup>3</sup> U.S. Bureau of Economic Analysis, U.S. Department of Commerce, “Personal Savings Rate.” <http://www.bea.gov/briefm/saving.htm>.

## 2006 REVIEW

For much of last year, it was unclear if the impending mid-term elections would crowd out the prospects for substantive policymaking. After the demise of the Social Security debate, no breakthrough legislation related to savings and asset building was expected and none occurred. In retrospect, several modest policy changes were achieved. Below is a review of these items.

### **Split Refunds**

The IRS implemented a policy change that will allow taxpayers to divide their tax refunds in up to three accounts. Previously, refunds were issued in a lump sum, but taxpayers will now be able to use the tax filing process to make direct deposits into multiple accounts. This is expected to simplify the savings process. The ability to automatically divide a refund into “money to spend” and “money to save” directly on Form 8888 may help families overcome any reluctance they may have in directing their entire refund into tax-preferred savings accounts, like IRAs, that are subject to restrictions on withdrawals.

The split refund proposal had been advocated by the asset building policy community for a number of years and had been included in the president’s budget since 2004. Given that many households up and down the income scale receive sizeable refunds—the average refund exceeds \$2,000—the ability to split refunds represents a potentially powerful institutional mechanism available to taxpayers and their tax preparers to facilitate savings. Moving 25 percent of refund deposits to savings products could net more than \$55 billion in new savings each year.<sup>4</sup> However, it is likely to take several years for this policy change to realize this potential, given the inevitable challenges of implementing and publicizing a new initiative.

### **Pension Bill and the Auto 401(k)**

President Bush signed the Pension Protection Act of 2006 into law this past August. In addition to requiring corporations to invest more in their defined benefit retirement plans, the act includes two major provisions that are expected to increase 401(k) and IRA investment among workers. The first provision makes permanent the higher contribution limits and salary deferral limits passed in 2001 (\$15,500 in 2007). These higher limits offer workers an increased ability to save and take advantage of the tax-favored status of these accounts. The second provision makes it easier for companies to automatically enroll their employees in a 401(k) retirement saving program. This proposal, known as Auto 401(k), is based on recent research findings from the field of behavioral economics that confirm higher participation and savings rates occur when employees are automatically included in employer-sponsored retirement plans and have to actively elect to opt out of them. Also building on research from behavioral economics, the bill additionally allows for the “automatic escalation” of an employee’s contribution by 1 percent of pay each year, up to 6 percent of total pay. In addition, employers are given greater flexibility to automatically invest employee funds into default accounts without losing their fiduciary protection.<sup>5</sup> The budget estimates that the cost of the 401(k) tax exclusion will increase to almost \$44 billion in FY 2008, up from \$42.4 billion in FY2007.

The pension bill failed to address the problem that roughly half the workforce does not have access to employer-sponsored savings plans of any kind. As a result, these individuals are unable to benefit from any of the institutional support structures and default mechanisms that research shows have promoted savings. A bill to partially fill this gap was introduced last year. This

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<sup>4</sup> Reid Cramer, “The IRS’ Saving Grace,” *Baltimore Sun*, August 24, 2006.

<sup>5</sup> For more information, see “Analysis of the Pension Protection Act of 2006,” Retirement Security Project: [http://www.retirementsecurityproject.org/img/File/RSP\\_Scorecard.Final.final-1.pdf](http://www.retirementsecurityproject.org/img/File/RSP_Scorecard.Final.final-1.pdf).

proposal, called the Automatic IRA would allow employers to let workers make automatic payroll deductions to fund individual retirement accounts (IRAs).<sup>6</sup> The proposal was not acted upon in Congress, but was recognized as a proposal likely to receive further attention in the years ahead.<sup>7</sup>

### **Saver's Credit**

Congress voted last year in the Pension Protection Act to make the Saver's Credit permanent and to index the income eligibility limit for inflation. The Saver's Credit provides an incentive for lower-income taxpayers to save in existing retirement products by offering a tax credit to taxpayers that make deposits to these products. The Saver's Credit is currently structured as a nonrefundable credit of up to 50 percent on contributions to existing retirement products, such as IRAs and 401(k)s. As a non-refundable credit, its value is limited to those with positive tax liabilities, and thus it fails to reach many families that would otherwise benefit from it, such as those with lower incomes that receive tax refunds. Still, the Saver's Credit remains one of the few saving incentives which are explicitly targeted to lower-income families. The budget estimates the Saver's Credit will cost \$670 million in FY 2008, down from \$690 million in FY 2007.

### **Children's Savings Account Proposals**

The year 2006 saw the proliferation of Children's Savings Account proposals. Although the proposals varied in detail, they collectively reflected the growing and bipartisan interest of lawmakers in creating additional avenues to promote savings by children and their families. By the end of the year, five proposals—two voluntary, and three which would automatically create a savings account for every newborn child—were under consideration by policymakers.

#### *ASPIRE Act*

The America Saving for Personal Investment, Retirement, and Education Act (The ASPIRE Act), which had been previously introduced in 2005, proposes to establish a universal accounts-at-birth system. Co-sponsored in the last Congress by senators Rick Santorum (R-PA), Jon Corzine (D-NJ), Charles Schumer (D-NY), and Jim DeMint (R-SC) and in the House by representatives Harold Ford, Jr. (D-TN), Patrick Kennedy (D-RI), and Phil English (R-PA), the ASPIRE Act would create a Kids Investment and Development Account (KIDS Account) for every child born with a starter deposit of \$500. The bill also provides incentives that encourage additional contributions to these accounts for families earning less than the national median income.

#### *Young Saver's Accounts*

Creating a new tax-preferred financial product, Young Saver's Accounts would allow parents, for the first time, to direct contributions to Roth IRA accounts for their children, not just for themselves. Introduced by Sen. Max Baucus (D-MT) in March as part of the Savings Competitiveness Act of 2006, this product would fill a gap in the savings continuum by creating a savings vehicle that could be used by children. A similar proposal to create Roth IRAs for Children was introduced by Rep. Connie Mack (R-FL) as part of the Lifetime Prosperity Act.

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<sup>6</sup> J. Mark Iwry and David C. John, *Pursuing Universal Retirement Security Through Automatic IRAs* (Washington, D.C.: Retirement Security Project, 2006).  
<http://www.retirementsecurityproject.org/pubs/File/AutoIRAworkingpaper.pdf?PHPSESSID=be8fb0c44f8b7eccfee9b617e21b9ac5>.

<sup>7</sup> This proposal was introduced in the Senate (S. 3921) by senators Gordon Smith (R-OR), Kent Conrad (D-ND), John Kerry (D-MA), and Jeff Bingaman (D-NM) and in the House (H.R. 6210) by Rep. Phil English (R-PA).

#### *401Kids*

Introduced in 2006 as HR 5314 by Rep. Clay Shaw Jr. (R-FL) and other House Republicans, this proposal would convert Coverdell Education Savings Accounts into 401Kids Savings Accounts, which would have expanded uses and the ability to be rolled over into a Roth IRA. This proposal would make it possible for a restricted, tax-advantaged savings account to be opened in a child's name as early as birth, with up to \$2,000 of after-tax contributions permitted a year. The funds could be used for the K-12 and post-secondary education expenses currently allowed under Coverdell Education Savings Account rules, but would also expand qualified uses to include a first-time home purchase, or for retirement.

#### *Baby Bonds*

In a July 2006 speech before the Democratic Leadership Council, Sen. Hillary Rodham Clinton (D-NY) called for \$500 Baby Bonds to be established for every child at birth and at age 10.<sup>8</sup> Funds could be used for college or vocational training, buying a first home, and retirement savings. Families earning below \$75,000 a year would have the option of directing their existing child tax credits into the accounts tax-free. Senator Clinton reiterated her commitment to pursuing a Baby Bonds proposal in her keynote address at the New America Foundation's Ten Big Ideas event in January 2007.

#### *PLUS Accounts*

As proposed by Sen. Jeff Sessions (R-AL), U.S. citizens born after December 31, 2007 would have a PLUS Account opened for them automatically by the federal government. These accounts would be endowed with a one-time \$1,000 contribution. Beginning January 1, 2009, individual PLUS accounts would be established for all working U.S. citizens under the age of 65, with a mandatory 1 percent of each worker's paycheck withheld pre-tax and automatically deposited into their account (workers could voluntarily contribute up to 10 percent). Employers would also be required to contribute at least 1 percent (and up to 10 percent) of earnings. No withdrawals from PLUS accounts could be made until the account holder reaches the age of 65, although there would be a loan program for pre-retirement uses.

#### **Financial Education**

In 2003, Congress created the Financial Literacy and Education Commission under the auspices of the Treasury Department. The Commission was tasked to prepare a *National Strategy for Financial Literacy* report. Released in April 2006, this report was expected to offer a clarification of the need for increased financial literacy, a review of current barriers, and a plan to deliver more effective financial education information. The plan, however, failed to provide any specific policy recommendations for Congress to act upon. According to a report released by the Government Accountability Office (GAO) in December 2006, the *National Strategy* "does not serve as a plan of action designed to achieve specific goals, and its recommendations are presented as 'calls to action' that generally are either descriptions of existing initiative or broad pronouncements that do not include a specific implementation plan."<sup>9</sup> While this certainly represents a missed opportunity, the commission's report serves as a marker which future efforts to expand access to financial education may build upon.

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<sup>8</sup> Hillary Rodham Clinton, "Remarks of Senator Hillary Rodham Clinton to the Democratic Leadership Council" (July 24, 2006), <http://clinton.senate.gov/news/statements/details.cfm?id=259561>.

<sup>9</sup> United States Government Accountability Office, Financial Literacy and Education Commission "Further Progress Needed to Ensure an Effective National Strategy" (December 2006). <http://www.gao.gov/highlights/d07100high.pdf>.

### **Predatory Lending**

In September 2006, Congress took significant steps to curtail predatory lending practices, especially payday lending, targeted at military families. Through an amendment to the 2007 Defense Authorization Bill, senators Jim Talent (R-MO) and Bill Nelson (D-FL) established a 36 percent cap on annual interest rates, including all fees, and outlawed the use of a vehicle title as collateral for a loan.<sup>10</sup> The legislation represents a significant breakthrough in identifying and outlawing predatory lending practices, although certain aspects of it, such as the prohibitions on direct debit and using accounts as security, will need to be addressed by the Department of Defense in regulation to avoid reducing positive credit opportunities for members of the military and their families. It also may serve as a beacon of additional congressional interest in regulating some of the alternative financial services that have spread in recent years.

### **Post-Secondary Education**

Under the Pension Protection Act of 2006, Congress made the tax break associated with Section 529 College Savings Plans permanent. This provision was initially set to expire in 2010, but the indefinite extension of tax-free earnings on contributions into these plans will lessen any investor uncertainty about future tax treatment. Even without this extension, these plans have proven to be popular—especially among middle- and upper-income households saving for college. By the end of 2005, there were over 6.2 million accounts, which held assets of almost \$69 billion, an increase of 32 percent of over the previous year.<sup>11</sup> The bill, however, did not include any provisions to extend incentives to families with more modest means. The tax benefits associated with contributing to Section 529 plans remain weak. Several policymakers have indicated an interest in pursuing a policy agenda that would make these plans more inclusive.

## **DESCRIPTION AND ANALYSIS OF THE PRESIDENT'S FY 2008 BUDGET**

The president's budget includes proposals for new initiatives, budget requests for existing programs, and a presentation of the government's finances. A description and analysis of each of these aspects of the budget is provided below. With a few exceptions described below, the administration has opted to recycle many of its proposals from previous years which have thus far failed to prompt congressional action. No new major asset-building proposals are included in this year's budget—in fact, for the first time the Bush administration chose not to include the Individual Development Account Tax Credit, a proposal previously estimated to cost \$1.7 billion over ten years.

In the broad arena of policies related to savings and asset building, much of the action remains on the tax side—both in proposed and existing policies. This is reflected in our analysis which catalogues over \$407 billion in tax expenditures related to asset building, compared to \$18.9 billion in requested appropriations. The tax breaks which support homeownership, retirement savings, and capital investment flow overwhelmingly to those on the upper half of the income scale. The federal resources available to assist those on the lower half of the income scale build up their asset base continue to pale by comparison. While most of the asset building programs in the Departments of House and Urban Development (HUD), Health and Human Services (HHS), and Treasury are slated for level funding, the administration is requesting an increase in funding for post-secondary education, mainly through Pell Grants.

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<sup>10</sup> For more information, see the Center for Responsible Lending:  
<http://www.responsiblelending.org/policy/congress/page.jsp?itemID=29895875>.

<sup>11</sup> Investment Company Institute and College Savings Plans Network (2006).

## **A. NEW INITIATIVES AND PROPOSALS**

### **Savings Policy and Tax Reform**

Tax reform was expected to be one of the major policy initiatives of the second term of the Bush administration. The final report of the President's Advisory Panel on Federal Tax Reform issued in November 2005 was designed to provide a foundation for a national discussion of transforming our tax system into one that is "simple, fair, and pro-growth."<sup>12</sup> For the second year in a row the budget reiterates this goal but does not articulate major proposals designed to reach these ends. Instead, the President has proposed "several changes that move the tax code in this direction," most of which involve the reintroduction of the administration's savings proposals that were presented in previous years.<sup>13</sup>

### **Retirement Savings Accounts and Lifetime Savings Accounts**

The budget again proposes creating two new consolidated savings accounts: *Retirement Savings Accounts* (RSAs) and *Lifetime Savings Accounts* (LSAs). As in previous years, the plan allows individuals to make annual nondeductible contributions of \$5,000 to an RSA, but this year's proposal reduces allowable contributions to LSAs from \$5,000 to \$2,000. Neither account would have income or age restrictions. 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 would 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.

### **Employer Retirement Savings Accounts**

The budget also proposes to create *Employer Retirement Savings Accounts* (ERSAs) to promote and simplify the current array of 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 would not accept any further contributions. Annual contributions would be limited to \$15,000 and, like existing employer-based accounts, would be tax-deductible for the current tax year.

### **Exclude Savings in 529 College Savings Plans from Financial Aid Calculations**

The budget proposes to exclude amounts held by students and parents in Section 529 Savings Plans in determining eligibility for student financial assistance. Any money saved in an account defined under Section 529 will not be included when determining a family's ability to pay, and therefore will not influence a student's eligibility for federal grants and subsidized loans. Currently, each state runs its own 529 plan, which has grown in popularity since the federal government made earnings on contributions to these accounts tax-free.

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<sup>12</sup> President's Advisory Panel on Federal Tax Reform. "Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System." *Report of the President's Advisory Panel on Federal Tax Reform* (2005).

<sup>13</sup> United States Department of Treasury, *General Explanations of the Administration's Fiscal Year 2008 Revenue Proposals*, 1.

### **Extending Saver's Credit to 529 College Savings Plan**

The budget proposes that eligible taxpayers can access the Saver's Credit when they make contributions to 529 Qualified Tuition Programs for post-secondary education. Currently, taxpayers qualify for a nonrefundable credit of up to 50 percent on contributions to existing retirement products, such as IRAs and 401(k)s. Taxpayers with adjusted gross incomes of up to \$52,000 are currently eligible for the credit. This proposal would extend the benefit to contributions to 529 College Savings Plans, creating a saving incentive for many lower-income families. An additional feature of this proposal is that the incentive can be triggered for contributions made on behalf of a child.

### **Asset Limits**

The budget proposes to exclude all assets held in retirement and education savings accounts when determining eligibility for the Food Stamp Program. By excluding these accounts from the current \$2,000 asset limit for eligibility (\$3,000 for households with an elderly or disabled member), a major disincentive is removed that prevents many low-income families from saving for targeted purposes such as retirement and education. The president, however, proposes to fund this exclusion by eliminating state flexibility in determining which assets to exclude from the limit, which will force eligibility rules to tighten in the ten states that have exercised this authority.

### **Social Security**

Reviving previous attempts to incorporate a privatized account system into the Social Security system, the president's budget proposes to establish voluntary personal accounts funded by a portion of worker's Social Security payroll taxes. The budget calls for these accounts to be inaugurated in 2012; therefore they are not included in the president's current budget projections. Even though Congress rejected previous overtures, it is possible that this proposal will serve as a point of departure for the consideration of other Social Security reform efforts, some of which may include the creation of new savings account structures.

**Table 1. New Tax-Based Programs to Build Assets—Effect of Budget Proposals on Receipts**

	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2008-2017</b>
Expand Tax-Free Savings Opportunities <sup>14</sup>	1,527	3,545	3,023	1,075	-1,314	-592
Consolidate Employer-Based Savings Accounts	-80	-120	-132	-141	-150	-1,484
Expand Saver's Credit to Include Qualified Tuition Programs	-63	-163	-176	-189	-200	-1,966

Source: Office of Management and Budget, Executive Office of the President. *Budget of the U.S. Government, Fiscal Year 2008*, "Analytical Perspectives." Table 17-3.

### **Homeownership**

In an effort to promote expanded homeownership opportunities, the administration is re-proposing several financing mechanisms which would be offered by the Federal Housing Administration (FHA). These financing products were proposed in the last three years but were not acted on by Congress. The first is an FHA Zero Downpayment program that would allow first-time homebuyers with good credit to receive 100 percent financing of their home purchase and closing costs. The second is a Payment Incentives program that would allow borrowers with

<sup>14</sup> 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.



weaker credit histories to access a mortgage that would have an initially higher rate, but would be gradually reduce with timely payments.

## **B. FUNDING REQUEST FOR EXISTING PROGRAMS**

### **Education**

#### *College Readiness*

In a reversal from last year, the president proposes to continue funding the GEAR UP college readiness program in full, at just over \$300 million. This program was slated for elimination in the FY 2007 Budget. The president also changed course on the TRIO program, which is slated to receive full continued funding of \$828 million, after a proposed cut of almost 50 percent in the FY 2007 Budget. Both of these programs will continue their mission to prepare low-income middle- and high-school students for college. In addition, the president again requests the elimination of the LEAP program, which provides grants to states for needy students.

#### *Student Financial Assistance*

Funded primarily through savings derived from the student loan program, the budget proposes a \$550 increase in the maximum Pell Grant award to \$4,600, a 14 percent increase that would represent the largest growth in the maximum grant in over 30 years. The request includes an additional \$800 increase in the maximum Pell Grant over the next five years, to \$5,400 in fiscal year 2012, which would enable more low-income students to attend college.

The administration also proposes a 50 percent increase in Academic Competitiveness Grants awarded to Pell Grant recipients in their first two years of college who completed a rigorous high school curriculum; from \$750 to \$1,125 for first-year students and from \$1,300 to \$1,950 for second-year students. The budget also reflects the scheduled increase in mandatory funding for the SMART Grant Program (up \$40 million to \$350 million), which provides additional assistance to third- and fourth-year undergraduates majoring in math, science, or a critical foreign language.

In addition to savings in the student loan program, the president proposes to pay for increases in Pell and Academic Competitiveness Grant funding by eliminating the “poorly targeted” Perkins Loan and Supplemental Educational Opportunity Grants programs.<sup>15</sup>

#### *Career, Technical and Adult Education*

The administration requests \$564.1 million for adult education formula grants to states (on par with funding levels in 2006 and 2007), \$6.6 millions for the National Institute for Literacy, and \$9.1 million for National Leadership Activities related to adult education.

The president also requests \$617.4 million in funding to improve the quality of career and technical education programs, down significantly from the \$1.3 billion in funds granted in 2006 and 2007. The administration also proposes to eliminate the Tech Prep Education State Grants due to redundancy with state grant activities.

### **Housing and Urban Development**

HUD reports that it is ahead of schedule on its established goal of creating 5.5 million new minority homeowners by 2010. Since the president issued this challenge in June 2002, 3.5 million

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<sup>15</sup> Office of Management and Budget, Executive Office of the President. *Budget of the U.S. Government, Fiscal Year 2008*, 53-54.

new minority families have become homeowners. A sustained period of low interest rates has been a primary driver of this performance, but HUD has contributed through several programs that continue to receive support. These include Housing Counseling, the HOME Investment Partnerships program (HOME), and the American Dream Downpayment Initiative.

HOME provides block grants to localities to promote a number of affordable housing programs, including homeownership. HOME funds are often used to provide eligible families with financial assistance to purchase or rehabilitate their homes or rental units. In FY 2006, the HOME program assisted more than 143,000 households—a 43 percent increase over the previous year. The FY 2008 budget proposes \$1.97 billion for the HOME program, an increase of \$50 million over last year's HOME request.

The American Dream Downpayment Initiative is funded as a carve-out from the HOME program, providing grants to low-income families to purchase their first homes. The budget provides \$50 million for this effort, down from the \$100 million requested by the administration last year but up from the estimated expenditure of \$25 million in FY 2007.

Housing Counseling, funded at \$45 million as a stand-alone program for the first time in FY 2007, will be receiving an increase in funding to \$50 million in 2008. This money will help expand programs targeting low-income families with a wide array of counseling services to prepare families to buy their first home, to avoid predatory lending practices, and to assist current homeowners facing default.

The administration is increasing its request to fund the Homeownership Voucher program to \$14 million this year, up from \$5 million last year. Under this program, Public Housing Authorities (PHAs) make monthly homeownership assistance payments to help first-time homeowners with monthly expenses and mortgage payments. Since the program's inception in 2000, more than 7,500 former public housing residents have become homeowners. The FY 2008 budget proposes helping 10,000 additional families to become homeowners through the voucher program.

The budget again requests \$120 million for the Neighborhood Reinvestment Corporation (NRC), a quasi-public organization engaged in many efforts to expand and sustain homeownership, increase financial capabilities, and promote affordable rental housing opportunities.

The Family Self Sufficiency program (FSS) is a potentially powerful asset-building vehicle that allows participating families in assisted housing to set aside money that would otherwise go to rent increases into an escrow account. Savings built up in this account can be accessed by the account holder once they complete their individualized self-sufficiency plan. The administration is proposing to provide \$48 million in funding for FSS coordinators in the housing choice voucher program. However, funding to support FSS coordinators in the public housing program is threatened because it has historically been funded out of the ROSS program which the administration is proposing to terminate. The potential loss of a funding stream for FSS coordinators would severely undermine the public housing FSS program.

The budget also requests \$40 million for the Self-Help Homeownership Opportunity Program (SHOP) to assist low-income homebuyers willing to contribute “sweat equity” toward the construction of their houses. A performance assessment of the program conducted last year found this program to be “effective.” The administration's request is \$20 million above last year's level.

**Health and Human Services**

The budget requests \$24 million for Assets for Independence grants, which support community-based Individual Development Account programs across the country. Under this program, amounts saved by participating low-income individuals are matched with federal funds when savings are used for specific purposes—buying a first home, paying for post-secondary education, or capitalizing a business. According to the Department of Health and Human Services, participants in this program increased their saving by 48 percent between FY 2004 and FY 2005. Assets for Independence grantees also receive intensive financial counseling and economic literacy education.

**Treasury**

The president requests \$28 million in funding support for the *Community Development Financial Institutions Fund*, \$20 million more than the administration requested last year, but down from \$54 million in FY 2006. The fund's investments work toward building private markets, creating healthy local tax revenues (through job creation, business development, commercial real estate and housing development, and homeownership), and empowering residents by stimulating the creation and expansion of diverse community development financial institutions.

**Labor**

The budget includes \$147 million to run the Employee Benefits Security Administration, the agency responsible for safeguarding workers' retirement savings. This is an increase of \$13 million from FY 2006.

More significant is the current state of the Pension Benefit Guaranty Corporation (PBGC), the entity that insures the defined-benefit pensions of 34 million workers against employer bankruptcy or other failures. At the close of 2006, PBGC had liabilities that exceeded its assets by nearly \$19 billion, a slight improvement over the \$23 billion shortfall in 2005. Reforms to the PBGC were included in the Pension Protection Act of 2006, which required firms to fully fund their pension plans over a seven year period in order to lessen reliance on the government safeguard.

**Small Business Administration**

The administration is proposing to terminate the Microloan program, arguing that it is "excessively expensive relative to other programs" and can be replaced by the existing 7a loan program. Despite this proposed funding cut, existing resources are expected to support \$25 million in loans for the coming fiscal year.

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

	<b>Actual 2006</b>	<b>Estimated 2007</b>	<b>Requested 2008</b>
<b>Department of Education</b>			
Pell Grants-Funds Available	12,880	12,954	15,175
Academic Competitiveness Grants	340	420	830
Supplemental Educational Opportunity Grants	975	975	0
Work-Study	1,174	1,174	1,174
Leveraging Educational Assistance and Partnerships (LEAP)	164	164	--
TRIO	828	828	828
GEAR UP	303	303	303
<b>Department of Housing and Urban Development</b>			
Self-Help Homeownership Program (SHOP)	--	20	40
Housing Counseling	38	42	50
American Dream Downpayment Fund	50	25	50
Family Self-Sufficiency—Voucher Program	93	48	48
Homeownership Vouchers	3	5	14
Neighborhood Reinvestment Corporation	117	117	120
<b>Department of Health and Human Services</b>			
Assets for Independence Demonstration Program	25	24	24
<b>Department of Treasury</b>			
Community Development Financial Institutions	64	38	29
<b>Department of Labor</b>			
Employee Benefits Security Administration	134	134	147
<b>Small Business Administration</b>			
Microloan Program, loan levels	20	10	25
<b>TOTAL</b>	<b>16,508</b>	<b>17,208</b>	<b>18,857</b>

Source: Office of Management and Budget, Executive Office of the President. *Budget of the U.S. Government, Fiscal Year 2008*.

### C. REVIEW OF EXISTING TAX EXPENDITURE PROGRAMS

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 investments related to asset building 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 is approximately \$407.7 billion on an annual basis, and thus deserve 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 should be considered together to capture the ultimate scale of the policy effort.

The theory behind using tax expenditures as a policy vehicle is that they work 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 potentially 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) primarily reach households with incomes above \$50,000 a year.<sup>16</sup> All told, the federal government offers over \$176 billion a year in support of homeownership, over \$111 billion to subsidize retirement savings, and over \$110 billion in support of private investment.

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.

**Table 3. Value of Select Asset Building Expenditures, Fiscal Year 2008**  
(in millions of dollars)

<b>Housing</b>	
Deductibility of Mortgage Interest on Owner Occupied Housing	89,430
Deductibility of Property Tax	12,620
Capital Gains Exclusion on Home Sales	38,890
Exclusion of Net Imputed Rental Income on Owner-Occupied Housing	35,680
<i>Subtotal Housing</i>	<i>176,620</i>
<b>Investment: Commerce</b>	
Capital Gains	51,960
Capital Gains Exclusion of Small Corporation Stock	320
Step-Up Basis of Capital Gains at Death	35,900
Carryover Basis of Capital Gains on Gifts	760
Exclusion of Interest on Life Insurance Savings	21,925
<i>Subtotal Commerce</i>	<i>110,865</i>
<b>Education</b>	
HOPE Tax Credit	3,350
Lifetime Learning Credit	2,220
Coverdell Education Savings Account (formerly Education IRA)	10
Deductibility of Student Loan Interest	820
Deductibility of Higher Education Expenses	1,180
State Prepaid Tuition Plans	1,000
<i>Subtotal Education</i>	<i>8,580</i>
<b>Retirement: Income Security</b>	
Net Exclusion of Pension Contributions: Employer Plans	48,480
Net Exclusion of Pension Contributions: 401(k) Plans	43,970
Net Exclusion of Pension Contributions: IRAs	6,650
Net Exclusion of Pension Contributions: Savers Credit	670
Net Exclusion of Pension Contributions: Keough Plans	11,890
<i>Subtotal Income Security</i>	<i>111,660</i>
<b>TOTAL</b>	<b>407,725</b>

Source: Office of Management and Budget, Executive Office of the President. *Budget of the U.S. Government, Fiscal Year 2008*, "Analytical Perspectives." Table 19-1.

### Potential Assets Building Resources Delivered through Tax Refunds

While not explicitly an asset-building program, the tax filing process creates an opportunity for many families to save. This is because most families—up and down the income scale— receive sizeable tax refunds. Through payroll withholding and refundable tax credits, such as the Earned

<sup>16</sup> United States Congress Joint Committee on Taxation. *Estimates of Federal Tax Expenditures for Fiscal Years 2006-2010* (April 25, 2006).

Income and Child Tax Credits, the average refund for all tax filers exceeds \$2,000 a year. These resources can potentially be used for personal investment and asset development, and with the IRS's new "split refunds" option, families can direct funds into multiple accounts, allowing families to easily invest these refundable credits into a variety of savings products. The table below provides an indication of the scale of these resources; the column on outlays refers to the money refunded to taxpayers, and the column on tax expenditures reflects the money not taken in by the government as a result of the lowering of tax liabilities.

**Table 4. Funding Levels for the Earned Income and Child Tax Credits FY 2008**  
(in millions of dollars)

	Outlays	Tax Expenditures	Total
Child Tax Credit	14,931	32,341	47,272
Earned Income Tax Credit	36,461	5,340	41,801

Source: Office of Management and Budget, Executive Office of the President. *Budget of the U.S. Government, Fiscal Year 2008*, "Analytical Perspectives." Table 19-1.

## 2007 PREVIEW

Democratic control of Congress will certainly affect the legislative agenda in the coming year. In the first months of the new year, several notable events have already occurred, including two House Ways and Means hearings focused on poverty issues.<sup>17</sup> The newly appointed director of the Congressional Budget Office, Peter Orszag, made his inaugural congressional testimony on the subject of economic volatility, reflecting the rising interest in economic insecurity.<sup>18</sup> More hearings on issues related to poverty, economic insecurity, and the role of savings and assets are expected, which may serve as a basis for specific congressional action.

What is less clear is how the White House will react. Given the relatively slim margin of the new Democratic majorities in both the House and Senate, the president may opt to begin using his veto power more frequently. Or, he may seek to engage selectively with congressional leaders on policy areas where there is potential for bipartisan support. His recent address on the subject of inequality and CEO pay may be a harbinger that the White House is preparing to enter into a number of policy debates that it has avoided to date.<sup>19</sup> However, the president's low approval ratings and limited domestic policy agenda will make it increasingly difficult for the White House to set the agenda, clearing the way for Congress to take the lead on a number of asset policy issues.

### Financial Services, Predatory Lending, and Debt Management

A host of economic trends are likely to garner the attention of policymakers in the coming year and lead to policy discussions around the related issues of financial services, predatory lending, and consumer debt. These trends include the recent cooling of housing prices in some markets, along with rising foreclosure rates, rising consumer debt, and the growth of alternative and potentially predatory financial services. Sub-prime mortgage lending has already been subjected

<sup>17</sup> Committee on Ways and Means, Subcommittee on Income Security and Family Support, Hearing on Economic Opportunity and Poverty in America (February 13, 2007), and Committee on Ways and Means, Hearing on the Economic and Societal Costs of Poverty (January 24, 2007).

<sup>18</sup> Testimony of Peter Orszag, Director of the Congressional Budget Office, on "Economic Volatility" to the House Ways and Means Committee (January 31, 2007).

<sup>19</sup> President Bush delivered his state of the economy report in New York City on January 31, 2007. He said, "The fact is that income inequality is real."

to greater congressional attention in the opening months of the year.<sup>20</sup> Building on the marginal efforts of the 109<sup>th</sup> Congress to reform predatory lending practices, this Congress is expected to tackle consumer protection issues more aggressively. We expect multiple hearings on accelerating consumer (credit card) debt, the impact of sub-prime lending, and the role of financial institutions.<sup>21</sup> Compared with their Republican predecessors, Congressional Democrats are more likely to search for consumer protections by emphasizing regulatory changes in the oversight of financial services.<sup>22</sup>

### **Savings and Children's Accounts**

We expect to see continued and possibly growing interest around Children's Savings Account proposals in the new Congress. The ASPIRE Act will be formally introduced in the spring with bipartisan, bicameral support. Additional proposals are also expected to be introduced early in the session, including Senator Sessions's (R-AL) PLUS Accounts plan and Senator Baucus's (D-MT) Young Saver's Accounts. Representative Biggert (R-IL) has already introduced a 401Kids proposal in this session with support from over twenty fellow Republicans.<sup>23</sup> The proliferation of these proposals may also lead to congressional hearings, which would present an opportunity for the asset building community to make its case for this type of policy intervention.

Senator Baucus is expected to introduce two major savings bills in 2007. The first is a far-reaching proposal that will include making the Saver's Credit refundable. The second bill will present other, less costly policy proposals to increase personal savings, and is likely to include Young Saver's Accounts.

### **Asset Limits**

There is a growing awareness on the part of policymakers that many of the asset limit provisions that are used to determine eligibility in a number of federal assistance programs are counterproductive. This is because they function as savings disincentives. These provisions will have to be addressed on a program-by-program basis. One of the first opportunities to explore alternatives to the current rules is in the Food Stamp program, which is up for reauthorization in the Farm Bill, and which also includes a large number of farmer subsidies and agricultural supports. As described above, the president is proposing to reform the asset limit for eligibility by exempting assets held in IRAs and Section 529 College Savings Plans.<sup>24</sup> This proposal would work to ensure that low-income families are not penalized for saving for retirement or higher education with a reduction or loss of program benefits.

While the president's proposal is a major step in ensuring that eligibility rules promote rather than prohibit saving, the Farm Bill presents a unique opportunity for more substantial reform. Some policymakers are exploring more aggressive reforms, including a direct increase in the resource limit, indexing the limit to inflation, excluding specific accounts and other assets, or completely

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<sup>20</sup> Mortgage Bankers Association, "The Residential Mortgage Market and Its Economic Context in 2007" (January 30, 2007).  
[http://www.mortgagebankers.org/files/News/InternalResource/48215\\_TheResidentialMortgageMarketandItsEconomicContextin2007.pdf](http://www.mortgagebankers.org/files/News/InternalResource/48215_TheResidentialMortgageMarketandItsEconomicContextin2007.pdf)

<sup>21</sup> The Senate Banking Committee has already held two hearings on Credit Cards: a hearing entitled "Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry and Their Impact on Consumers" was held on January 25, 2007 and a hearing entitled "Predatory Lending Practices and Home Foreclosures" was held on February 7, 2007.

<sup>22</sup> "Review 2006/Preview 2007," *American Banker*, January 2, 2007.

<sup>23</sup> Introduced in January, H.R. 87 would amend the tax code to expand uses of education savings accounts.

<sup>24</sup> Senators Chambliss (R-GA) and Harkin (D-IA) introduced the Food Stamp Savings and Investment Act of 2007 which not only excludes 529 college savings accounts and tax-preferred retirement savings account, but also indexes the general resource limit to inflation.

eliminating the asset test. Additionally, there is a possibility that this discussion could be extended to other programs, such as Medicaid and the Supplemental Security Income (SSI) program.

#### **Alternative Minimum Tax and the Estate Tax**

Both the president and Congress have signaled their interest in reforming the Alternative Minimum Tax. As the AMT is not indexed to inflation, over time an increasing number of households have fallen under the AMT income threshold. Legislators on both sides of the aisle, particularly Democrats, whose “blue state” middle- to upper middle-income base is increasingly affected by the AMT, are interested in reform. Congress may choose to address this issue on a year-by-year basis, which would push off a long-term fix indefinitely, but the scale of the AMT issue potentially provides an opportunity to incorporate a number of asset-building related concepts to the legislative vehicle.

A similar dynamic holds for discussion of the Estate Tax. Many Republicans have long favored a complete repeal of this tax, and this year the new Democratic chairman of the powerful Senate Finance Committee, Max Baucus (D-MT), has indicated his interest in exploring additional estate tax reform or repeal. Consideration of both of these issues could at least provide a forum to discuss the effect of the tax code on the distribution of income and wealth, and may even provide an opening for the inclusion of larger asset-building proposals.

#### **Housing**

The administration plans to introduce legislation to reauthorize the American Dream Downpayment Initiative in early 2007. This HUD program seeks to expand homeownership opportunities to low-income, first-time homebuyers. It appears to have been successful in attracting bipartisan support, but reauthorization opens up the possibilities for consideration of additional proposals related to homeownership.

#### **Post-Secondary Education**

The new Democratic leadership and the White House have already signaled their respective interest in putting education issues on the agenda. Speaker Pelosi’s first 100 hours and the president’s budget proposal have already resulted in a great deal of debate and interest around expanding access to higher education through student financial assistance. Democratic congressional leaders have proposed to reduce student indebtedness by cutting the interest rates on federal subsidized loans. The president’s budget proposes a substantial increase in the maximum Pell Grant to provide increased financial assistance to low-income students. While both sides agree on the need to increase Pell Grants, there remains broad disagreement over whether to cut student loan interest rates.

Another potential point of disagreement rests in the president’s proposal to exclude money in 529 college savings accounts when calculating a family’s ability to pay for higher education. Some Democrats may oppose such an exclusion, fearing it allow families with significant assets to qualify for student financial assistance.

#### **Retirement and Social Security**

Retirement security continues to be a perennial issue of interest to federal lawmakers. If the debate over Social Security emerges later this year, the debate is likely focus on establishing solvency and creating add-on accounts. While the Democratic controlled Congress is not likely to give much consideration to President Bush’s proposal to establish voluntary private accounts for Social Security, retirement issues will continue to play a significant role in the rhetoric of domestic policy. While it is unclear if any legislative vehicle related to retirement savings will



make progress this year, the decline in personal savings and the beginning retirement of the baby boom cohort's leading edge is likely to keep this issue current.

### **Individual Development Accounts (IDA) Tax Credit**

In a departure from previous budget proposals, the administration declined this year to include their \$1.7 billion proposal for creating an IDA Tax Credit. In past years, this proposal was designed to provide a public subsidy to support savings by lower-income individuals. It offered a dollar-for-dollar tax credit to financial institutions that matched the savings deposits of qualifying individuals up to \$500. 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 taxpayers, \$30,000 for heads of household, and \$40,000 for married taxpayers filing jointly. A bill based on the administration's proposal, called the Savings for Working Families Act, was introduced in the last Congress with bipartisan, bicameral support. Despite the White House's retreat, Rep. Joseph Pitts (R-PA) has already introduced a new version of this bill in Congress.

### **Financial Education**

Congress remains hungry for innovative and effective policies designed to improve financial literacy and increase access to quality financial education. The Financial Literacy and Education Commission's (FLEC) national strategy paper was released in 2006 but resulted in no new legislative policy agenda. Congress may show increased interest in designing a relevant policy agenda, signifying that the new Democratic leadership will potentially call for another broad discussion involving hearings and research on the topic of financial education.

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