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How to Help the Working Poor Develop Assets

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This article explores the inability of the working poor to withstand income shocks. Because they often lack assets, the working poor are increasingly vulnerable to increasing deprivation. Interestingly, the welfare state enables the middle-class to develop and maintain assets through institutional arrangements. It is argued that solutions to the problem of poverty must include ways for the working poor also to develop and maintain assets.

Over the last several years some discussion has focused on the financially vulnerable state of the working poor (O'Hare, 1985) with scholars, such as Sherraden (1988) and Belcher and DiBlasio (1990), arguing that more attention needs to be directed towards the working poor's inability to accumulate and maintain assets. Household incomes continue to shrink for the average American family, which places them at greater risk of falling into poverty. Assets enable individuals to withstand income shocks, such as unemployment, divorce, disability, or a death in the family. Facilitating asset development is designed to supplement already existing income maintenance programs by expanding support to Americans who make too much income to qualify for income maintenance, but earn too little to participate in traditional middle class entitlement programs.

During the 1980s social welfare policies were criticized for affording too many people the opportunity to participate in welfare entitlement programs, such as food stamps and Aid To Families with Dependent Children (AFDC) (Murray, 1984; Abramovitz, 1983). The neo-conservative attack on the welfare state focused on those individuals receiving entitlements, however, it ignored one of the greatest beneficiaries and also one of the greatest costs to the social welfare state; people who earn middle and upper incomes (Belcher & Singer, 1988).

The American welfare state has developed a two tier layer of benefit programs with a growing number of Americans unable to participate in either layer. Income maintenance programs are reserved for the very poor and the tax shelters provided by the federal tax code primarily benefit people with higher incomes. For example, in 1987 approximately 75 percent of the benefits from housing related tax shelters were utilized by people in the top 15 percent of the income distribution or people with incomes over \$30,000 (Leonard, Dolbeare, and Lazere, 1989). People who do not fall below the official poverty line and do not earn over \$30,000 are often overlooked by the welfare state.

A goal of the social welfare state is to motivate people to become invested in society by staking their future on both the vitality and stability of society. The state facilitates this process for the middle class through institutional asset development mechanisms, such as the home mortgage interest deduction. The working poor are overlooked and the very poor are only marginally and inconsistently sustained. The working poor's disaffiliation is not easily measured, but it is apparent in the growing number of working poor who vote for political candidates who blame the desperate economic times on welfare mothers and inner city poor people who allegedly do not want to work. It is also apparent in the number of voters who have simply quit participating in the electoral process.

This paper explores the problem of asset insecurity and develops workable strategies to expand asset accumulation efforts for more Americans.

Asset Insecurity

Many Americans within the middle class have been afforded a stake in society through the mosaic of accumulation programs that enable them to develop assets (Pechman, 1989; 1990). The federal tax code allows people to shelter income from taxation through the purchase, improvement, and maintenance of an asset. For example, home ownership enables many taxpayers to use interest, insurance, and property taxes paid on their residence to reduce their tax liability which in turn reduces revenue to the federal treasury. People also shelter income through the

use of tax deferred annuity accounts commonly known as 401K plans. These benefit programs enable thousands of Americans to develop and maintain assets that can later be converted to cash or used to leverage greater wealth.

A growing number of American's incomes are so low that they are unable to take advantage of traditional middle class accumulation programs, such as home ownership. Income disparity has significantly increased between 1977 and 1988. In 1988, the most recent year for which the federal government has published a poverty line, the official poverty line was set at \$12,092 for a family of four. This meant that approximately 32.5 million people were officially poor. Nearly two million married couple families live below the poverty line. At least one parent worked in 82 percent of these families, and both parents worked in 30.6 percent of these families. The Census Bureau reported that in 1990, 33.6 million Americans were poor. This figure is 2.1 million higher than in 1989. Income for middle-income households declined by \$525. These figures, while alarming, do not begin to show the extent of poverty in many inner cities where the Census has historically under counted and under-reported rates of poverty.

The poverty line is a somewhat arbitrary number and many experts believe that it does not accurately reflect the purchasing power of an income. A recent study conducted by the Center on Budget and Policy Priorities in which a sample of 3,511 people were asked how much a family of four needed to pay for rent, food, health care, transportation, and other expenses placed the figure at \$20,913 (O'Hare, Mann, Porter & Greenstein, 1990). This figure is 73 percent higher than what the government has determined to be necessary for a family of four to simply survive.

Another way to examine the extent of poverty is to examine the portion of income received by different groups. Table I highlights the fact that the second poorest and the poorest two fifths of the nation's population received a total of 19.9 percent of the national income.

Many of the people in the second poorest fifth quintile are not included in official poverty estimates because their income is just above the poverty line, however, their incomes are not

Table I.

Income Distribution of American Families in 1988

<i>Population Category</i>	<i>Percentage of Total National Family Income Received</i>	<i>Comment</i>
Poorest Fifth	4.6%	Lowest since 1954
Second Poorest Fifth	10.7	Lowest ever recorded
Middle Fifth	16.7	Lowest ever recorded
Next Richest Fifth	24.0	
Richest Fifth	44.0	Highest ever recorded
Richest Five percent	17.2	Highest since 1952
Middle Three-Fifths	51.4	Lowest Ever recorded

Source: Center on Budget and Policy Priorities U.S. Census Bureau.

sufficient to enable them to avoid poverty. Over the last decade people with incomes in the poorest and second poorest fifth quintiles have lost ground with their share of the national income declining (Greenstein & Baranick, 1990).

As some people's wages have declined relative to prices, they are at greater risk of sliding into economic hardship when they are confronted with divorce, a major illness, unemployment, and an accident related disability. These families have been characterized as the "working poor" or "income marginals" because their persistently low-incomes always make them vulnerable to any loss of resources or supports (Rodgers, 1982; Wyers, 1988).

The working poor live in both rural and urban environments. Those who live in urban centers are often impoverished minority groups and displaced manufacturing workers who live out their lives in urban environments with declining public services and a high crime rate (Levine, 1987; Wilson, 1987). The working poor in rural areas are also confronted with abandoned manufacturing jobs and a growing number of service sector jobs that pay low wages. Over the last two decades the American

job machine has generated many more low-paying jobs as compared to high paying jobs and more companies are using sub-contracting as a means to reduce expenses (Belous, 1989).

A Future of Lousy Jobs

The growth of the working poor has taken place as a result of structural changes in the economy in which the number of working poor have risen, while the number of people on welfare (i.e., on AFDC), have not changed appreciably (Shapiro & Greenstein 1989). When people suffer an income loss they turn to other resources, such as family and/or savings. However, the working poor often have no savings and their extended families are often in similar fiscal straits. The present recession has shown the financial vulnerability of many Americans as the number of participants in programs such as food stamps, general public assistance, and Medicaid increases.

The working poor tend to have entry level skills and comparatively low educations. They were often raised in families with similar skills. Beginning in the 1970s the economy experienced a significant growth of low-paying service sector jobs and a decline in relatively high-paying manufacturing jobs (Bluestone and Harrison, 1982; Harrison & Bluestone, 1988; Murnane, 1988; Belcher & DiBlasio, 1990; Krugman, 1990; Wagner, 1991). Manufacturing jobs have traditionally employed people with low skills at relatively high wages, however, as these jobs continue to disappear, incomes will continue to decline for many unskilled workers. The state of Maryland provides a graphic example of this trend. From 1980 to 1986, Maryland experienced an 11.4 percent decline in manufacturing jobs. At the same time, service jobs increased by 41.7 percent (MDEED, 1987). Wages in these newly created jobs are as much as 80 percent less than in manufacturing (Kasarda, 1988). Many urban areas were radically changed in the 1970s and 1980s. For example, Baltimore, Maryland, which lost a majority of its manufacturing base, has been promoted as a city that moved from an industrial base to a more dynamic service industry (Frieden & Segalyn, 1986). However, the assessable tax base, which is a reflection of the incomes of city residents, declined by 49.5 percent between 1970 and 1985 (Budget in Brief, 1990).

Declining incomes and increasing economic dislocation is also highlighted by the fact that incomes have declined among all income groups, except those individuals earning over \$50,000 or more a year (Horrigan & Haugen, 1988). Underemployment is increasingly becoming a permanent way of life for many Americans. Retailing jobs, which is one of the more rapidly growing sectors of the economy, pay wages averaging \$2,000 less per year than the poverty level for a family of four (Moorehouse & Dembo, 1986). The proliferation of low-wage jobs has contributed to an overall decline in living standards. Since 1973, wages have stagnated. Interestingly, women between the ages of 35–44 with four years of college showed some increase in wages, while men, even with a college education, showed declines (Levy, 1989). The change in the economy towards jobs that pay low-wages is highlighted by the growth in the number of working poor people. The number of poor people who worked full-time year-round was 42.9 percent greater than in 1978. Full-time year round work provided them with low enough wages that they remained poor. Continuing income loss for a majority of Americans creates a window of opportunity to broaden asset accumulation among more income groups.

The Tax Reform Act of 1986 (TRA) and Recent Budget Agreement

The federal income tax provides the institutional means by which most Americans develop and maintain their assets. Therefore, it is important to review the most recent changes in the tax code and examine the support the tax system provides to the working poor.

The Tax Reform Act of 1986 (TRA) was described by President Reagan as “the best antipoverty bill . . .” and as a bill that would “keep America competitive” (Conlan, Wrihston, and Beam, 1990). The TRA did remove approximately six million poor people from the tax rolls by increasing the standard deduction and personal exemption and liberalizing the earned income tax credit. The TRA also repealed many deductions and exclusions, such as the deduction for state and local sales taxes and for credit card interest. On balance, however, the TRA retained the major tax shelters that enable people with higher

incomes to develop and maintain assets. These deductions include; the deduction for state and local income tax, real estate, and personal property taxes; the deduction for home mortgage interest on a primary residence and a vacation home; and the exclusion of employer provided fringe benefit. The deductions for contributions to individual retirement accounts (IRAs) and to 401 (K) plans were limited, but the limitations kept in force these provisions as tax deferred mechanisms to develop and maintain assets.

The TRA did not improve the ability of Americans with incomes below \$30,000 to develop assets. The earned income tax credit was expanded, but only for families with children. Those families that were dropped from the tax rolls because of the increased standard deduction and personal exemptions will be better able to support themselves or their families, but their low incomes make them unable to take advantage of asset building tax strategies, such as the deduction for home mortgage interest. The TRA did not recognize the increase in social security payroll taxes that in tandem with already low wage bases resulted in less take home pay for many Americans (Aaron & Bosworth, 1990). The thrust of the TRA was to maintain this nation's preference in assisting Americans with asset accumulation who earn moderate to high incomes, but ignore the needs of lower-income Americans to create savings and assets.

The recent compromise to reduce the federal budget deficit also disproportionately taxes low-income individuals as compared to higher income individuals, because many of the tax increases are to levied on gasoline, liquor, and cigarettes (Greenstein & Leonard, 1990). It is true that the final budget package is more progressive than the original summit agreement. Nevertheless, wealthy taxpayers will retain most of the large tax cuts they received during the Reagan years. Therefore, the overall effect on the tax system is only minimally progressive and disproportionately taxes people with lower incomes so that people with higher incomes can enjoy asset building tax preferences. Leonard and Greenstein (1990) note:

The average tax burdens of people with incomes below \$20,000 will decline when these people are considered as a group.

However, this decline is due entirely to the net tax credits for low income working families with *children* p. 11).

Historically the federal tax code has set a precedent for "resisting fundamental change" (Conlan, Wrightson, and Beam, 1990). Crafted by congressional committees to placate lobbyists as well as the executive branch, the federal tax code is an example of creeping incrementalism. Therefore, while the federal tax code can provide some expanded opportunities for the working poor to develop and maintain assets, it is also important to craft strategies that can complement the federal tax code.

Strategies to Facilitate Greater Asset Accumulation

Declining incomes should be a sign that the nation needs to examine its mix of jobs and use a combination of economic development efforts and fiscal policy to create better paying jobs. The cost of certain essential services, such as health care, now consume such a large portion of the Gross National Product (GNP) that reform is also necessary to create legislation that both expands access to health care and controls its runaway costs through a national health care system (Belcher and Palley, 1991). Such a system will lessen the need for asset building strategies, because people will not have to prolong needed medical intervention. Nevertheless, people need assets to provide resources for food, clothing, and shelter in case of an income shock. In addition, people need assets in order to supplement social security at retirement.

Three strategies that can be enacted to complement the federal tax code and respond to the growing disaffiliation among many working Americans. These efforts concentrate on increasing and expanding the earned income tax credit, increasing home affordability, and expanding the availability of tax supported retirement accounts. These strategies will gain political support because they are broad based and address the concerns of the growing number of Americans who are experiencing a decline in their standard of living because of stagnant or reduced wages. One of the unfortunate legacies of the Reagan administration is a burdensome federal deficit, therefore, it is also important to pay for these strategies in ways that do not add to the federal deficit.

Expanding the Earned Income Tax Credit (EITC)

In order to assist poor people in developing and maintaining assets, it is also necessary to increase the incomes of poor Americans. One way to do this is to expand and increase the EITC. The EITC already enjoys broad political support, because in order to qualify a person must earn an income. The EITC applies to families defined as a man, woman, and at least one child where at least one of the adult family members is employed at least part of the year. The credit is applied against earned income in a manner that provides an incentive for the family to earn higher wages. Shapiro & Greenstein (1980) provide an example of how the credit is applied;

For example, in 1989, a family received a 14 cent credit for each dollar earned up to \$6,500. The credit does not begin to phase out until earnings exceed \$10,240, and then does so at a slow pace (10 cents for each dollar earned) (p. 11).

Scholars, such as Ellwood (1988) have argued that the EITC should be adjusted to exclude more poor people's wages from taxation. One way to accomplish this goal is to make all working poor people regardless of family composition eligible for the EITC. As already noted the EITC was expanded for working families with children so that more earned income is excluded from taxation. Secondly, the 14 cent credit could be raised to a higher number, such as 18 cents, and the full credit could be applied to a higher income amount, such as \$10,000. The EITC enjoys widespread support and some adjustment in it is likely (Shapiro & Greenstein, 1989). Paying for an expanded EITC can be done by raising marginal rates on higher incomes. Revenues from these taxes should be earmarked to fund an expanded EITC. The U.S. tax system is only mildly progressive and Americans enjoy one of the lowest tax rates for an industrialized nation.

The EITC is the engine for the other two initiatives, increasing housing affordability and the national pension base, because the EITC will place more money in the pockets of the working poor. This extra cash can expand the asset base of the working poor by providing them with the money for investment opportunities that have been historically closed.

Increasing Housing Affordability

Increasing the affordability of homes can be accomplished in three ways; first, real estate commissions should reflect the true cost of selling a home; second, the cost of borrowing should be reduced; and third, deductions for home mortgage interest should be graduated so that people with smaller incomes receive a greater deduction than those with larger incomes.

The first proposition, reducing real estate commissions is a thorny issue. Realtors do perform meaningful services, however, realtor's fees are often set and maintained by associations of realtors. For example, realtor's commissions are often set at somewhere between seven and ten percent regardless of the services actually performed. In many cases their service amounts to little more than facilitating the settlement. Nevertheless, the realtor still receives his/her seven to ten percent, which increases the price of a house. If realtor's fees were determined by the market and more buyers entered the market because of a greater supply of mortgage money available, realtor's fees would decline and the price of homes would not be inflated to reflect the cost of the more traditional seven percent realtor fee.

The National Association of Realtors is a powerful lobby and state realtor's associations are significant players in state legislatures. Discount realty firms, despite lower fees, have been unable to significantly penetrate the market. Increasing the market share controlled by discount brokers would increase pressure on full service brokers to reduce fees and would lower the price of homes by reducing an inflationary element in home pricing.

Three barriers inhibit discount realty firms in their quest for greater market share; first, full service realty firms control the multiple listing service; second, full service realty firms usually have special relationships with bankers to obtain mortgage money; and third, realty firms are a relatively self-regulated industry. The self-regulating nature of the real estate market shields realtors from public scrutiny and effectively enables full service realtors to collude to prevent discount brokers from capturing larger market share. Real estate laws vary from state to state, but the law in general does not prohibit discount brokers from becoming members of the multiple listing service. In

addition, discount brokers are not prohibited from developing relationships with bankers. An "old boy" network exists in the real estate industry that effectively excludes discount brokers because they have chosen to violate the rules of the network or club. Bankers are also part of the club. The rule that they have violated is simple; they compete against their peer real estate firms on the basis of price.

The most effective way to break the power of real estate firms is to investigate the real estate market for potential violations of state and federal anti-trust laws. It only takes one enterprising district attorney or states attorney, which could then act as a precedent for similar actions. In fact, the state of New York has begun such litigation (Belcher and DiBlasio, 1990). Similar litigation could be initiated in other states by class-action law suits.

Reducing the cost of borrowing is the second means to lower the price of homes. The cost of borrowing is not determined by the supply and demand for homes. Instead, the Federal Reserve controls interest rates through its actions (Greider, 1987). The Federal Reserve's (FED) actions are determined by the Federal Reserve Chairman and the Reserve Bank's judgement about whether inflation is rising or falling. The FED has tended to want to maintain low rates of inflation, even if it means interest rates are driven up. As interest rates increase more home buyers are driven out of the market and more people are excluded from the opportunity to develop and maintain assets. A lower mortgage interest rate can reduce monthly payments and enable people with lower incomes to afford housing. One way to lower interest rates is to raise marginal tax rates for individuals by one percent, which in 1989 dollars would raise approximately 24 billion dollars (Mann & Schultz, 1988/89). This money would be earmarked for housing loans. This program would be different than the Federal Housing Administration (FHA). The FHA guarantees the loans of commercial banks, but the program does not create a pool of additional mortgage money that can be used to increase the overall supply of mortgage money available.

Banks are the usual conduit for mortgage money. For example, states have often used bonds to raise mortgage money. The money is then distributed by banks. Banks are able to charge

points and other fees to home buyers in order to obtain this money. An alternative approach is to set strict limits on the fees that banks can charge for these funds. In addition, the availability of these funds would be widely advertised to both full service and discount brokers to prevent any attempt by bankers to limit the availability of these funds.

It is true that an increased supply of mortgage money could place some upward pressure on home prices by increasing the number of home buyers relative to the supply of existing homes. However, demographic changes in the United States suggest that the number of people seeking single family detached dwellings will decline. Therefore, the two forces should balance out one another by creating competing pressures.

The third method to lower home prices, which is to graduate the home mortgage interest deduction, would enable lower income buyers to shelter income as well as higher income buyers. One alternative would enable home buyers to deduct a portion of their home mortgage interest up to a limit of \$7,500 of interest. The remainder would not be deductible. The home mortgage interest deduction would also be based on earned income so that as income increased, the amount of interest that could be deducted would decline. Finally, low-income home buyers could take advantage of a special tax credit. This credit would refund a portion of the interest payment that they had paid. While the home mortgage interest deduction is somewhat sacred in the United States, other industrialized countries, such as Canada, do not support home ownership through the tax code. People in Canada still buy homes and realtors make profits. Therefore, it is important to educate the American public that other countries do address home ownership differently and in ways that can increase housing affordability.

The combination of these approaches would lower the price of homes and redirect investment into more modestly priced homes. As home builders found that buyers were unwilling to buy more expensive homes, they would probably respond by building lower priced homes. This is a long term process and the effects of these changes would gradually bring about a reduction in housing prices.

National Pension Base

A third mechanism to increase asset accumulation is to create a nationally based pension system. The working poor generally work in jobs where they receive only 25 percent of employer contributions to health and pension funds (Rothschild, 1988). This comes about because many of the working poor are employed part-time, seasonally, or they are underemployed and receive no pension benefits. In addition to the fact that many people are excluded from participating in a pension system, other people either lose the employer's contribution to their plan because they terminate employment before they are vested or they quit a job and use the employer's contribution for living expenses. Even the Bush administration recognized the fact that at least 45 percent of the workforce is not covered by a pension account.

A national based pension system would address some of these problems. All employees would have the right to participate and direct their employer contributions to the plan. Employers would have to comply with the employee's request. In addition, all employers would be subject to a minimum pension tax for each employee, which they would have to contribute to the plan. The plan would be portable from employer to employer. Unlike the social security program, it would strictly be a pension program.

A universal pension plan was proposed by the President's Commission on Pension Policy in 1981 in which three percent of an employer's payroll would be dedicated to a universal pension system (Munnell, 1982). The plan was not enacted because of strong opposition from business groups who argued that it represented another tax on business. Without universal pension coverage, however, low-paid workers will continue to subsidize the pension savings of higher paid workers.

The 1990s are particularly critical times for American industry. Foreign competition continues to threaten both the market share and profitability of core American industries. Therefore, any additional tax on business might act to destabilize industry and further erode American productivity. One way to fund a universal pension system without negatively impinging on

American business is to provide business with an incentive to contribute to the plan. Business groups as well as many investors have argued for many years that the double taxation of dividends is wrong because it encourages business to take on too much debt and it also taxes capital twice (Shoven and Waldfogel, 1990). An alternative to the current approach is to allow businesses to deduct the cost of dividends paid out. This will enable businesses to gain a tax break, which will have been traded for a universal pension system. The revenue lost to the federal treasury can be made up by increasing individual marginal tax rates by one to two points. Another alternative is to exclude small businesses that have a certain number of employees and earn less than a certain amount of money from the law. Unfortunately, such an alternative would be difficult to enforce because businesses would tend to overstate expenses in an effort to evade the law.

A universal pension system will enable the working poor to move from job to job and remain covered. Participants would not be able to cash-in their benefits until retirement, however, they could borrow against their accumulated savings up to a defined maximum.

The three alternatives suggested can together include more Americans in asset development and maintenance strategies. These strategies can help some people avoid falling into poverty or more severe poverty by developing an asset that can be utilized during times of economic hardship. The universal pension system can act as a source of credit during a person's working life and can help a person avoid poverty in retirement by creating a supplement to social security. These strategies do not replace the entitlement based welfare system. Instead, they enhance it by providing more Americans with a means of saving for the future and avoiding economic dislocation.

The Political Challenge

Crafting the legislation described in the article and encouraging some enterprising lawyers to sue associations of realtors would not be difficult. The more difficult part is convincing the Congress that it should move beyond vested interest groups, such as the National Association of Realtors,

the American Bankers Association, and the American Manufacturers Association, and develop legislation that responds to the needs of the working poor. The thrust of asset development is that it reduces reliance on the welfare state by providing people with a cushion that can be utilized during economic hardship. The plan can be sold to the Congress because it does not add to the federal deficit, reduces reliance on the welfare state's traditional entitlement programs, and enables more Americans to purchase a stake in the future of America.

Congress appears to be aware of greater voter discontent, but are either unwilling or unable to respond. As fewer Americans can afford to purchase a home or be protected by a pension plan, they have less incentive to support traditional politicians and are more likely to support political demagogues, such as David Duke. While some scholars, such as (Brown, 1991), blame the disaffection of the working poor, particularly white voters, on issues of race, the economics of low wages and the growing inability to achieve or even sustain a modest standard of living are the more likely culprits (Sleeper, 1991). Asset development is a way to bring the working poor back to the democratic process by providing them with some of the same opportunities afforded the middle class.

A recent example of a politician taking advantage of voter discontent and exploiting it is Senator Wolford of Pennsylvania. He defeated Dick Thornburgh by portraying Mr. Thornburgh as an insider and someone who had forsaken the needs and aspirations of working Americans. Political interest groups who support progressive legislation have a window of opportunity. As incomes continue to fall for many Americans the income gap between lower income groups and the lower middle income groups is narrowing. This phenomenon provides a unique opportunity to educate these two groups that they have much in common (Belcher and Hegar, 1991). Issues that have tended to divide these groups, such as race, will continue to be sources of contention, but the common bond of low incomes and shattered expectations can create leverage for change.

The reforms outlined to increase asset development and maintenance should be sold to Congress as a package. The package does make demands on the business community and

does limit the power of some groups, such as realtors. At the same time, the package provides business with incentives that will enable businesses to lower tax liabilities. Some individuals will have to pay increased taxes. In today's political climate the notion of raising taxes is usually met with immediate disfavor. Selling higher income taxes will be difficult, however, there is a growing sense among many politicians, scholars, and lay people that a tax increase is necessary. These taxes would be earmarked for a specific purpose, which might make them more palatable than arguing that they would go to support a bloated government.

There is no magic or secret to pushing through these efforts. They will require the support of a coalition of advocates that should include both traditional welfare type advocates and progressive business groups. The support of both kinds of groups illustrates the middle ground that these strategies attempt to achieve.

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