NEW AMERICA FOUNDATION
ASSET BUILDING PROGRAM

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THE ASSETS REPORT 2006:
A Review, Assessment, and Forecast of Federal Assets Policy

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The second year of the Bush Administration's second term is underway and the prospect of a large breakthrough for asset building policy appears remote at this time. The President's second Inaugural Address, which highlighted the transformative potential of "ownership" and an "ownership society," has given way to the political realities of budget deficits, international commitments, and uncertain electoral prospects.

In this difficult political environment, a "dual track" strategy should be pursued: continuing to lay the foundation for larger, more ambitious asset-building policies while aggressively pursuing lower-cost policies that are poised to boost savings and asset accumulation by the poor in the near term—especially ensuring that the IRS's "split refunds" proposal becomes a reality in 2007, as promised. The other potentially low- to modest-cost idea that could advance this year is promoting financial education for children and youth by creating a KIDS Accounts at birth for all newborns. Congressional attention is likely to focus on financial education following the Administration's release of a "national strategy" paper in April.

The Assets Report 2006 – Highlights

2005 Review

* Gulf Coast hurricanes wreck havoc on communities, federal budget, and political agenda.
* President's proposal to reform Social Security and introduce private accounts fails to generate political support.
* Little attention is given to alternative means to promote savings.
* The America Saving for Personal Investment, Retirement, and Education (ASPIRE) Act was reintroduced in both the houses of Congress.
* The bi-partisan Congressional Savings and Ownership Caucus was formed in the House and Senate.
* A congressional hearing, entitled "Building Assets for Low-Income Americans," was held before the Senate Finance Committee, a landmark for the asset building field.

President's Budget Proposals FY 2007

* Of the $383.8 billion in budget resources for asset building activities in 2007, $366.9 billion are tax expenditures that primarily benefit families earning above the national median income.
* The budget includes $16.9 billion in asset building direct expenditures for 2007, down $608 million from 2006.
* The Administration reiterates its commitment to allow the splitting of tax refunds among multiple accounts.

2006 Preview: What's on the Agenda in Congress This Year

* Election year clouds the prospects of ambitious, large-scale asset building policy proposals.
* Pension reform bill expected to be completed this year, extending Saver's Credit and promoting automatic enrollment in 401(k) plans.
* Financial Education proposals likely to emerge after the release of the FLEC strategy paper.
* Estate tax repeal debate slated for May.

The purpose of this annual report is to summarize and take stock of the current state of federal policy through an asset-building lens, especially as it affects the asset base of the poor. Accordingly, this report is divided into three sections. The first is a review of policy developments of the past year related to asset building; the second is an examination of the President's budget proposals for Fiscal Year 2007 from an assets perspective; and the third is a forecast of the assets policy issues that may be considered in Congress during 2006.

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. Much of our work focuses on asset building efforts for households with limited financial means but many policy efforts affect families throughout the income distribution. In fact, it is remarkable that overwhelming majority of resources and subsidies that promote asset building accrue to families earning well above the national median income.[1] Further details on the policies and proposals discussed in this report can be found at www.AssetBuilding.org.

While not intended to be a definitive list, the report identifies almost $383.8 billion in resources related to savings, asset building, and wealth creation that are included in the Bush Administration's FY 2007 Budget. The lion's share of these resources, $366.9 billion, is catalogued as tax expenditures, while $16.9 billion of discretionary spending is proposed. In total, the $383.8 billion represents a slight increase in budget spending over last year, but that is because tax expenditures related to asset building increased 0.5% ($1.9 billion), whereas discretionary funding for asset building, which generally supported programs targeted to lower-income persons, decreased by $608 million from last year. Much of this decline occurred within the area of funding that promotes access to post-secondary education.

I. 2005 IN REVIEW

Gulf Coast Hurricanes

The hurricane season of 2005 wrought havoc on families and communities across the Gulf Coast and poignantly revealed how the debilitating effects of poverty persist across the country. Though seasonal, the devastation of these events was large and unprecedented, and the government's response was poor by many measures. The work of rebuilding New Orleans, and other affected regions, is a project that will be expensive and lengthy. The political impact of the hurricanes also carried a legislative cost as it derailed other items that may have been on the political agenda.

Interestingly, the President proposed several 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 limited in their scope, these proposals identified a promising path for federal policy efforts. Congress took up the legislative challenge by passing two bills. The first, the Katrina Emergency Tax Relief Act of 2005, was signed into law in September 23, 2005. This Act provided emergency tax relief for affected individuals and employers. Provisions included special rules to allow for access without penalty to funds in retirement accounts. The second, the Gulf Opportunity Zone Act of 2005, was enacted in December and provided additional tax relief, extending benefits to those affected by Hurricanes Rita and Wilma. Even though the initial proposals of the White House pointed in the right direction, there was little follow-up and Congress choose to ignore the homesteading and savings account proposals, instead focusing on targeted tax relief.

Social Security, Pension Reform, and Savings

Social Security was expected to dominate the political agenda in 2005. Early in the year, President Bush signaled his intention to expend some of his political capital to support a revamping of the Social Security program, especially through the introduction of private accounts. Democratic opposition to this concept was strong, persistent and unified. Democrats were wary of trying to refocus this debate toward savings and other means to support retirement security. Consequently, no legislative proposal for Social Security was considered in Congress and little attention was given to alternative savings policy efforts.

Legislative action focused on pension reform occurred throughout the year, but this work was not completed and remains an outstanding issue for the 109th Congress to resolve in 2006. Many legislators interested in the broad issues of pensions and savings expressed a preference for linking this work to tax reform and were waiting for the final report of the President's Advisory Panel on Federal Tax Reform to be issued. However, even when the

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

panel's final report was released in November interest in tax reform was weak. This report includes a range of far reaching ideas and specific proposals for reforming the tax code, many of which would affect fundamental decisions about how households choose to save or consume, and thus directly impact the broader process of asset building.[2] Some of these proposals may influence consideration of future savings policy debates.

The America Saving for Personal Investment, Retirement, and Education (ASPIRE) Act which would create a universal system of children's savings accounts established at birth with progressive saving incentives was reintroduced in April 2005. This legislation helped raise the profile of the potential of children's savings accounts and asset building. One result was a hearing on asset building held before the Senate Finance Committee entitled, "Building Assets for Low-Income Americans." This was the first time the assets field has testified before the Senate Finance Committee, which has jurisdiction over the vast majority of the nation's existing asset-building policies. Further evidence of the growing recognition of savings as a policy topic was the formation of the bi-partisan Congressional Savings and Ownership Caucus in the House and Senate where key Members of Congress can learn about and discuss a variety of issues and policies related to expanding savings and broadening asset ownership.

Post Secondary Education

Portions of the Higher Education Act were reauthorized until 2010 through the Deficit Reduction Act of 2005, which was signed into law by President Bush in early February 2006. Changes to the student loan program were among the most significant in the reauthorization. Currently, student loans have a variable interest rate which is now at about 5.37% with a cap of 8.25%. This new law will change student loans to a fixed interest rate of 6.8%. PLUS loans, which can be taken out by the parents of a college student, will also switch from a current variable rate of 6.1% to a fixed rate of 8.5%. In addition, loan limits have been increased in recognition of rising college costs.

A supplemental Pell Grant award, an Academic Competitiveness Grant, will be made available for low-income freshman and sophomore college students that complete a rigorous high school curriculum. To qualify, students must be attending a four-year institution full-time and be eligible for the Pell Grant. Awards will range from $750 to $1,300 per student. In addition, a National Science and Mathematics Access to Retain Talent (SMART) grant of up to $4,000 will be awarded to college juniors and seniors majoring in science, math, foreign languages or other disciplines deemed critical to national security. The Deficit Reduction Act allocates $789 million for FY 2006, increasing to $1.01 billion in 2010.

This new law also revised the application process for financial aid to make it easier for those whose families are already receiving some kind of public assistance such as TANF, food stamps, SSI, or reduced priced school lunch, as well as families earning under $20,000 a year. Finally, savings in restricted savings accounts such as 529 college savings plans, Coverdell education savings accounts, or prepaid tuition plans will be considered assets of the parent which will mean that these savings will impact the total amount of financial aid a student receives more favorably.

Bankruptcy Bill

After many previous attempts at reforming bankruptcy laws, the Bankruptcy Abuse Prevention and Consumer Protection Act was passed in April 2005. A flurry of bankruptcy filings occurred in advance of the more restrictive provisions, which came into effect on October 17, 2005. The new law makes it more difficult to file Chapter 7 bankruptcy and instead generally requires those filers above the state median income to file Chapter 13 which entails at least some level of debt repayment. Potential filers must first go through a financial counseling session by phone, web, or in person to review the implications of a bankruptcy filing and any available alternatives. Additionally, before debts can be fully discharged, the filer must go through a personal financial management course that covers subjects such as budgeting, credit, and rebuilding finances.

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[2] See Cramer (2006) paper entitled "Savings and Tax Reform: Analysis of the Savings Proposals of the President's Advisory Panel on Federal Tax Reform. Washington D.C.: New America Foundation.

Financial Education, Predatory Lending, Financial Services

Various policy proposals related to financial education and curbing predatory lending were introduced in Congress over the past year. Financial education proposals were largely targeted to adults nearing retirement, low-income tax filers, TANF recipients, K-12 youth, and young adults attending college. Despite the attention to this issue in Congress, none of these bills became law. The Financial Literacy and Education Commission (FLEC) led by the Treasury Department continued to work towards drafting a national strategy for increasing the financial literacy of all Americans, which is expected to be issued by April of this year. Finally, as required by the Fair and Accurate Credit Transactions (FACT) Act, a system allowing all Americans to access their credit report annually for free was fully implemented across the country.

Two competing anti-predatory lending bills were again introduced in Congress this year. The industry-favored Responsible Lending Act sponsored by Rep. Ney (R-OH) would provide some additional federal protections to mortgage loans, but would also pre-empt tougher state and local laws already on the books. Consumer advocates instead favor the Prohibit Predatory Lending Act sponsored by Rep. Brad Miller (D-NC) which is modeled after North Carolina's anti-predatory lending law.

II. DESCRIPTION AND ANALYSIS OF THE PRESIDENT'S FY 2007 BUDGET

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

This year a $2.77 trillion budget was unveiled for 2007. Highlighting the need for deficit reduction and economic growth through increased competitiveness, the rollout focused much attention on the President's priority to "make the tax cuts permanent." Last year's Budget included an explicit call for increasing ownership as a means of allowing individuals to assert a greater control over their lives, but this emphasis was essentially dropped this year. Much attention was instead devoted to getting the long-term deficit under control, projected to be $354 billion for 2007. However, this estimate only includes a $50 billion estimate for Iraq war costs, a figure which most analysts agree is unrealistically low. Certainly costs pressures associated with Iraq and the aftermath of the Gulf Coast hurricanes should be expected to continue.

Since federal policy has many levers, it is important to distinguish between the different types of policies and programs. Accordingly, this analysis will identify (a) new initiatives and proposals, (b) funding for existing programs, and (c) tax expenditures as a means of describing the Administration's budget from an assets perspective.

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 was designed to provide a foundation for a national discussion of transforming our tax system into one that is "simple, fair, and pro-growth."[3] 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 involved the reintroducing the savings proposals that were presented last year.[4]

[3] President's Advisory Panel on Federal Tax Reform (2005). "Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System." Report of the President's Advisory Panel on Federal Tax Reform.
[4] U.S. Treasury Blue Book. General Explanations of the Administration's Fiscal Year 2007 Revenue Proposals. Page 1.

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

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

As in previous years, the Budget proposes creating an *Individual Development Account (IDA) Tax Credit* to help lower-income individuals save. This proposal would provide dollar-for-dollar matching contributions of up to $500 a year targeted to lower-income individuals through a 100 percent credit to sponsoring financial institutions. Taxpayers would be eligible to establish and contribute to an IDA if their modified Adjusted Gross Income in the preceding taxable year did not exceed $20,000 for single, $30,000 for heads of household, and $40,000 for married taxpayers filing jointly. The credit would apply to contributions made to the first 900,000 accounts opened after December 31, 2007 and before January 1, 2015.

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

Without the Saver's Credit or any other alternative policy to promote savings, on balance, the proposed accounts create incentives that are regressive, could reduce saving among the most vulnerable populations, and would exacerbate the already bleak long-term budget outlook. Instead of creating a new set of incentives that promote deposits from existing resources that can grow tax-free, it would be more effective to target incentives for people who currently don't save enough and may not benefit from the current system of tax benefits.[5]

[5] For New America's federal policy agenda for broad-based savings and asset ownership, see Boshara, Ray, Reid Cramer, and Leslie Parrish (forthcoming 2006). *Policy Options to Promote Savings and Asset Ownership for All Americans*. Washington, D.C.: New America Foundation. Available on AssetBuilding.org.

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

	2007	2008	2009	2010	2011	2007-20016
Expand Tax-Free Savings Opportunities[6]	4,796	10,407	7,507	3,970	-383	-122
Consolidate Employer-Based Savings Accounts	--	-542	-579	-618	-1,826	-20,063
Establish Individual Development Accounts	--	-134	-286	-326	-300	-1,763

Source: Office of Management and Budget, Executive Office of the President. Budget of the U.S. Government, Fiscal Year 2007, Analytical Perspectives. Table 17-3.

Split Refunds

The Administration remains firm in its commitment to amend the tax filing process to allow all taxpayers to channel their tax refunds into more than one account. Treasury's Blue Book describes the effort in the following terms:

> "Savings will be further simplified and encouraged by administrative changes to the tax filing process that, beginning in the 2007 filing season, will allow taxpayers to direct that their tax refunds be directly deposited into more than one account…Simplifying the rules, making savings opportunities universally available, and making it easier for people to set money aside through direct deposit will complement the Administration's commitment to programs focusing on financial education, and specifically, retirement planning."[7]

Split refunds would represent a significant step in establishing the infrastructure to promote asset building because savings rates are strongly influenced, not just by tax incentives, but by the administrative ease of savings programs. The ability to automatically divide a refund into "money to spend" and "money to save" directly on tax returns may help families overcome any reluctance they may have in directing their entire refund into tax-preferred savings accounts, like IRAs, that are subject to restrictions on withdrawals. This is particularly relevant as the percentage of electronic filing of tax returns continues to increase from 31 percent in 2001 to 51 percent in 2005.

While the split refund concept is more of a reform than a program initiative, results from a recent pilot project suggests that it holds much promise. When taxpayers were offered this opportunity at a demonstration site in Oklahoma, about one-third wanted to participate, and of those that did, they deposited on average almost half of their expected refunds into savings accounts. The Earned Income Tax Credit (EITC) is the source of tax refunds for many low-income families, and the split refund proposal offers an opportunity to convert this asset into savings. If offered to all taxpayers, the ability to split refunds right on the tax form can create a prime opportunity for tax preparers to more easily enable their clients to save a portion of their refund and to educate them about the benefits of saving at al income levels.

Homeownership

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

[6] 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.

[7] U.S. Treasury Blue Book. General Explanations of the Administration's Fiscal Year 2007 Revenue Proposals. Page 8.

B. Funding Request for Existing Programs

Education

Many elements of the President's budget for post-secondary education, such as changes to loan programs and the addition of the Academic Competitiveness Grants program, have been incorporated in the Deficit Reduction Act signed in February 2006 and described above. This proposal is similar to a previous one in last year's budget for Presidential Math and Science Grants. The President proposes the elimination of the college readiness program GEAR UP again this year, and significantly decreases funding for the TRIO program, both of which serve prospective first-generation, low-income college students. In addition, the President again requests the elimination of the LEAP program which provides grants to states for needy students. In a departure from a proposal to increase the Pell Grant award gradually each year, the Administration shows the maximum Pell Grant award remaining at $4,050 for another year. In other programs, such as the Supplemental Education Opportunity Grants (SEOG) and Work-Study, funding is held somewhat steady.

Housing and Urban Development

HUD reports progress on its established goal to create 5.5 million new minority homeowners by 2010. Low interest rates have been one of the primary factors supporting the increasing rate of homeownership, but HUD has supported homeownership through several programs which continue to receive support. These include Housing Counseling, HOME, and the American Dream Downpayment Initiative.

Housing Counseling, funded at $45 million, is being proposed this year as a stand alone program with its own budget line as opposed to being funded as a set-aside within the HOME program. This approach, if Congress agrees, could establish a more secure funding stream for years to come. The American Dream Downpayment Initiative provides grants to low-income families to purchase their first homes. The budget provides $100 million for this effort. Funds requested for the Homeownership Voucher program are up this year to $14 million from $5 million last year. In its five year history, it has supported 5,000 families that lived in public housing or received a rental voucher to become homeowners. In budget terms, this is a small program but the budget proposes to almost triple its resources. The budget also requests $120 million for the Neighborhood Reinvestment Corporation (NRC). This program has not been considered as an asset building program in previous analyses but this quasi-public organization is engaged in many efforts to expand homeownership, increase financial education levels and promote affordable housing opportunities. In 2007, NRC expects to provide direct assistance to over 180,000 families through affordable mortgage and rehabilitation lending, homebuyer education, and counseling services.

The Family Self Sufficiency program is a potentially powerful asset building vehicle which allows participating families in assisted housing to set aside money into an escrow account that would otherwise go to rent increases. The administration is proposing to provide $48 million in funding for FSS coordinators in the housing voucher program. Recent evaluations of the program found it to be well designed and effective in increasing the earnings and savings of participants, but it was also found to require greater participation by the housing authorities. In previous years, the Administration has proposed adjusting the funding formula for the public housing and voucher program in a way that created uncertainty for the Family Self Sufficiency program with respect to the money available to fund the escrow accounts. This year the Administration has proposed an important "fix" that would ensure more stable funding for the escrow accounts and allow public housing authorities to continue their participation in FSS without jeopardizing funding for their other housing programs.

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. Last year an evaluation conducted as part of the budget process found that the program addresses the specific problem of asset poverty. A national impact evaluation to determine whether this policy helps families become economically self-sufficient has been planned but is not yet completed. The assessment did find that the program lacked adequate performance goals, and subsequently, the program initiated a working group among grantees to develop new measures. The Budget included the following improvement plan for the program:

- Developing grantee-supported performance outcome measures and targets that demonstrate improved efficiencies or cost effectiveness.
- Identifying cost-neutral ways, through legislation, regulation and administrative action, to improve the effectiveness and efficiency of the program.
- Supporting efforts to reauthorize the program with legislative proposals for program improvement.[8]

Treasury

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

Labor

The Budget includes $144 million to run the Employee Benefits Security Administration, the agency responsible for safeguarding workers retirement savings. More significant is the current state of the Pension Benefit Guaranty Corporation (PBGC), the entity that insures the defined-benefit pensions of 34 million workers against employer bankruptcy or other failures. At the close of 2005, PBGC had liabilities that exceeded its assets by nearly $23 billion, double what it had been in 2003. The Administration has outlined a strategy to reform the funding rules; improve disclosure to workers, investors, and regulators; and adjust PBGC insurance premiums to improve the financial condition of the insurance program. Legislation, described below, is pending in Congress.

Small Business Administration

The 2007 budget proposes termination of the Microloan program. This cut is justified by the claim that the Microloan program "has been excessively expensive relative to other programs. The 7a program is capable of serving similar clientele through Community Express program at a much lower cost to taxpayers."

[8] Description of program assessments can be found at ExpectMore.gov.

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

	Actual 2005	Estimated 2006	Requested 2007
Department of Education			
Pell Grants-Funds Available	12,594	12,746	12,986
Academic Competitiveness Grants	--	790	850
Supplemental Educational Opportunity Grants	986	976	976
Work-Study	1,184	1,172	1,172
Leveraging Educational Assistance and Partnerships (LEAP)	167	165	--
TRIO	837	828	380
GEAR UP	306	303	--
Department of Housing and Urban Development			
Self-Help Homeownership Program (SHOP)	--	20	40
Housing Counseling	38	42	45
American Dream Downpayment Fund	50	25	100
Family Self-Sufficiency—Voucher Program	--	93	48
Homeownership Vouchers	3	5	14
Neighborhood Reinvestment Corporation	114	118	120
Department of Health and Human Services			
Assets for Independence Demonstration Program	25	24	24
Department of Treasury			
Community Development Financial Institutions	55	54	8
Department of Labor			
Employee Benefits Security Administration	131	134	134
Small Business Administration			
Microloan Program, loan levels	18	20	--
TOTAL	**16,508**	**17,515**	**16,907**

Source: Office of Management and Budget, Executive Office of the President. Budget of the U.S. Government, Fiscal Year 2007.

C. 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 asset-building investments such as mortgage payments, business investments, retirement savings, and educational expenditures. As calculated by the government, the value of these asset building tax expenditure programs is approximately $366.9 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 consider together to capture the ultimate scale of the policy effort.

The theory behind using tax expenditures as a policy vehicle is that it works best when the benefits or incentives are related to income and are intended to be widely available. While tax expenditure programs may subsidize worthy activities and generate sizeable social and economic returns, they are not accessible to a large number of citizens that would 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.[9] All told, the federal government offers over $170 billion a year in support of homeownership and over $110 billion to subsidize retirement savings.

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

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 2007
(in millions of dollars)

Housing	
Deductibility of Mortgage Interest on Owner Occupied Housing	79,860
Deductibility of Property Tax	12,810
Capital Gains Exclusion on Home Sales	43,900
Exclusion of Net Imputed Rental Income on Owner-Occupied Housing	33,210
Subtotal Housing	*169,780*
Investment: Commerce	
Capital Gains	26,760
Capital Gains Exclusion of Small Corporation Stock	260
Step-Up Basis of Capital Gains at Death	32,460
Carryover Basis of Capital Gains on Gifts	640
Exclusion of Interest on Life Insurance Savings	20,770
Subtotal Commerce	*80,890*
Education	
HOPE Tax Credit	3,060
Lifetime Learning Credit	2,020
Coverdell Education Savings Account (formerly Education IRA)	110
Deductibility of Student Loan Interest	810
Deductibility of Higher Education Expenses	--
State Prepaid Tuition Plans	620
Subtotal Education	*6,510*
Retirement: Income Security	
Net Exclusion of Pension Contributions: Employer Plans	52,470
Net Exclusion of Pension Contributions: 401(k) Plans	39,800
Net Exclusion of Pension Contributions: IRAs	5,970
Net Exclusion of Pension Contributions: Savers Credit	830
Net Exclusion of Pension Contributions: Keough Plans	10,670
Subtotal Income Security	*109,740*
TOTAL	**366,920**

Source: Office of Management and Budget, Executive Office of the President. Budget of the U.S. Government, Fiscal Year 2007, Analytical Perspectives. Table 19-1.

III. 2006 PREVIEW

In devising a forecast to what the upcoming year will bring for assets policy, it is useful to consider the context of the political calendar. Mid-term elections will be held in November and that means that the next nine months will be called an election year. Traditionally, these years are difficult to predict—sometimes there is a stalemate, other times there is a flurry of activity. Regardless of the political calculations, the fiscal constraints of a growing budget deficit are real and likely to limit the prospects of legislative proposals that have big-ticket price tags. Funding the Iraq war and the ongoing reconstruction of New Orleans will continue to drain budget resources.

The White House has signaled that their main priorities for the year will be legislative action to extend the tax rates initially passed in 2001 and 2003. The call to "make the tax cuts permanent" would result in an estimated $1.4 trillion in revenue losses over 10 years. The two issues which were indicated to be top policy priorities for the second term, Social Security and tax reform, appear to have lost steam, at least for the near term. Many are predicting that these issues will be renewed in 2007, but that remains to be seen and undoubtedly will be influenced by the outcomes of November's elections.

Pension Reform

Congressional action is required to complete work begun last year on pension reform. A conference is scheduled to be convened to reconcile separate bills passed by the House and the Senate (H.R. 2830 and S. 1783). The push for pension reform is being driven by concerns with the financial health of the Pension Benefit Guaranty Corporation, which insures employer defined benefit retirement plans. Temporary funding and other legislative fixes have been made but they are due to expire. Congress is expected to impose additional funding requirements for "at risk" plans, modify rules for credit balances used to satisfy contribution requirements, and increase the PBGC flat-rate premiums. The effectiveness of these provisions has been the subject of debate.

Additionally, Congress has used this as a legislative opportunity to promote other policies designed to promote retirement savings, such as extending the Saver's Credit and facilitating automatic 401(k) enrollment. The bill encourages employers to offer the automatic enrollment option by adjusting the rules which consider the treatment of highly compensated and non-highly compensated employees. The bill also offers firms some protections from lawsuits if investment performance is poor. The Saver's Credit provides an incentive for lower-income workers to contribute to existing retirement products. Created in the 2001 tax, it is set to expire this year. The House bill makes it permanent while a different Senate bill (S.2020) extends it to 2009. There are other improvements to the Saver's Credit which neither the House or Senate has passed mainly making it a refundable credit that would increase its value to its targeted population.

Children's Savings Accounts

The reintroduction of the ASPIRE Act in April 2005 succeeded in raising the profile of children's savings accounts proposals as a means of promoting savings and asset building. It continues to be one of the most prominent proposals for the asset building field. The likelihood of passing this bill has diminished as the size of the savings debate has shrunk with the demise of the Social Security reform and retirement savings debate. A related bill that would establish accounts at birth with modest initial contributions may be considered in the context of a policy effort to promote financial education.

Estate Tax

In a recent speech, Senate Majority Leader Frist, announced plans to bring legislation to the floor in May that would repeal the estate tax. It is unclear if there is enough support to provide for the full repeal of the estate tax as 60 votes would be needed to protect it from a filibuster. Last year a group of Senators from both parties held ongoing negotiations on a potential compromise. The outline of this deal would entail a reduced rate for the estate tax and a higher exemption level. Senate Finance Committee member Jon Kyl (R-AZ) has taken the lead for Republicans on this issue and announced that those negotiations will soon begin again.

Individual Development Accounts

A legislative version of the White House's proposal to create an IDA Tax Credit has been under consideration from Congress for a number of years. The Savings for Working Families Act (SWFA) has been introduced in both houses of Congress. The tax credit would support matching contributions to Individual Development Accounts (IDAs) for low-income people saving for a first home purchase, business capitalization or expansion, or post-secondary education or training. Under this program, financial institutions would offer IDA accounts in which participants could deposit up to $1,500 a year. For each dollar the financial institution matches, they would receive a tax credit, up to $500 per IDA account per year. The Senate bill (S. 922) has been lead by Senators Rick Santorum (R-PA) and Joseph Lieberman (D-CT) and the House has recently introduced their bill (H.R. 4751) sponsored by Representatives Joe Pitts (R-PA), Phil English (R-PA), Melissa Hart (R-PA), Stephanie Tubbs Jones (D-OH), Mike McIntyre (D-NC), and Jane Harman (D-CA). Both bills include $20 million for nonprofit organizations to offer financial education to support the savings process.

Financial Education and Predatory Lending

Financial education will continue to be a focus this year for Congress, the Administration, and the states. The Financial Literacy and Education Commission's (FLEC) national strategy paper will likely be released in April. While this paper will encompass topics such as savings, homeownership, retirement, investor protections, and taxpayer rights, it is unclear whether it will provide general best practices or be more prescriptive. Once this paper is released, the General Accounting Office will issue an evaluation and potentially make further recommendations based on the contents of the strategy. These documents will likely serve as a starting point for new policy proposals from the Administration and Congress for the next several years. This legislative effort may provide a means to include proposals to create children's savings accounts with modest initial contributions to facilitate the demand of financial education.

Post-Secondary Education

The remaining sections yet to be reauthorized of the Higher Education Act were extended until spring, when they will likely be taken up again. In the fall, Education Secretary Margaret Spelling's Commission on the Future of Higher Education is scheduled to release a national strategy which is expected to offer a guide for future White House policy efforts.

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