

# UPSIDE DOWN

THE \$400 BILLION FEDERAL  
ASSET-BUILDING BUDGET



The Annie E. Casey Foundation

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## INTRODUCTION

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**Economic mobility** is the abiding ethic of this country: The working poor are expected to bootstrap their way into the middle class, as middle-class families aspire to greater wealth. But for the first time, we face a scenario where the current generation of teenagers may well be less successful than their parents.

This comes, in part, because of a sour economy that dampens investment and job growth. But it also reflects a misguided federal approach to helping families save money and build wealth for the next generation.

Income alone is not enough to progress in the American economy. It also takes assets: homes, businesses, savings, and education. Recognizing this, the U.S. government has long invested in helping families build assets. The Homestead Act was basically an asset-building tool. So are the G.I. bill, home mortgage deductions, and more recently 401(k) plans and Individual Retirement Accounts (IRAs). Through the years, these strategies have helped create the strong middle class that is the hallmark of American productivity.<sup>1</sup> In fiscal year 2009 alone, the federal government spent nearly \$400 billion on policies that help families buy homes, start businesses, put their children through college, and retire comfortably.

But these policies, administered largely through the tax code, are terribly skewed. They tend to subsidize wealth building for the wealthiest among us, rewarding them for size of their homes and investment portfolios. Low-income households, who don't make enough money to itemize deductions or even to accrue much tax liability, receive next to nothing from these strategies. For the poorest families, federal policy actually penalizes efforts to save money by cutting off benefits to those who manage to create even the smallest financial cushion.

The inequities extend beyond poor families. A typical middle-class household making \$50,000 a year receives less than \$500 in benefits from the most expansive of these federal policies annually; families making \$100,000 get about \$2,000. By contrast, taxpayers bringing in more than \$1 million enjoy \$95,820 in annual support through mortgage and property tax deductions and investment tax breaks.

Expressed differently, more than half of the \$400 billion in benefits go to the top 5 percent of taxpayers, those earning more than \$167,000. Meanwhile, low-income families get next to nothing.

This upside down set of tax subsidies has to change. At a time when the economic downturn has left many low- and middle-income families struggling to get by, we can ill afford a federal wealth-building strategy that primarily helps those who are already wealthy. Many of these families already benefit from the financial and educational capital passed down through the generations; poverty has its own inheritance: poor health, academic struggles, dangerous streets, and life lived on the margins of society.

Redirecting the federal dollars spent on building assets more equitably would not only help poor families gain a foothold in the economy, it would fortify middle-class households. They are more likely to see their small businesses crushed by this recession's tighter credit markets, more likely to defer their child's college education until their savings rebound, and increasingly more likely to tap into the nest eggs they set aside for retirement.

Beyond the inequity, the excessive federal investment to help wealthier families is simply wasteful. Policymakers, eager to reduce the deficit, could curb the amount of money dedicated to building assets and still find a way to distribute the remaining dollars more fairly.

But the decision to embed most of these strategies in tax deductions, credits, and preferential rates, rather than in the federal discretionary budget, obscures the policies from public and congressional scrutiny and debate; even worse, it ensures that the skewed distribution of benefits is rendered all but invisible. Congress has recognized the need for more transparency and accountability in the financial regulatory system. It's time to do the same for our asset-building policies.

**At a time when the economic downturn has left many low- and middle-income families struggling to get by, we can ill afford a federal wealth-building strategy that primarily helps those who are already wealthy.**

## OVERVIEW *of* FEDERAL ASSET-BUILDING POLICIES

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**The federal government** spent \$384 billion to help households build assets in fiscal year 2009. Every taxpayer who took a deduction for interest on a mortgage or a small business loan; every employee who deposited tax-deferred money into a 401(k) plan or an IRA; and every family who took advantage of Pell Grants or tuition tax credits for college benefited from these strategies. Nine out of 10 federal dollars spent to help individuals build assets were in the form of tax expenditures, rather than direct budget outlays.

The analysis echoes the results CFED found in research on the fiscal year 2003 and 2005 budgets, similar studies that analyzed the full dollar amount that the federal government was spending in direct outlays and tax incentives to support asset building.<sup>2</sup> Direct spending as part of the federal budget is largely discretionary and subject to congressional review, authorization, and appropriation. In contrast, tax expenditures—deductions and credits available through tax returns—are not

typically subject to regular review or reauthorization, and they tend to be more valuable to higher-income households, which have a larger tax liability and a higher marginal tax rate.

As in the previous studies, this analysis assesses who benefits from those policies, and how the benefits are distributed across society. For the purposes of this report, federal asset-building policies are defined as any policies that encourage individuals to acquire and maintain assets that enable them to build long-term financial stability and security. As with previous versions, the analysis focuses on policies that meet a set of strict criteria:

1. They are related to specific, explicit federal policies that reward asset building. Policies aimed at asset protection are not included.
2. They are directed at individuals or households. Policies that promote asset building among corporations are not included.
3. They are available to most of the general public, but also are the result of some personal action, rather than benefiting broad segments of the population more or less equally. Policies aimed at unique subgroups, such as veterans, that have access to exclusive programs are not included.

Using these criteria as a starting point, the report focuses on five categories of assets:

- Homeownership
- Savings
- Retirement accounts
- Small business development
- Postsecondary education

This marks the first time that the study has included select programs that support and encourage postsecondary education, in recognition of the fact that higher education is an essential asset that expands economic opportunity. The addition of the data means that this year's report is not directly comparable to past versions, and the authors abstain from any aggregate trend analysis.

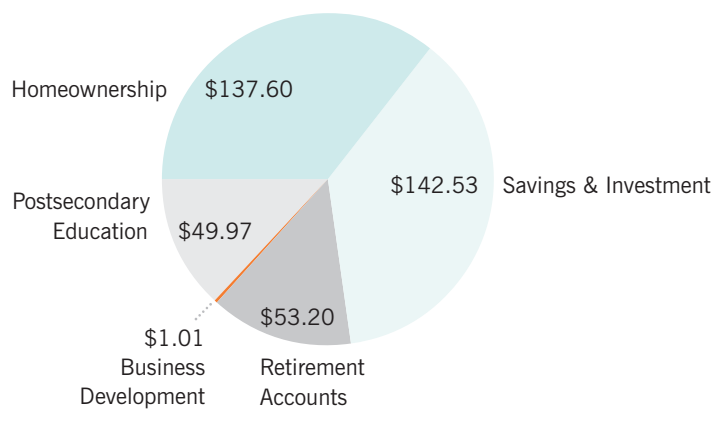
**Table 1. 2009 Federal Asset Budget**

IN BILLIONS OF DOLLARS, FY 2009

	Direct Outlays	Tax Expenditures	Total
Homeownership	\$ 1.10	\$136.50	\$137.60
Savings & Investment	\$ 0.03	\$142.50	\$142.53
Retirement Accounts	–	\$ 53.20	\$ 53.20
Business Development	\$ 0.11	\$ 0.90	\$ 1.01
Postsecondary Education	\$35.27	\$ 14.70	\$ 49.97
<b>Total</b>	<b>\$36.52</b>	<b>\$347.80</b>	<b>\$384.32</b>

**Federal Asset Budget**

IN BILLIONS OF DOLLARS, FY 2009



*The data in this study are compiled from the FY 2009 federal budget. Data on direct outlays come from line items in departmental budget appropriation documents. Data on tax expenditures come from the U.S. Congressional Joint Committee on Taxation. All figures cited in the study are in nominal dollars.*

## HOMEOWNERSHIP

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**The largest component** of household wealth in the United States is homeownership, and home equity accounts for a greater share of the wealth held by middle- and lower-income households than it does for higher-income homeowners.<sup>3</sup> As such it provides one of the chief means for transferring wealth from one generation to the next. Despite the recent wave of foreclosures, buying a home still represents an important strategy for building assets and securing a measure of financial stability for families moving out of poverty.<sup>4</sup>

Homeownership also has benefits for the broader community, as it stabilizes neighborhoods and influences children's health and well-being: Children of homeowners are generally healthier and better educated, studies show.<sup>5</sup> Yet, current programs and policies foster homeownership for the families who least need the assistance.

Federal asset-building policies allocate \$137.6 billion toward encouraging homeownership, and all but \$1.1 billion of that is through tax expenditures. These policies disproportionately benefit higher-income owners who have more expensive homes, allowing them to deduct more mortgage interest and property tax payments and avoid more capital gains when they sell the home.

Homeowners with lower incomes often find the amount they could claim in their deduction would not be large enough to make a difference in their tax liability. This explains, in part, why only 27 percent of taxpayers claimed the deduction in 2008<sup>6</sup> despite the fact that 67 percent of Americans owned homes, and two out of three of those homeowners held a mortgage.<sup>7</sup> Analysis of the data shows that nearly 80 percent of the value of mortgage and property tax deductions accrued to the top fifth of taxpayers.

The \$1.1 billion allotted in direct outlays goes to programs such as the Self-help Homeownership Opportunity Program (SHOP), geared toward helping low- to moderate-income families purchase homes. Even so, far more federal dollars for low-income housing go toward rental subsidies: The administration's FY 2009 budget proposal includes \$15 billion for tenant-based Housing Choice Vouchers. Essentially, it's easier for poor families to get help paying the rent than paying a mortgage.<sup>8</sup>

That exacerbates a gap in homeownership between the richest and poorest families. In 2009, the homeownership rate for households making at least \$57,175 (the median family income) was 81 percent; for those earning up to \$25,000 it was 32 percent.<sup>9</sup> Between 2004 and 2006, homeownership rates among low-income populations fell by 3.6 percent, while homeownership rates stayed steady overall.<sup>10</sup>

A more equitable approach to encouraging homeownership would provide more direct outlays to help families buy homes and pay mortgages, with an emphasis on the low- and moderate-income households.



**Table 2. Cost of Homeownership Policies**

IN BILLIONS OF DOLLARS, FY 2009

Direct Outlays	Self-help Homeownership Opportunity Program (SHOP)	\$ 0.03
	Home Investment Partnership Program (HOME–American Dream Downpayment Initiative)	\$ 0.01
	Community Development Block Grants	\$ 0.04
	USDA Section 502 Direct	\$ 0.10
	USDA Section 502 Guarantee	\$ 0.85
	Section 504 Loans	\$ 0.01
	Section 504 Grants	\$ 0.04
	Community Development Financial Institution (CDFI)*	\$ 0.14
	Rural Housing and Economic Development (RHED)	\$ 0.03
Tax Expenditures	Exclusion of interest on state and local bonds for owner-occupied housing	\$ 1.00
	Deduction for mortgage interest	\$ 86.40
	Deduction for property taxes	\$ 25.10
	Exclusion of capital gains on sales of principal residences	\$ 15.30
	First Time Homebuyer Tax Credit**	\$ 8.70
	<b>Total</b>	<b>\$137.60</b>

\*CDFI homeownership funding equals fiscal year appropriation and ARRA stimulus funds.

\*\*Credit authorized for FY 2009 only.

## SAVINGS *and* INVESTMENTS

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**All families** need savings to ensure financial stability, especially in times of economic crisis. The Great Recession that began in 2008 has served as an unfortunate reminder of this. Many middle-income families are sliding into perilous financial situations, in part due to insufficient savings and investments. Poor families, with even fewer assets, are navigating a very thin line between stretching paychecks and juggling bill payments to avoid service cut-offs.

By accruing savings, families create buffers when crises occur in housing, health, or employment, as well as provide for future generations. The savings rate for U.S. households has climbed in recent years, from a low of 0.8 percent in April 2008 to 3.6 percent in April 2010.<sup>11</sup> But many working poor families have no savings, or live in debt. In 2009, total household debt equaled 122.5 percent of income.<sup>12</sup> A full one-third of all low-income households were spending nearly twice what they were earning.<sup>13</sup>

By contrast, eight out of 10 of the wealthiest families were saving approximately one-third of their household income in 2009.<sup>14</sup> If necessary, most of these families can exhaust other assets, such as retirement savings and housing equity, to meet their expenses before going into debt.

As with homeownership, the primary incentives for Americans to save and invest are found within the tax code and provide reduced tax rates on dividends and long-term capital gains, as well as exclusion of capital gains at death and of investment income on life insurance and annuity contracts. In fact, tax expenditures account for 99.98 percent of the federal government's total investment in this category.

The notable two-hundredths-of-one-percent exception is the funding that supports Individual Development Accounts (IDAs) through the federal Assets for Independence Act and the Office of Refugee Resettlement. IDAs are matched savings accounts for low-income families. Thousands of families have used these accounts to start businesses, finance higher education, or buy homes. Rigorously evaluated research has shown that IDAs have given low-income and even very poor families the opportunity to save and invest in businesses, homes, education, retirement—often at rates higher than wealthier households.<sup>15</sup> Also, a recent analysis by CFED and the Urban Institute demonstrates that homeowners who used these accounts for home purchases were less likely to face foreclosure than similar buyers in their communities.<sup>16</sup> But at 1/5000 of the funding allocated to encourage savings and investments, these programs are just a sliver of the money the federal government invests.

As the recession drags on, families without savings are stretched thin. Increasingly, middle-income families are afflicted, as well. Prices for necessities—such as medical care, housing, food, household operation, and cars—are growing more than twice as fast as prices for all other purchases.<sup>17</sup> At the same time, debt payments, including interest and principal, relative to disposable income are also at the highest level since the Federal Reserve began recording in 1980. This high level of debt service leads to a further decrease in savings. The situation is exacerbated by wage stagnation: The

wages of middle-income American workers have remained relatively flat for decades.<sup>18</sup> And during the most recent business cycle, incomes in the middle actually declined for the first time since the 1940s.<sup>19</sup>

Low-income families, who are even more financially fragile, suffer from this wage stagnation, as well as increasing unemployment and inflation.<sup>20</sup> Many are falling prey to predatory lending, relying on high-risk financial products and increasing their levels of debt.

The ill effects of the recession show no signs of abating. Between July 2007 and August 2009, there were more than 7 million foreclosure filings and in the next five years, 12 million more homes are expected to go into foreclosure.<sup>21</sup> The number of bankruptcy filings rose by 64.6 percent during the same period.<sup>22</sup>

While the economy may begin to grow and job creation increase, families who lack savings and investments will continue to struggle. As the Obama administration urges the nation to move from a borrow-and-spend economy to a save-and-invest economy, it's critical to flatten and extend savings incentives. In that way, federal policy can encourage efforts to invest for the next generation and reclaim a measure of financial security.

**Table 3. Cost of Savings and Investment Policies**

IN BILLIONS OF DOLLARS, FY 2009

Direct Outlays

Assets for Independence Program (AFI) \$ 0.03

Office of Refugee Resettlement \$ 0.00

Tax Expenditures

Exclusion of investment income on life insurance and annuity contracts \$ 27.50

Reduced rates of tax on dividends and long-term capital gains \$ 89.50

Exclusion of capital gains at death \$ 23.70

Carryover basis of capital gains on gifts \$ 1.80

**Total \$142.53**

## RETIREMENT

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**Most Americans** put aside too few resources for their retirement, despite the importance of retirement savings to economic security in the senior years and despite a range of tax incentives. The economic downturn has exacerbated this problem, prompting some workers to cut back on contributions or start spending down their accounts.

This is evident in this report's analysis of how much money the federal government gave up by allowing pre-tax savings in retirement accounts. When you subtract tax payments and penalties that households paid for cashing out pre-tax savings or moving money to taxable accounts, the net cost for the federal government was about \$53.2 billion. For IRA programs, the federal government actually gained more tax revenue from cashed-out plans than it gave up in deferred taxes to families saving for retirement.

Much has been reported over the past year about the decline in retirement savings, and there are many reasons for this trend.<sup>23</sup> For employer-based plans, the economic downturn may have led to decreased contributions. Unemployed workers cannot make their contributions. Those who still have jobs often face tighter family budgets and increased financial pressures that make saving for retirement a lower priority. Businesses temporarily have reduced or eliminated their contributions to employee plans to lower their costs—sometimes to preserve employment, sometimes in response to turnover, and sometimes to save money.

In terms of individual plans, workers who converted their traditional IRAs to Roth IRAs paid taxes on that money. Those who needed to use their retirement savings to cover expenses paid an early withdrawal penalty (if they were under age 59.5 years), in addition to paying federal income taxes on the appreciation. Flexibility in spending this money is not necessarily bad, especially if these pretax savings are invested in buying a home, paying for a college education, or other asset-building activity. But if the accounts are simply being drained to cover everyday expenses, families are losing their financial cushion.

The 2010 Retirement Confidence Survey, conducted by the Employee Benefit Research Institute, confirms that retirement saving is down from previous levels; currently, 69 percent of workers say they are saving for retirement, a 10 percent drop from the previous year.<sup>24</sup> What's more, a study by AARP found that last year nearly one in five Americans age 45 or older took money out of their retirement accounts prematurely. Many expressed difficulty paying their mortgage, utility bills, or health expenses.<sup>25</sup>

Yet, every dollar not saved for retirement reduces post-retirement income or extends the number of years that must be worked. A median worker who is 35 years from retirement will have to work an extra year for every \$2,350 not saved for retirement.<sup>26</sup>

The taxpayers who are enjoying federal incentives for retirement fall disproportionately in the higher tax brackets. Roughly 70 percent of workers who earn \$50,000 or more participate in an

employer-retirement plan while only one-quarter of workers who earn between \$15,000 and \$19,999<sup>27</sup> participate. Those who earn less are even less likely to participate: of those who earn less than \$5,000, just one in 15 participates.<sup>28</sup>

Those without retirement savings tend to be the most vulnerable populations: with lower educational attainment, poor health, lower health status, and part-time jobs. Latino and African-American workers are disproportionately represented.<sup>29</sup> Altogether, as many as 78 million people, half of all American workers, have no access to a retirement plan at work. These retirement accounts are often the easiest way to save, with contributions made in pre-tax dollars and deposited through the employer's payroll operations.

The self-employed or those whose employers do not offer a plan can save in individual retirement plans or IRAs. Like other asset-building platforms, ownership of IRAs increases disproportionately with income: Nearly two-thirds of households with incomes higher than \$100,000 have IRAs while 14 percent of households with incomes less than \$35,000 do.<sup>30</sup> Further, more than three-quarters of households with IRAs also had an employer-sponsored retirement plan or a defined benefit plan coverage (pension).

Despite these efforts, it is not even clear that the billions of federal dollars spent to encourage retirement saving are effective at inducing *new* saving; some experts suggest that many families are merely making a decision to put money they were already saving into a tax-preferred account.<sup>31</sup>

**Table 4. Cost of Retirement Policies**

IN BILLIONS OF DOLLARS, FY 2009

Tax Expenditures	Employer plans	\$ 71.00
	Individual retirement plans*	\$-27.90
	Keogh plans	\$ 9.20
	Tax credit for certain individuals for elective deferrals and IRA contributions (Savers Credit)	\$ .90
	<b>Total</b>	<b>\$ 53.20</b>

\* Note on IRAs: Actual FY 2009 expenditure for traditional IRAs was \$-28 billion; figure is \$-27.9 because Roth IRA was positive \$0.1.

**Entrepreneurship** has long been regarded as a critical route out of poverty. The 2006 Nobel Peace Prize to Muhammed Yunus and the Grameen Bank affirmed the importance of fairly priced credit for business development in stabilizing family incomes among the most economically vulnerable and providing opportunities for those families to progress up the economic ladder. Similarly, the Aspen Institute Self-Employment Learning Project found that 53 percent of micro-entrepreneurs moved out of poverty and that micro-businesses—those with five or fewer workers and less than \$35,000 in startup capital—had higher survival rates than other small businesses.<sup>32</sup> Business enterprises, like other assets, can be passed down from generation to generation.

Owning a small business has some significant implications for wealth: Households that own a small business are almost eight times as likely to have \$1 million in net worth as households that do not.<sup>33</sup> Also, households with a business owner are more than twice as likely to have incomes exceeding \$50,000 a year than those without.<sup>34</sup>

The \$1.1 billion spent on small business development accounts for the smallest portion of the federal asset-building budget. While the tax code contains many sizable tax preferences for corporations, few accrue to individuals, the criterion for inclusion in this report. The amortization of business startup costs is the only tax benefit identified as being directed to individuals and therefore suitable for inclusion.<sup>35</sup> There are five direct outlay programs for business development that seek to expand credit for small businesses or microenterprises, addressing the frozen credit markets that have made the economic downturn so hard on these businesses.

Without credit, these businesses are unable to invest or rehire. During the recession, the availability of credit to small businesses has fallen, and the terms of the credit are more costly for the lucky few who can get it.<sup>36</sup> The American Recovery and Reinvestment Act provided resources that aim to get the Small Business Administration's loan programs moving again, and President Obama has met with bank executives to impel large national banks to increase their small business lending and launched a \$21 million pilot program to expand small business lending.<sup>37</sup>

Small and micro-businesses are as important to the U.S. economy and local communities as they are to the entrepreneurs who own and operate them. The Association for Enterprise Opportunity estimates that the 24 million microenterprises in the United States represent 18 percent of private employment and 87 percent of all businesses.<sup>38</sup> Small businesses, independent firms with fewer than 500 workers, employ roughly half of all American workers and create more than half of the

**Owning a small business has some significant implications for wealth: Households that own a small business are almost eight times as likely to have \$1 million in net worth as households that do not.**

nonfarm gross domestic product (GDP).<sup>39</sup> Small businesses also account for between 65 and 90 percent of the net new job creation in the private sector in the past 15 years.<sup>40</sup> And they are more likely to employ lower-skilled workers, including those with only a high school diploma.<sup>41</sup>

**Table 5. Cost of Small Business Development Policies**

IN BILLIONS OF DOLLARS, FY 2009

Direct Outlays	SBA's MicroLoan Program	\$ .004
	USDA's Business and Industry Guaranteed Loan Program	\$ .006
	SBA 7(a) Program	\$ .010
	PRIME	\$ .005
	CDFI	\$ .026
	Rural Business Enterprise Grants (RBEG)	\$ .039
	Rural Microentrepreneur Assistance Program (RMAP)	\$ .004
	SBA MicroLoan TA	\$ .020
Tax Expenditures	Amortization of Business Startup Costs	\$ .900
<b>Total</b>		<b>\$1.015</b>

## POSTSECONDARY EDUCATION

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**In today's economy,** a college degree is a valuable asset that has direct and significant impact on earning power and economic mobility over a lifetime. In 2008, the average annual income for individuals with bachelor's degrees was nearly double that of those with a high school diploma (\$58,613 vs. \$31,283).<sup>42</sup> Though less tangible than other assets, educational capital can also be passed down to future generations, with children more likely to attend and graduate from college if their parents attended.

Education can also help children exceed their parents' economic status. The Pew Economic Mobility project shows that students whose parents were in the bottom quintile for income significantly increased their chances of moving up if they obtained a college degree. That, in turn, increased the likelihood they would find the sort of jobs that include retirement, health benefits, and wages sufficient to build savings and other assets. The same study shows that without a college education nearly half the adult children of families in that bottom quintile stayed at the bottom.<sup>43</sup>

The benefits of postsecondary education go beyond increases in earnings. Studies show that individuals with a college education cost the federal government less: They are less likely to be unemployed at any point in time, less likely to require government assistance, and more likely to report better health, regardless of income level and age.<sup>44</sup>

Because higher education is such a fundamental asset-building strategy, we have included in this analysis any federal expenditures that are directly linked to providing incentives for and supporting postsecondary education. In fiscal year 2009, the U.S. government spent nearly \$50 billion in direct outlays and tax expenditures to assist individuals in their postsecondary education endeavors.

Unlike other asset categories, education policies are intentionally progressive and skew toward low- and moderate-income families, who receive direct expenditures on student aid through Pell Grants and other financial aid programs. Also the asset-building opportunities in education are not directly tied to the size of the assets, as they are in homeownership or investments.

Direct expenditures on student aid through the Pell Grant program accounted for 71 percent of the total education asset budget in fiscal year 2009. The initial appropriation for the year was \$19.4 billion, but the stimulus (ARRA) added an additional \$17.1 billion.

Given the importance of higher education to economic mobility, it is distressing that there continues to be such a large and persistent gap in both college attendance and completion between students from households with different means. High school graduates from low-income families are far less likely to attend college than their counterparts from families at the top end of the



income scale.<sup>45</sup> And in terms of college completion, longitudinal research has shown that a higher percentage of poorly performing students from high-income households complete college than high performing students from low-income households.<sup>46</sup>

**Table 6. Cost of Postsecondary Education Policies**

IN BILLIONS OF DOLLARS, FY 2009

Direct Outlays

Pell Grants*	\$ 36.49
Stafford, PLUS, and Consolidation Loans (FFEL)**	\$ -1.22

Tax Expenditures

Tax credits for postsecondary tuition	\$ 8.60
Deduction for interest on student loans	\$ 0.80
Deduction for higher education expenses	\$ 0.70
Evaluation of interest of earnings of trust accounts for higher education	\$ 0.10
Deferral of tax on earnings of qualified state tuition programs	\$ 0.30
Exclusion of scholarship and fellowship income	\$ 1.80
Exclusion of employer-provided education assistance benefits	\$ 0.80
Exclusion of interest on state and local government qualified private activity bonds for student loans	\$ 0.40
Parental personal exemption for students age 19 to 23	\$ 1.20

**Total \$ 49.97**

\*For FY 2009, Pell Grants received funding from ARRA which was included in this number. FY 2009 = \$19.38 and ARRA additional funding = \$17.11.

\*\*Repayments on outstanding Stafford, PLUS, and Consolidation Loans exceeded new loan disbursements.

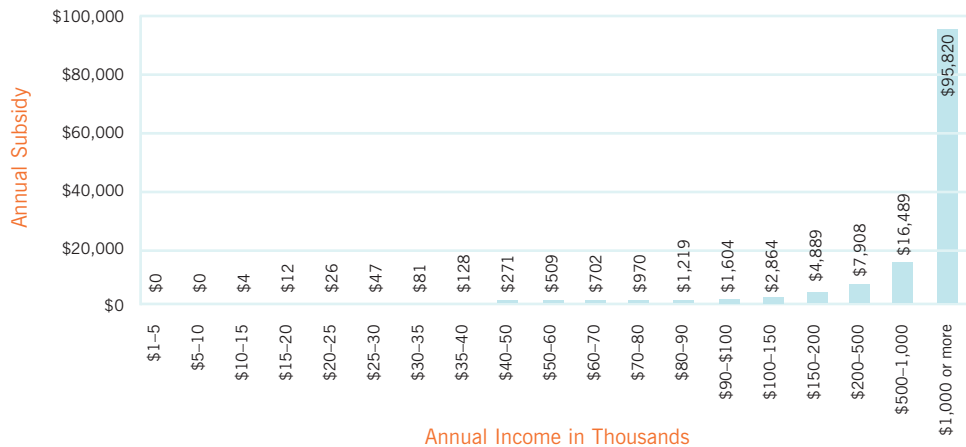
## WHO BENEFITS?

**With a price tag** of nearly \$400 billion, the federal government is making a significant investment in helping families save, invest, and build assets. But the fact that most of this investment comes through the tax code makes it all but inaccessible to millions of Americans who do not make enough money to itemize their tax returns or accrue much income tax liability. As a result, most of the federal wealth-building policies benefit wealthier households while doing very little to support low- and moderate-income families.

Three of the largest asset-building policies—the mortgage interest deduction, property tax deduction, and preferential rates on capital gains and dividends—comprise 65 percent of total tax expenditures in the asset budget. An analysis of these 2009 tax expenditures reveals that more than 53 percent of all subsidies went to the top 5 percent of taxpayers—those with incomes higher than \$160,000; the top fifth of taxpayers—those with incomes greater than \$80,000—received 84 percent of the benefits, with an average subsidy of \$5,109 per taxpayer. The average asset subsidy awarded to households making more than \$1 million was nearly \$96,000. In contrast, the bottom 60 percent of taxpayers (those making \$50,000 or less) received only 4 percent of the benefits, and the bottom fifth of taxpayers (incomes of \$19,000 or less) received 0.04 percent of benefits, amounting to \$5 on average for each taxpayer.

**Chart 1. Distribution of Asset-Building Subsidies, Average Benefit by Income Bracket**

Tax benefit, in dollars, from the mortgage interest deduction, property tax deduction, and preferential rates on capital gains and dividends to households of different income levels.



Source: ITEP Microsimulation Model, FY 2009.<sup>47</sup>

Some would argue that higher-income households should receive more of a tax break because they face higher income tax rates and pay a larger proportion of all taxes. But this line of argument is flawed. First, data show that top earners receive benefits from current asset policies at levels that exceed their rate of tax liability. While the overall share of the tax bill for the top 1 percent of earners was 27.7 percent in 2005, their share of total benefits from asset policies that same year was over 45 percent.<sup>48</sup>

The second and more fundamental issue, however, is that this argument presupposes some forethought and intentionality in the country's decision to use tax expenditures as the primary mechanism to spur personal savings and investment. In fact, no such overt discussions or decisions have ever taken place. It is time that they did.

Just as Congress has agreed to overhaul the financial regulatory system, it needs to take a careful look at how it delivers the incentives for families to save money and build wealth—and whether these strategies are aimed at the right people.

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## GETTING MORE *from* FEDERAL ASSET-BUILDING POLICIES

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**The fiscal crisis** and historic budget deficit magnify the importance of ensuring that every dollar of public investment is targeted and effective. Indeed, it is more important than ever to stop and assess the efficacy of the methods we use to deploy nearly \$400 billion every year to encourage Americans to save and build assets. This is real money, and we can ill afford to see it misdirected.

But it will be wasted if, at the end of the day, our asset policies are not structured in a way that facilitates new savings, investment, and asset ownership among a wider portion of the population. The evidence presented in this analysis suggests that our current policies—or at least the 90 percent that operate as tax expenditures—are regressive and unregulated, and as such are of little help to low- and moderate-income households trying to become more financially self-reliant.

We cannot escape the reality that the vast majority of the \$137 billion subsidizing homeownership goes to taxpayers who already own their homes, and that two-thirds of homeowners don't take these deductions. We can't deny that more than 78 million Americans—more than half the workforce—do not have access to an employer-sponsored retirement plan. We cannot avoid the sad irony that government policy aimed at building wealth is largely helping the rich get richer. Long before he ran the Office of Management and Budget, Peter Orzag urged Congress to fix the “upside down set of tax incentives” that allows wealthier taxpayers to shelter income for retirement while doing little to help low- and middle-income families.

What we can do is work toward creating a more equitable and transparent set of strategies for saving money and building wealth. That means changing the way we deliver this asset-building assistance: Refundable tax credits can prove more equitable and accessible to lower-income taxpayers than deductions. Placing caps on the value of homes and other assets that can be deducted could also even the playing field. When possible, we should invest directly through budget outlays, rather than in the tax code, so that the policies receive a thorough and public review. That means looking for more opportunities to help low- and moderate-income families put aside savings, buy homes, and send their children to college. That means creating incentives, rather than penalties, to encourage our poorest families to save money or buy a home.

**What we can do is work toward creating a more equitable and transparent set of strategies for saving money and building wealth. That means changing the way we deliver this asset-building assistance.**

Real economic recovery will happen only when both markets *and* households regain their footing. Public policy must help with this. We must reform the existing approach to wealth building, which amounts to an ad hoc, uncoordinated, and misaligned set of strategies. We must recognize that these policies are costing our nation dearly, even as the federal deficit mounts. In its place, we must create a coherent, transparent policy that builds a better future for all American families and the generations to come.

## ENDNOTES

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## APPENDIX: ITEP MODEL

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Reprinted from Institute on Taxation and Economic Policy. (2009, November). *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States, 2nd Edition.*, pp.120–121.

The Institute on Taxation and Economic Policy has engaged in research on tax issues since 1980, with a focus on the distributional consequences of both current law and proposed changes. ITEP's research has often been used by other private groups in their work, and ITEP is frequently consulted by government estimators in performing their official analyses. Since 1994, ITEP has built a microsimulation model of the tax systems of the U.S. government and of all 50 states and the District of Columbia.

### What the ITEP Model Does

The ITEP model is a tool for calculating revenue yield and incidence, by income group, of federal, state and local taxes. It calculates revenue yield for current tax law and proposed amendments to current law. Separate incidence analyses can be done for categories of taxpayers specified by marital status, the presence of children and age. In computing its estimates, the ITEP model relies on one of the largest databases of tax returns and supplementary data in existence, encompassing close to three quarters of a million records. To forecast revenues and incidence, the model relies on government or other widely respected economic projections. The ITEP model's federal tax calculations are very similar to those produced by the congressional Joint Committee on Taxation, the U.S. Treasury Department and the Congressional Budget Office (although each of these four models differs in varying degrees as to how the results are presented). The ITEP model, however, adds state-by-state estimating capabilities not found in those government models.

Below is an outline of each area of the ITEP model and what its capabilities are:

**The Personal Income Tax Model** analyzes the revenue and incidence of current federal and state personal income taxes and amendment options including changes in:

- rates, including special rates on capital gains,
- inclusion or exclusion of various types of income,
- inclusion or exclusion of all federal and state adjustments,
- exemption amounts and a broad variety of exemption types and, if relevant, phase-out methods,
- standard deduction amounts and a broad variety of standard deduction types and phase-outs,
- itemized deductions and deduction phase-outs, and
- credits, such as earned-income and childcare credits.



**The Consumption Tax Model** analyzes the revenue yield and incidence of current sales and excise taxes. It also has the capacity to analyze the revenue and incidence implications of a broad range of base and rate changes in general sales taxes, special sales taxes, gasoline excise taxes and tobacco excise taxes. There are more than 250 base items available to amend in the model, reflecting, for example, sales tax base differences among states and most possible changes that might occur.

**The Property Tax Model** analyzes revenue yield and incidence of current state and local property taxes. It can also analyze the revenue and incidence impacts of statewide policy changes in property tax, including the effect of circuit breakers, homestead exemptions, and rate and assessment caps.

**The Corporate Income Tax Model** analyzes revenue yield and incidence of current corporate income tax law, possible rate changes and certain base changes.

**Local taxes:** The model can analyze the statewide revenue and incidence of aggregate local taxes (not, however, broken down by individual localities).

## Data Sources

The ITEP model is a “microsimulation model.” That is, it works on a very large stratified sample of tax returns and other data, aged to the year being analyzed. This is the same kind of tax model used by the U.S. Treasury Department, the congressional Joint Committee on Taxation and the Congressional Budget Office. The ITEP model uses the following micro-data sets and aggregate data:

### *Micro-Data Sets:*

IRS 1988 Individual Public Use Tax File, Level III Sample; IRS Individual Public Use Tax Files 1990 and later; Current Population Survey: 1988–93; Consumer Expenditure Survey, 1988–90 and 1992–93; U.S. Census, 1990; American Community Survey, 2004–2007.

### *Partial List of Aggregated Data Sources:*

Miscellaneous IRS data; Congressional Budget Office and Joint Committee on Taxation forecasts; other economic data (Moody’s Economy.com, Commerce Department, WEFA, etc.); state tax department data; data on overall levels of consumption for specific goods (Commerce Department, Census of Services, etc.); state specific consumption and consumption tax data (Census data, Government Finances, etc.); state specific property tax data (Govt. Finances, etc.); American Housing Survey; Census of Population Housing; etc.

*A more detailed description of the ITEP Microsimulation Tax Model can be found on the ITEP website at [www.itepnet.org](http://www.itepnet.org).*



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