Stakeholding:
A New Direction in Social Policy

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"Them that got shall get, them that not shall lose. So the Bible says, and it still is news. Papa may have. Mama may have. But God bless the child that's got his own." -Billie Holliday-

Introduction

Although Billie Holliday undoubtedly was not thinking about public policy when she wrote these lines, they capture an enduring truth with far-reaching policy implications. People with assets -- them that got -- tend to fare better in this world than those without them. Yet contemporary anti-poverty policy is debated almost exclusively in terms of income and consumption rather than savings and investment. This paper seeks to broaden that debate by proposing a way to help low-income families build financial assets and so become stakeholders in American society.

In several important respects, social welfare policy in the United States is not working. Three million more children live in poverty than a decade ago. Traditional income transfer programs have failed to address deeply rooted social ills or stem the growth of a socially isolated "under-class." The ranks of the working poor have swelled by two million over the last decade, and living standards among this group have been severely squeezed by falling incomes and rising payroll taxes.[1]

Such developments have led to public disenchantment with conventional welfare programs. In seeking more effective alternatives, however, both conservative and liberal thinking have been narrowly circumscribed within the idea of income and consumption.

The concept of asset-building offers a new dimension of social policy for low-income Americans. In general, "assets" refers to the stock of wealth in a house-hold, its net worth. Assets are defined here chiefly in financial terms -- as savings that can be applied toward acquiring homes, education, pensions or the capital to start a small business. Under current welfare policies, poor families must deplete their assets before qualifying for cash benefits. It is time to think anew about policies that discourage poor families from saving.

An assets-building strategy could lead to greater equality in the distribution of wealth, while stimulating greater private savings and investment. We have become a nation of borrowers and spenders, and while we generally try to convince our-selves that spending is a sign of wealth, this is a very short- sighted view. Wealth is not income, spending, and consumption, but rather savings, investment, and accu- mulation of assets. Very few people manage to spend their way out of poverty.

For the past 55 years, the federal government has tried to improve social welfare mainly by transferring income from middle-and upper-income Americans to the poor. Such transfers are essential; they provide the bare minimum to poor citizens who subsist on the margins of an affluent society. But while Social Security benefits, which are indexed for inflation, have sharply reduced poverty among the elderly, other income transfers have not proved successful in moving poor families -- particularly those with children -- into the economic mainstream.

Our challenge is to invent a progressive social policy that goes beyond simple income maintenance to foster individual initiative and self-sufficiency. We should create a system of incentives that offers low- income citizens the same opportuni-ties that middle- and upper-income Americans have to plan ahead, set aside sav-ings and invest in a more secure future. Such a policy would stimulate economic growth while giving more citizens a chance to share the rewards of demo- cratic capitalism.

Assets and Well-Being

Assets are important because, unlike income, they represent a stake, a piece of the wealth and productive capacity of America. People think and behave differ- ently when they are building assets, and the world responds differently to

them. They are more likely to defer consumption in order to save for a better future. With assets to provide a cushion against adversity, their lives become economically and psychologically more stable, less vulnerable. People with assets have a more solid financial foundation, which often leads to greater family security, social esteem, and political involvement. And, by passing on their assets, parents are able to contribute to the well-being of their children and grand-children.

Assets are distributed far more un-equally than income. The richest five percent of Americans receive about the same income as the bottom 40 percent, but the richest one percent own as many assets as the bottom 90 percent. {See Graphs 1-3}. By age, assets tend to grow larger through age 65, then decline somewhat. Not surprisingly, education and asset accumulation are closely related.

The assets distribution is especially skewed against minorities. In 1984, the median white household had a net worth eight times higher than the median Hispanic household, and 12 times higher than the median black household.[2] Even middle-class whites and blacks have very different asset holdings. Among those earning $24,000 to $48,000 per year, the average net worth of whites is more than three times greater than the aver- age net worth of blacks.[3] In one study, three-quarters of the wealth gap between blacks and whites remained unexplained after controlling for differences in in- come. The researchers speculated that differ-ences in intergenerational transfers play an important role.[4]

Although there are many individual exceptions, the children of the asset-wealthy tend to stay wealthy, and the children of the asset-poor tend to stay poor.[5] Why do these uneven patterns of asset distribution persist? To examine this question, let us consider attitudes toward income and assets among four broad social groups: the wealthy, the middle class, low-income families (including the working poor), and the welfare poor.

Graph 1-[6]

Graph 2-[7]

Graph 3-[8]

The Wealthy

For the wealthy, assets are far more important than income. The wealthiest fifth of Americans receive less than half of the nation's total household income, yet they own nearly three-quarters of its household wealth. The distribution of capital wealth (primarily non-pension stocks and bonds and real es- tate) is even more concentrated at the top.

Children growing up in wealthy households learn about investment around the dinner table or among peers whose families likewise own many valuable assets. Moreover, wealth generates power, and power creates privileges conducive to accumulation of still greater wealth. Such privileges take many forms, the most common of which are access to capital on advantageous terms, access to critical information and prize jobs, and favorable business and investment tax laws.

Thus, the wealthy build and maintain their assets not entirely through superior intelligence, good char- acter, or hard work, but through elaborate structures of information, associations, procedures, and favorable rules. In short, they operate within privileged institutions, both public and private, that facilitate asset building, and such advantages are passed on to the next generation. The majority of wealthy people in the United States have inherited their wealth.[9]

The Middle Class

For the affluent middle class, income is uppermost. This group is made up primarily of professionals and managers whose families often did not have large as- sets. However, their parents probably owned a home, planned ahead, and valued education and achievement. While this group's income and consumption are substan- tial, their savings and investment are surprisingly limited. (As individuals, Americans save less than their counterparts in the rest of the industrialized world. The U.S. personal savings rate has increased to about five percent, but still compares unfavorably to Japan's 15 percent rate and the European rate of 7-10 percent.)

Nonetheless, the middle class benefits from two crucial forms of asset-building encouraged by the tax system -- home ownership and retirement pensions. Federal tax expenditures for home mortgage tax deduc- tions will be an estimated $25.4 billion for 1990, more than twice the federal expenditure for Aid to Families with Dependent Children

(AFDC). Tax expenditures for various retirement fund contributions and earnings are expected to total $61.8 billion in 1990.[10] These two tax privileges have created the bulk of the nation's household asset accumulation.[11]

In short, the middle class accumulates much of its wealth, not so much through saving or shrewd invest- ment, but through public policies that create struc- tured, institutionalized asset building opportunities that are in many respects difficult to miss.

Low-Income Familites

Low-income and working poor families are not so fortunate. This group has less income and job stabili- ty. Often, private pensions are not available at the workplace, and most members of this group (excepting retirees) do not own a home. They save less and thus get less benefit from public policies that promote saving. Low-income families have little to fall back on when a job loss, divorce, major illness, or other life crisis strikes. It is members of this group who slip into hardship and public assistance, then work their way out again, accounting for the dynamic nature of poverty in the U.S.

Federal support for the working poor has been modest and uneven. The two public policies that most affect them are the minimum wage and the Earned Income Tax Credit (EITC), both income-based policies linked to work. Throughout the first half of the 1980s, due to declining real wages and increased tax burdens, the number of working poor rose dramatically to more than 9 million.[12]

In 1986, the Federal income tax burden on the work- ing poor was eased. The minimum wage was recently raised, and pending legislation would expand the EITC. These are welcome developments because the working poor are, by far, the least assisted members of society (average transfers to working poor households, both direct and through the tax system, are much smaller than transfers to welfare recipients or to non-poor house-holds).

Most of the working poor do not have access to health benefits linked to jobs and do not qualify for Medicaid benefits. The working poor and their depen- dents make up about 80 percent of the 37 million Ameri- cans who lack health insurance.[13] In 1984, two-thirds ofthe heads of impoverished households who worked full- time for forty weeks or more were not covered by employer- or union-subsidized health insurance.[14]

The working poor and their families are ideal candi- dates for asset-based social policy because they may have enough income to meet immediate consumption needs, but cannot get far enough ahead to save signifi- cant amounts of money. No less than middle-class Ameri- cans, the working poor need and deserve help in buying a home, saving for their childrens' college educations, and supplementing Social Security retirement benefits. Asset-building policies for the working poor would help to "make work pay" in terms of these cherished family goals, and do so in a way that current income-based policy, alone, cannot.

The Welfare Poor

The welfare poor are in still worse shape. Many have no earned income during the year. For those who work, their jobs tend to be low paying, less stable, and almost assuredly without benefits. Rarely do they have pensions other than Social Security. Their rates of home ownership are lower. And even when the poor have pensions or own homes, the tax benefits they receive (and thus economic incentives for participation) are small or non-existent because the poor are in low tax brackets, or owe no Federal income tax at all. More- over, welfare households that receive AFDC (Aid for Families with Dependent Children) cannot own more than a trivial amount of assets in order to qualify and remain eligible for income transfers.

The logic of this rule is that taxpayers should not support families that have their own resources. Howev- er, the self-defeating nature of the policy is apparent. Forbidden to build assets that might sustain them during a climb out of poverty, families are dis- couraged from planning ahead for a better future. Instead, they simply subsist from check tocheck. Thus does the current policy of income redistri- bution leave untapped their economic potential and help to perpetuate rather than break the cycle of poverty and dependence.

Toward Assets: A Progressive Alternative

Several states recently have moved toward asset- building policy for middle class families in the form of state-sponsored savings plans for college. These plans vary, some guaranteeing a certain rate of college tuition and others providing tax-deferred or tax-exempt savings for college. In a similar vein, Michigan has a program to help first-time home buyers save enough for a down payment for a home. Though open to all, in practice, these education

and housing plans are aimed at the middle class. Like IRAs, they offer smaller incentives to low-income families, so few partici- pate.

Individual Development Accounts

In order to extend asset-building opportunities to those toward the bottom of the income scale, the feder- al government should create Individual Development Accounts (IDAs or "Ideas") similar to Individual Re- tirement Accounts (IRAs). IDAs would be optional, earnings-bearing, tax-benefitted accounts in the name of each individual, begun as early as birth, and re- stricted to designated purposes: housing, post-second- ary education, self-employment, and retirement. Al- though IDAs could be made universal, open to all but with greater incentives for the poor, this proposal assumes that IDAs are specifically targeted on low- income Americans.

The idea is simple: Washington would match IDA deposits made by people inqualifying low-income families. A wide range of match- ing formulas is possible, designed for different purposes and different levels of eligibility. For a high-priority purpose, such as savings for college, a federal match as high as five to one could be offered the poorest families. On the other hand, a lower-prior- ity purpose, such as a supplemental retirement account, might warrant a match as low as one to five. Eligibili- ty for federal matching would be based on a sliding scale. Ultimately, the size of federal matching should be based on empirical evidence from demonstration projects. The federal's government role should be to stimulate asset-building; subsidies should be only large enough to yield the desired effects.

An asset-based social policy using IDAs would be based on the following principles:

Asset-based policy would complement rather than replace income-based policy;

Participation would be voluntary;

Responsibility would be shared -- even the poorest participants would have to contribute in order to qualify for the government subsidy;

Accounts would be restricted to specific purposes;

Deposits and earnings would be excluded from federal income tax; and

IDAs would be used to promote economic education and training.

In determining who is eligible for IDAs, we should take into account both income and assets. In other words, individuals would have to be both income poor and asset poor to qualify. Therefore, some low-income families may be barred from participating if they already own their home or have other substantial assets. As with income poverty, we can draw an asset poverty line based on some absolute definition of minimal resources. For example, one could define the asset poverty line as 20 percent of the median value of existing single-family housing. Again, we ought to use evidence from demonstration projects to establish the appropriate level of asset poverty.

There is good reason to believe the public will support an asset-building strategy. Studies indicate that Americans are more apt to support spending on specific needs -- such as housing, food, medical care, child care, and education -- than on "public assis- tance" in gen-eral.[15] In similar fashion, IDAs are intended to help low-income families get what most Americans strive for: a college education or vocational training, a home, and a secure retirement. IDAs can also foster entrepreneurial behavior and self-suffi- ciency by making it possible for some to go into busi- ness for themselves.

IDAS for Post-Secondary Education

Because the world economy puts a premium on knowl- edge and brain power, the wherewithal to pay for post-secondary education or training may be the single most important financial asset anyone can have. Yet college costs today are rising faster than inflation, beyond the reach of many low- and middle-income families. Since 1980, tuition costs have risen by about 40 per- cent after inflation, while median family income has increased by just 6 percent. Meanwhile, federal student aid has grown by 18 percent after inflation.[16]

Student borrowing and loan defaults also skyrocketed in the last decade. In 1976, loans made up 21 percent of all college aid; by 1987, loans accounted for 66 percent of all aid. Defaults on college loans cost the federal government about $1.8 billion in 1989. These trends have hit black families hardest. Between 1976 and 1986, the percentage of

black high school graduates enrolled in college dropped from 34 percent to 29 percent.[17]

These realities have led Congress as well as several states to create new ways to help families save for their childrens' education. Beginning in 1990, parents with joint incomes under $90,000 can get tax breaks on income from Series EE U.S. Savings Bonds if it is applied toward tuition and fees at any col- lege, university, or vocational school. Even so, both the national and state savings programs primarily benefit middle-class and upper-income families. IDAs for post-secondary education, with the federal govern- ment matching the contributions of low-income families, would extend similar opportunities to our neediest citizens.

In the case of educational IDAs especially, there is potential for creative funding. For example, state and local governments may wish to match contributions to IDAs. Also, private corporations might "adopt a school" (as many do to-day) and make federally unmatched depos- its for students in that school. Students could also engage in fund-raising activities for their IDAs.

IDAs in Housing Policy

Federal housing policy is in shambles. Leaving aside the scandalous mismanagement of the Department of Housing and Urban Development in the last eight years, there are three principal reasons for growing housing problems: (1) A decline in the number of low-cost units available, (2) A decrease in real wages earned by poor families, and (3) A cut in federal assistance to the poor.

U.S. housing policy has revolved pri- marily around giving private developers incentives to build low- income housing and rent subsidies. Why not channel subsidies to IDAs for down payments, putting money directly into ownership by the poor and bypassing developers, land-lords and bureaucrats? Such a strategy would buttress growing community-based efforts to stimulate home ownership by low-income families, as well as federal initiatives to sell public housing to tenants.

The inability to save enough for a down payment poses the most critical barrier to home ownership. Research indicates that mortgage default rates do not depend on income. According to Gregory Barmore, chairman of GE Capital Mortgage Insur- ance Co., an insurer of mortgages to low-income fami- lies, "Once the down payment is made, people have a commitment to their homes." Contrary to popular concep- tion, owning is often cheaper than renting. At all income levels below $40,000, home owners, on average, pay a smaller proportion of their income on housing costs than do renters.[18]

Among the states, Michigan again appears to be in the lead in asset-based policy. Early in 1989, Governor James Blanchard proposed that first-time home buyers in Michigan earn tax-free interest on savings invested three to ten years in state-issued bonds. The earnings on savings are guaranteed to keep up with inflation in housing costs. Modeled after Michigan's college saving plan, this pro-gram marks the first time that a state has directly assisted first-time buyers with a down payment.

In 1989, Senator Alfonse D'Amato (R-N.Y.) and Sena- tor Alan Cranston (D-Ca.) introduced legislation that would allow first-time home buyers and others who have not owned a house for three years to use money from an IRA or a 401(k) savings plan as a down payment on a house. This approach could easily be revised to include deposit subsidies in housing IDA accounts for the poor.

IDAs for Self Employment

America's economic dynamism stems in part from its strong entrepreneurial tradition. During 1988, 8.6 percent of all employment was self-employment.[19] Without romanticizing self-employment -- many small businesses fail -- there is no doubt that small ventures are an important well-spring of business ideas, new jobs and future productivity. About 18 percent of businesses started in 1987 began with less than $5,000 in capital, and half the new jobs created during the last 15 years have come from independent firms under five years of age.[20]

Starting a small business requires seed capital, but current income-based welfare policy bans capital accumulation. Self-employment IDAs could remedy that defect by encouraging people to build enough assets to risk going into business for themselves.[21] Naturally, this use of IDAs would require approval of a sound business plan.

Employment-related IDAs might also be used to support job training and/or labor market mobility. The Ford Foundation has recommended lump sum payments for AFDC and Unemployment Insurance to persons in declining

labor markets to enable them to "move to areas of more promising economic opportunity."[22] This would be a step toward asset-based policy. But why assets only for moving? Some people would rather stay where they are and try to create their own employment. Public policy should encourage them to do so.

IDAs for Retirement Pensions

Nearly half of the American work force, some 47 million people, do not have private pension coverage, either because of low-benefit jobs, or because employees have changed jobs before becoming vested in a defined-benefit retirement plan.[23] Typically, defined-benefit pension plans do not allow workers to take money with them when they change jobs.

By matching contributions to a tax-favored IDA, the federal government would, for those with "bad jobs" and no benefits, make available the same sort of public subsidies currently enjoyed by those with "good jobs" and good benefits. The opportunity to build private pensions as a supplement to Social Security would also help make work -- even low-paid work -- more attractive than welfare.

Retirement IDAs could be developed through an expansion of Simplified Employee Pensions (SEPs), designed by Congress in 1978 as an alternative for small businesses that cannot afford to pay high start- up and operating costs of conventional employee pension plans. A SEP allows workers to take retirement money with them from job to job -- in other words, it creates a portable pension. In very small businesses (less than 25 employees), workers may contribute themselves if their employers do not. SEPs can also be set up by the self-employed. A retirement IDA program would add matching government subsidies to this system, giving the working poor a public subsidy similar to that received by the non-poor through the tax system.

Structure and Control of IDA Accounts

An asset-building IDA would operate in a manner similar to a defined contribution retirement plan. The money typically would go into a bank savings account or be invested in a money market fund, with stock or bond fund options for the more ambitious. Thus, IDAs would also serve the purpose of financial education by giving low-income families a reason to learn more about money, markets and investing.

Administering the IDA system would not entail creating an extensive new layer of bureaucracy. In the case of educational IDAs, universities and other institutions of post-secondary education would certify enrollment and distribute IDA funds to students just as they distribute federally guaranteed student loans today. In the case of housing IDAs, lending institutions would certify home purchases and directly receive IDA balances for down payments. In the case of retirement IDAs, age would determine eligibility, just as it does for IRAs. As for the case of IDAs for self-employment, business plans using IDA funds could possibly be submitted to local Private Industry Councils (PICs), set up under the Job Training Partnership Act.

To oversee the entire IDA system, Congress and the White House would appoint an independent Board of Trustees. The Board would establish basic investment guidelines and monitor pri-vate investment companies which would compete for shares of IDA investment funds on the basis of earnings performance. It would not participate directly in investment decisions. Using private sector fund managers would greatly reduce the federal bureaucracy required to manage IDA funds and create a competitive investment climate, leading to higher gains over the long term.

The costs of public subsidies provided to IDA accounts depends on how many people participate in the program and on how the federal matching formulas are set. If the IDA program is targeted strictly on the working poor, the costs could range from less than one billion dollars for a modest program to as high as $15 billion for a comprehensive system of IDA subsidies for education, housing, self-employment and retirement. While deferring taxes on IDA accounts would also entail tax expenditures, these would be small, since low- income participants have little tax liability.

Making Work Pay

In order to test the IDA concept, the federal gov- ernment should create demonstration projects designed to elicit answers to four key questions: (1) How large a subsidy is needed to induce low-income Americans to make deposits into an asset-building IDA? (2) Does the opportunity to build assets through an IDA lead to changes in attitudes and be-havior? (3) Does the existence of IDAs for the working poor tend, over time, to draw welfare recipients at the margin into the labor force? (4) Can IDAs be designed in such a way as to benefit those on welfare?

Obviously, the welfare population presents greater challenges than the working poor because the vast majority are not working and lack marketable skills. Also, the current assets tests would have to be changed. Although the value of a home and personal effects are usually disregarded in deciding who is eligible for welfare, liquid assets -- such as savings accounts -- are counted. As such assets increase, families quickly become ineligible for the cash income transfers on which they depend.

Relaxing the assets-based tests for AFDC and other income transfer recipi-ents might make more people eligible for welfare. However, the proposal here is that such a relaxation would apply only to savings in restricted IDA accounts. This would be a signal to the welfare poor that, through effort and economy, they might save enough to make a down payment on a home, post-secondary training or starting a small business. Again, we should test IDAs for the welfare poor in small demonstration projects.

The obvious objection to assets-based social policy is that the poor, almost by definition, need income more than assets. When you do not have enough money to decently feed, clothe and house your children, the issue is not saving for tomorrow, but getting through another day. From this perspective, it is unrealistic to expect that poor families could divert a portion of an already meager income into a restricted savings account.

For many of those mired deepest in poverty, the foregoing will unfortunately be true. However, the poor are not a monolithic or static group. Some poor adults work or are seeking work. Some surmount enormous obsta- cles and go on to college, or buy a home. While we should be realistic about the financial capacities of poor families, the graver error is to set our expecta- tions too low.

As one example of what poor but motivated people can do, writer David Osborne cites the "College Here We Come" program at the Kenilworth-Park-side public hous- ing project in Washington, D.C. Under the leadership of Kimi Gray, young residents there are encouraged to take summer and part-time jobs and open savings accounts for college. Those who don't save enough can get extra help from a college fund raised by project residents, large- ly through bake sales and raffles.[24]

Conclusion

It is a mistake to treat social welfare policy as a separate, residual function. Instead, it should be integrated with the major social, economic, political purposes of the nation. Our policies for assistingthe poor should reflect both humanitarian concern and economic self-interest. In this regard, social welfare policy in the United States, although occasionally couched in the rhetoric of "human capital investment," has promoted income maintenance over individual economic development. Maintenance is the result of policies based on income and consumption. The development of personal capacities, on the other hand, stems from policies based on savings, invest- ment, and asset accumulation.

As it offers new opportunities to America's low- income families, asset-based social policy would also contribute to the pool of national capital available for investment and economic growth.

Making more Americans stakeholders in our free enterprise economy fulfills a basic democratic ideal; it is also clearly in the nation's economic interest. The U.S. today needs a reinvigorated anti-poverty policy, one that combines the interests of economic producers and impoverished individuals. The concepts of investment and asset accumulation, rather than spending and consumption, can provide the moral and economic foundation for this new policy.

Notes

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