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A POST-HURRICANE POLICY RESPONSE TO POVERTY IN AMERICA

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The recent hurricanes wrought havoc on families and communities across the Gulf Coast and poignantly revealed how the debilitating effects of poverty persist across the country. The President has wisely proposed asset-based ideas as the core of his policy response—a urban homesteading act to encourage the ownership of land and homes, a Gulf opportunity zone to foster business ownership, and worker recovery savings accounts for job training and education. While insufficient in their scope, these proposals identify a promising path for federal policy efforts.

After the federal government responds to the immediate needs of those affected, a primary goal of rebuilding should be to assist evacuees build up long-term savings and assets as a means of reconstructing their financial lives. But the President should not lose this moment to provide a coherent and far-reaching strategy to address poverty. Poverty, such as that which was on display in New Orleans in the aftermath of Katrina, remains a national affliction, and it has been on the rise since 2000. Even by the Census Bureau's outdated measures, 37 million Americans—including one in four blacks and one in three black children—are now living in poverty. And since initial surveys indicate that more than half of the evacuees do not plan to return to the Gulf region, how can we discriminate between the evacuees and the poor in their midst? In responding to Katrina, the federal government should assume the responsibility of severing the disquieting ties between race, poverty, and ownership.

As recent events have shown, families without a stock of assets to draw upon in times of need are vulnerable to unexpected events. Their lack of a personal safety net makes them completely dependent on others. Policies that enable families to save and build up resources offer a means to move up and out of poverty. These policies will be most effective if they are delivered through a platform that is flexible and portable, one that works for evacuees regardless of where they re-settle as well as for others from the general population.

This brief offers a blueprint for a post-Katrina policy response to poverty in America. The proposals highlighted here are designed to address poverty by promoting the development of long-term savings and assets. Several proposals can be targeted to those directly affected by the Gulf Coast Hurricanes, while others can be implemented more broadly as a down payment on a renewed national commitment to strengthen anti-poverty efforts.

SUMMARY OF RECOMMENDATIONS

<u>Proposals to Help Katrina Evacuees Acquire Long-Term Savings and Assets</u>

- Deploy a “Financial Service Corp” of financial and tax advisors to assist evacuees.
- Designate Series I Savings Bonds as “Katrina Bonds.”
- Promote homeownership through a tax credit for evacuees who lost or never owned a home.
- Provide a $5,000 “Katrina Tax Credit” available to those that save in a Roth IRA, education account, low-cost bank account, or purchase a savings bond.
- Encourage financial institutions to offer simple, low-cost bank accounts to evacuees.

<u>Proposals to Address Poverty with Long-Term Savings and Assets Development</u>

- Expand Housing Voucher Program along with the Family Self-Sufficiency Program.
- Expand homeownership opportunities for lower-income families by increasing down payment assistance, and enacting a refundable First-Time Homebuyers' Tax Credit.
- Revise or eliminate asset tests in public assistance programs.
- Create a system of children’s savings accounts at birth.
- Expand the Earned Income Tax Credit (EITC).
- Use tax returns to connect tax refunds to savings products by encouraging IRS to allow refunds to be split among multiple accounts and offering a matching deposit for low-income savers.
- Create a targeted Lifetime Savings Account.
- Expand access to college and post-secondary education by expanding and revising Pell grants and improving the effectiveness of Section 529 College Savings Plans.
- Support microenterprise by creating a new Entrepreneur Tax Credit, supported by a self-employment literacy campaign.

PROPOSALS TO HELP KATRINA EVACUEES ACQUIRE LONG-TERM SAVINGS AND ASSETS

- **Deploy a "Financial Service Corp" of financial and tax advisors to evacuees.**

To help evacuees rebuild their financial lives and navigate through the range of relief programs, serious and ongoing financial counseling and tax-preparation assistance will be greatly needed. We thus propose a "Financial Service Corp" of financial and tax advisors, similar in structure to the Army Corps of Engineers or AmeriCorps. We propose a tax credit to tax preparation firms (such as H&R Block) and financial institutions to help off-set some of their costs of training personnel and advising evacuees. Recognizing that many financial educators may work for non-taxpaying entities (non-profits, credit unions, etc.), a direct grant program could be administered by the existing Treasury-led Financial Literacy and Education Commission.

- **Designate Series I Savings Bonds as "Katrina Bonds."**

Just as Series EE Savings Bonds were renamed "Patriot Bonds" following September 11th, Series I Savings Bonds could be designated "Katrina Bonds." Katrina Bonds would provide an opportunity for all Americans to contribute to the Katrina recovery effort while providing an easy, safe way for them to save for their future. I Bonds offer investors a fixed rate combined with semiannual inflation adjustments that will help protect purchasing power. Naturally, I Bonds would continue to honor eight prominent Americans, whose portraits appear on the different denominations offered. Finally, Savings Bonds are, in general, an excellent place for low-income Americans and Katrina victims to save money—Savings Bonds are safe, investment risks are low, and no bank account is required for purchase.

- **Promote homeownership through a tax credit for evacuees who lost or never owned their own homes.**

Homeownership must be central to any rebuilding of lives or affected regions. A "Homebuyers Tax Credit" would be available to qualifying households for the three years after purchasing a home. The credit could be pegged to a percentage of purchase price with a cap of 6% and restricted by an appropriate income level as well. This kind of temporary tax relief targets families that are ready and capable of buying a home but deterred by the increased financial commitment in succeeding years. This policy would help augment demand for homeownership and be implemented as one part of a vigorous strategy aimed at increasing homeownership in the Gulf region and for evacuees any where they may decide to live.

- **Provide a $5,000 "Katrina Tax Credit."**

To "jump start" long-term savings and asset-building, we propose a new Katrina Tax Credit that could be delivered directly on tax returns as a new refundable credit or simply by increasing the EITC or Child Tax Credit by the amount of the Katrina Credit. Only persons who lived in zip codes affected by Katrina (regardless of where the evacuees may reside at the time they file their tax return) could claim the credit. This $5,000 credit could be used only for:

* Saving in a Roth IRA, which allows penalty-free withdrawals for first-home purchase and post-secondary education, in addition to retirement. We recommend increasing the cap on homeownership non-penalized withdrawals from $10,000 to $30,000;
* Saving in a tax preferred education savings account;
* Opening a low-cost bank account or purchasing a US Savings Bond directly on a tax return.

- **Encourage financial institutions to offer simple, low-cost bank accounts.**

In one recent survey of New Orleans evacuees, 70% lacked a checking or savings account as well as a usable credit card. Without a basic bank account, financial stability will be nearly impossible to achieve.

We thus propose increasing both the supply of and access to low-cost bank accounts in the private sector. An easy way to achieve this would be to offer financial institutions a one-time payment to open "Electronic Transfer Accounts," or ETAs, which are low-cost accounts currently provided by the Treasury Department for people who receive recurring federal payments such as Social Security. Through participating financial institutions, the ETA could be made available to Katrina evacuees—provided banks would be given greater flexibility to tailor the product to meet their and the evacuee's needs. Tax credits could be offered to banks that offer ETAs, while direct payments from Treasury could be offered to credit unions and other non-taxpaying financial institutions.

PROPOSALS TO ADDRESS POVERTY BY SUPPORTING LONG-TERM SAVINGS AND ASSETS DEVELOPMENT

The images of the hurricane's aftermath were especially powerful because they exposed the despair that is often intrinsic to poverty. The pervasiveness of this despair extends far beyond the Gulf Coast. The following proposals are intended to address anti-poverty efforts on a national scale. Some of these ideas could be tailored to populations in specific regions, but they would have the greatest impact if implemented across the country.

- **Expand Housing Voucher Program along with the Family Self-Sufficiency Program**

For many low-income families, the lack of affordable housing options leads to housing costs that eat away at a family's budget. Securing affordable rental housing is also often the first step towards homeownership. Expanding the voucher program would increase the demand for rental housing at the same time as it would control a family's housing costs. It is essential that this expansion occurs in accordance with the principles of the Moving to Opportunity Demonstration project, which has reinforced the advantages of promoting economic integration and avoiding the concentration of poverty in specific communities. This expansion should accompany increased use of the Family Self-Sufficiency Program, which allows public housing authorities to create escrow accounts where earnings increases are stored rather than being used to pay for rent.

Individuals gain access to these accounts once they are employed, free of welfare assistance for at least 12 months, and substantially achieve the goals in their self-sufficiency plan. While public housing authorities have the ability to open escrow accounts, they are required to identify designated case managers. HUD should either increase its dedicated funding to hire case managers or more effectively seek partnerships with agencies already in the case management business.

- **Expand Homeownership Opportunities for Lower-Income Families**

Homeownership is at the core of the American Dream. Supported by a steady stream of public policy interventions that have facilitated the purchase and continued ownership of homes, the rise in the national homeownership rate has been impressive. Yet lower-income families face significant hurdles in becoming homeowners and do not benefit from most of the current policy incentives designed to promote homeownership. This can be addressed through a series of new policies, program, and reforms.

> **Increase Down Payment Assistance.** This can either be achieved through small grants or mortgages subsidies that bring down the costs of getting into a new home.
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> **Make the homeowner's mortgage deduction refundable for lower-income households.** This tax break provides $70 billion a year in tax relief. Since the mortgage deduction is not refundable, the bulk of the benefits go to higher income families. 54 percent of the homeowner's deduction goes to households earning more than $100,000 a year, and nearly 90 percent of this benefit goes to households with adjusted gross incomes over $50,000. Making the deduction refundable for households earning under $50,000 will open up this subsidy to families on the cusp of achieving the American Dream.
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> **Enact a refundable First-Time Homebuyers' Tax Credit**. The largest obstacle for most first-time homebuyers to overcome is saving for the down payment. This problem has only increased as home

prices have risen. First-time homebuyers earning under $50,000 a year should be eligible for a dollar-for-dollar tax credit for money used as a down payment, up to a $10,000 amount. This tax credit should be made refundable to benefit families without high tax liabilities.

- **Revise or Eliminate Asset Tests in Public Assistance Programs**

The application of low asset limits to determine eligibility for federal public assistance benefits is a huge disincentive for saving. One of the great policy achievements of the 1990s was that nearly all states raised their assets limits as part of their TANF plans. Several have dropped them altogether. While states continue to innovate where they have the flexibility to do so, an opportunity also exists to reform these limits at the federal level. Restricted savings should be excluded from eligibility resource tests. Currently, only retirement savings in pension plans are universally excluded from consideration in assistance eligibility, while 401(k)s are excluded in only some programs, and IRAs are generally counted. Resources in these types of accounts should be exclude across the board so that these savers are not rewarded in some programs and penalized elsewhere. Further, if the asset limits are not eliminated entirely, they at least should be raised to make them more in line with contemporary standards. The asset limit for the Supplemental Security Income program has remained frozen at $2,000 ($3,000 for couples) since 1989. Indexing these limits for inflation would help to gradually raise the amount that families can save without need for additional legislative or other action. Or, these limits should be raised enough so that everyone can keep three months emergency savings on hand—an amount most financial planners agree provides an appropriate contingency.

- **Create a System of Children's Savings Accounts at Birth**

One of the most novel and promising ways to achieve a universal, progressive asset building system over time would be to provide each generation of children a restricted, start-in-life asset account at birth. These accounts would establish a universal platform and infrastructure to facilitate future savings and lifelong asset accumulation. While every child would have an account, it would especially benefit the 26 percent of white children, 52 percent of black children, and 54 percent of Hispanic children who start life in households without any resources whatsoever for investment. The America Saving for Personal Investment, Retirement, and Education Act (ASPIRE Act) is sponsored by a strong bi-partisan coalition of legislators in both the House and the Senate. The ASPIRE Act would provide every child with an account at birth—called a KIDS Account—that would be endowed with $500 and supported with progressive, targeted savings incentives until age 18, at which point it could be used for going to college, buying a home, or building up a nest-egg for retirement. (For more information, see www.AspireAct.org.)

- **Expand the Earned Income Tax Credit (EITC).**

An expansion of the EITC, in addition to enabling more low-income Americans to save, would provide tax relief to lower-income working families. Previous expansions of the EITC have proven to be effective at providing work incentives and lifting families out of poverty. A well-crafted expansion would increase the maximum credit for working families with three or more children, expand the credit for married, two-earner couples, and expand the credit for families with two or more children. An expanded EITC program will create larger tax refunds, which in turn can be linked to savings products.

- **Use Tax Returns to Connect Tax Refunds to Savings Products**

The tax system can be a gateway to the financial system and to building savings and assets. Last tax season the IRS sent refund checks averaging $2,100 to 106 million tax filers. These cash infusions are often the best chance people have to save some money in any given year. This is particularly true for lower-income families.

Over 20 million lower-income families—one in six taxpayers—received an average $1,700 boost to their refund from the Earned Income Tax Credit (EITC), a refundable tax credit designed to reward work. The Child Credit is another vital source of tax refunds. Also, for the millions of Americans who do not have bank accounts, tax time is an opportunity to help them open accounts to receive their refunds electronically, to take their first step to enter the financial mainstream, and begin to save. People may spend rather than save their refunds because they do not have an easy way to convert a portion of their refunds into savings vehicles. Recent research finds that many Americans—including lower income ones—can and will save their refunds if offered appropriate incentives and a clear way to do so. The challenge for policymakers is to facilitate and incentivize the savings of tax refunds into existing—and possibly new—savings products.

Encourage the IRS to allow tax refunds to be split among multiple accounts. Under this proposal, people could deposit their refund into IRAs, 529 college savings plans or a variety of other savings accounts. Right now, taxpayers have only one choice; refunds are issued in a lump sum. If it is easier for people to save right on their tax forms, to split their refunds into "money to save" and "money to spend," people will save more, perhaps much more. Research has indicated that even low-income tax filers would use this "splitting" option to save. The Administration has signaled their intention to implement this change to the tax filing process by the 2007 tax year; they should be encouraged to keep to this implementation schedule.

Provide a matching deposit, up to $500 per year, if a low-income taxpayer saves part of their tax refund in a targeted savings account (such as a 529 college savings plan or a Roth IRA). If a low-income taxpayer is willing to set aside up to $500 of their tax refund in an after-tax savings product, they would be eligible for a 1 to 1 match, up to $500 per year, to be deposited directly by the government into that account. This matched IRA could be justified as providing EITC recipients with similar opportunities for tax-favored savings enjoyed by higher-income workers. While legislation would be necessary to provide the matching deposit, no new refundable tax credits, and no new financial products would be required. Ideally, at some point the IRS could consider listing these savings products directly on tax forms, so that with a check-of-the-box a portion of a tax refund could be saved.

- **Create a Targeted Lifetime Savings Account**

The President's Lifetime Savings Account (LSA) proposal, which would create an incentive for savings, should be modified to target low-income families. Since LSAs as proposed are available to everyone regardless of income, they would likely provide tax-sheltering or "asset shifting" opportunities for better-off Americans while doing little to encourage low-income Americans to save. LSAs should be revised to encourage more low-income Americans to save. In addition to adding an income limit on persons eligible to save in LSAs to reduce the likelihood of asset shifting, LSAs can be made more inclusive by offering a matching deposit, on a 1-1 basis, for low-income persons who save in LSAs. The matching deposit could be delivered through a tax credit to financial institutions that offer LSAs, through existing refundable tax credits, or through the creation of new refundable tax credit.

- **Expand Access to College and Post-Secondary Education**

For many, higher education is a prerequisite for securing a well-paying job, but is also often the first step to achieving security, acquiring assets, and building wealth. While educational attainment rates continue to rise across all race and income groups, persistent gaps remain between races and people of difference socio-economic backgrounds. Financial barriers prevent almost half of academically qualified low-income students from attending a four-year college and financial aid increasingly is offered through loans, merit awards and tax credits rather than need-based assistance.

Revise and expand Pell Grants. An increase in the maximum Pell Grant award that a student can receive every year would be the most beneficial way to increase access to college.[1] However, the current Pell Grant program should be restructured so that aid is concentrated in the first two years of college. This "front-loaded" grant would cover a larger percentage of expenses and greatly reduce the need for a loan in the first two years. While students would then have to finance their remaining years of school with a federal loan, they would be less averse to taking out a loan after having gained confidence in their abilities to complete their education.

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[1] In the FY 2006 Budget, the Bush Administration calls for increasing the maximum Pell Grant award from $4050 to $4550 over the next five years.

Expand pre-college programs. One of the most important parts of making college more accessible is ensuring that every child receives a quality K-12 education so that they are prepared to succeed in college. They must also begin their school career with the expectation that college is within their reach. To this end, it is important to increase awareness and financial support of pre-college programs which have shown that they are successful. The TRIO and GEAR UP programs should be dramatically expanded so that far more than the current 10 percent of eligible students are able to take advantage of these programs.

Improve the effectiveness of Section 529 Savings Plans. 529 savings plans offer an account-based approach to saving for post-secondary education. While the structure of most state-run 529 plans offers a useful savings platform, the federal tax incentives associated with these accounts primarily restrict benefits to middle- and upper-income families. This platform should be strengthened by making the system more transparent, inclusive, and offering saving incentives for those who need them most. Options could include an initial public deposit delivered directly or through a refundable tax credit, matching grants, or setting up a system of children's savings accounts for each child through the 529 account infrastructure already in place. These reforms will enable families to evaluate and make informed choices as to how best to save for college.

- **Support Microenterprise**

Microenterprises—businesses with five or fewer employees that can benefit from a loan of $35,000 or less—are an important source of household income for many families. These businesses access training and financial services from more than 600 microenterprise development organizations nationwide. Yet public support for these programs, and the businesses they serve, has been fragmented and uneven.

Create a New Entrepreneur Tax Credit and Self-Employment Literacy Campaign. Filing Schedule C is perhaps the single most important "formalizing" event in a new business's start-up process. Schedule C could be an appropriate vehicle for targeting different kinds of asset-building deductions and credits for micro businesses and other self-employed businesses. A New Entrepreneur Tax Credit could be offered to first-time Schedule C filers that have at least $10,000 in net business income. The credit could be taken over a multiple-year period for new entrepreneur start-ups. Further, a Business and Tax Literacy Campaign would inform sole proprietors about the benefits of Schedule C filing and the new tax credit.

Restructure the SBA Microloan Program. Since 1992, the Small Business Administration has provided grants and loans to nonprofit intermediary lenders engaged in microenterprise development. This program could be more effective if the following changes were made: (a) create a credit enhancement pool of $500 million; (b) expand the target market; (c) establish standards for borrower, loan performance, and technical assistance.

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