Wealth Creation in the New Millennium: Transforming Poverty in America

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When causes of poverty are discussed—lack of educational resources, drug abuse, racism, family breakdown—one that is often overlooked is access to capital and barriers to wealth creation. In the last century, poverty among the elderly was one of the defining social problems. However, today's growing disparity between the rich and poor is one of the critical social dilemmas we face in the 21st century. I believe that the growing wealth gap is one of the key reasons for this increasing disparity.

Despite a strong economy through the 1990s, the gap between the rich and the poor expanded. Among Americans who reach age seventy, the top ten percent own more wealth than the bottom ninety percent.\(^1\) How do we address this inequity? Do we restrain those at the top? No, the answer lies in strengthening the asset base of the remaining ninety percent, especially those at the bottom of the income scale.

Increased income is one way for families and communities to climb out of poverty. Wealth creation is another. Wealth allows for ownership, fosters self-reliance and independence, and it creates jobs. Wealth in turn creates more wealth. Initiatives that encourage individual wealth creation are imperative to closing the gap between the rich and the poor. I believe the government can play a role in helping many Americans who struggle to enter the economic mainstream. We have a continuing responsibility to carry out the mission we began with the 1996 Welfare Reform Act.\(^2\)

Welfare reform was really only the first step on a long road to bringing economic stability and intergenerational self-sufficiency to the families that have been mired generation after gen-

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eration in the U.S. social welfare system. Since 1996, more than 50% of Americans on welfare left the welfare rolls and transformed their lives and the lives of their children by modeling a different example for the next generation. Americans who spent years on welfare are now employed and gaining the skills that will take them closer to economic independence.

However, the next phase of welfare reform must address the long-term asset accumulation that is the foundation for personal wealth in this country. Home ownership, savings, investment, and access to capital are key elements of the economic mainstream—of America's middle class. These are the elements that we must bring to those who have been left on the sidelines of American prosperity.

Success in today's new economy is defined less and less by how much you earn and more and more by how much you own: your asset base. The U.S. Census Bureau defines assets as

Interest-earning assets held at financial institutions (passbook savings accounts, money market deposit accounts, certificates of deposit, and interest earning checking accounts), other interest-earning assets (money market funds, U.S. government securities, and municipal or corporate bonds), stocks and mutual fund shares, mortgages held for sale of real estate, amounts due from sale of business or property, regular checking accounts, U.S. savings bonds, real estate, IRAs and Keogh accounts, and motor vehicles.3

This is great news for the millions of middle-class homeowners who are tapped into America's economic success, but it is bad news for those who are simply tapped out—those with no assets and little hope of accumulating the means for upward mobility and real financial security. This widening asset gap was underscored in a report issued earlier this year by the Federal Reserve. The Fed found that while the net worth of the typical family has risen substantially in recent years, it has actually dropped substantially for low-income families.

Until recently, the booming American economy had delivered significant income gains to the nation's upper-income earners, leaving lower-income workers on the sidelines. Some believe that closing this divide between the have-mosts and the have-leasts is simply a matter of raising wages. But the reality is that the income gap is a symptom of a larger, more complicated

problem. The problem is that low income-Americans have not historically been able to tap into the same resources that the middle class has used to build assets.

How do we address this fundamental problem for those who may not believe that the American dream is also meant for them? How do we bridge this divide? We must provide opportunities for individuals and families to build tangible assets and acquire stable wealth. Unfortunately, however, most public attention focuses on our growing income gap. The income gap is not the root problem. The real problem is the asset gap.

Our focus should now be on helping those who have worked hard to break free of government dependence so they can move to the next level—to the American middle class. This means savings, investment, home ownership, community revitalization, and access. Increased income can help a low-income family pay its bills, but it does not help that family invest in the American dream. Too many Americans lack the knowledge to acquire these things, but they do not lack the desire for them. Hardworking low-income earners want to save for a home, improve their earning potential by getting a meaningful education, turn a good idea into a thriving and family-supporting small business, save for retirement, build their communities, and pass their wealth on to their children. I believe that smart, effective government policies can help them attain these goals.

Savings

Providing low-income families with incentives and the means to save is one way to shrink the growing gap between the rich and the poor in our country. In order to provide savings incentives, we need to give low-income families a chance to accrue savings for education, job training, starting or expanding a small business, or for the purchase of a home.

Non-profit groups around the country have launched innovative private programs that are achieving great success in transforming the “unbanked”—people who have never had a bank account—into individuals with a financial stake in their future, their country, and their communities. With these Individual Development Accounts (IDAs), banks and credit unions offer special savings accounts to low-income Americans and match their deposits dollar-for-dollar. In return, participants take an economic literacy course and commit to using their savings to buy a home, upgrade their education, or to start a business.

Individual and matching deposits are not co-mingled; all matching dollars are kept in a separate, parallel account. When
an account holder has accumulated enough savings and matching funds to purchase the asset (typically over two to four years), and has completed a financial education course, payments from the IDA are made directly to the asset provider.

There are approximately fifty credit unions offering IDAs in various neighborhoods across the country as part of a pilot program. In fact, thousands of people are actively saving today through IDA programs, including faith-based programs, in about 350 neighborhoods nationwide. In one demonstration project undertaken by the Corporation for Enterprise Development (CFED), a leading IDA promoter, 2,378 participants have already saved $838,443, which has leveraged an additional $1,644,508 in matching funds.

However, while the growth of IDAs has been encouraging, access to IDA programs is still limited and scattered across the nation. The IDA provision of the Savings Opportunity and Charitable Giving Act of 2001 (S.592), a bill I introduced with Senator Joe Lieberman, expands IDA access nationwide by providing a significant tax credit to financial institutions and community groups that offer IDA accounts. It allows for the creation of IDAs by federally insured banks. This credit would reimburse banks for the first $500 of matching funds they contribute, thus significantly lowering the cost of offering IDAs. Other state and private funds could also be used to provide an additional match to savings. It also benefits our economy, the long-term stability of

4. The 1996 law permits states to use Temporary Assistance to Needy Families (TANF) funds to carry out a program of IDAs established by (or on behalf of) persons eligible for TANF, with no dollar limit. Accounts are to contain deposits from the recipient's earnings, matched by a contribution from a not-for-profit organization, or a state or local government agency in cooperation with the organization. Withdrawals are allowed only for postsecondary educational expenses, first home purchase, and business capitalization. All means-tested programs must disregard amounts, including accruing interest, in TANF-funded IDAS. Some states mention IDAs in their TANF plans. In 1998, Congress established a 5-year program of IDA demonstration projects (Assets for Independence Act [AIA], Title IV of P.L. 105-285) for TANF-eligible persons and certain other low-income workers. Appropriations for FY1999 and FY2000 were $10 million each; for FY2001, $25 million (budget request) was appropriated (Consolidated Appropriations Act, H.R. 4577). In determining means-tested eligibility, states originally were allowed to count deposits by the account holder into these IDAs, but H.R. 4577 requires that means-tested programs disregard amounts in these IDAs. Announced at the end of September 2000 were second year awards of $8.3 million for AIA demonstration projects ($4.5 million to 25 new grantees, $2.1 million in supplements to 14 previous grantees, and $1.7 million to state departments in Indiana and Pennsylvania that had begun IDAs before AIA was passed).

which is threatened by our negligible national savings rate. In fact, according to some estimates, every one dollar invested in an IDA returns five dollars to the national economy.

If enacted, our bill will complement current IDA pilot programs that exist throughout the country, including our own program in Pennsylvania. IDAs give individuals a real chance to accumulate financial assets to achieve long-term goals.

Individual Development Accounts, combined with other community development and wealth creation opportunities, are a first step towards restoring faith in the long-standing American promise of equal opportunity. That faith has been shaken by stark divisions of income and wealth in our society. Congress will take this first step toward restoring the long-cherished American ideals of rewarding hard work, encouraging responsibility, and expanding savings opportunity.

**SOCIAL SECURITY ASSETS**

Another means to creating personal wealth for low-income Americans is through fiscally sustainable and actuarially sound Social Security reform. The creation of personal retirement accounts has the potential to save the system from insolvency, but it can also create wealth progressively, benefiting low-income workers and families who have few opportunities to save under today's system.

There are two issues relating to Social Security and wealth creation. The first issue has to do with increasing the burden Social Security taxes (also known as the Federal Insurance Contribution Act (FICA)) placed on workers, which when combined with everyday living expenses, absorbs a great deal of the disposable income of most American families. This prevents them from setting aside savings at the end of each month. The second issue has to do with how unfair the current system is to low income workers who currently are not building up wealth with their tax "contributions."

Social Security is a good and necessary program, and provides vital income support to some of our most vulnerable populations. President Franklin D. Roosevelt's vision for our most important and popular social program speaks to the very values we as a nation hold dear: a democratic people coming together and using government to provide for the common good. And Social Security has achieved some wonderful things over the past sixty-five years: it sharply cut poverty among the elderly. In 1960, more than one-third of all elderly Americans lived below the poverty line, a rate as high as for the rest of Americans. Today, less
than 13 percent of elderly people are poor, a smaller share than for the rest of America. But the program is significantly under-funded over the long-term, and policy-makers must grapple with this reality and reach consensus on what options will preserve the system's financial dependability at a cost that future generations can bear.

Social Security's financing challenges are well known and have been studied extensively. There is widespread agreement that the sooner steps are taken to reform the program on a lasting basis, the more manageable will be the solutions. Today, it has evolved into a "pay-as-you-go" system, an intergenerational income transfer program where current workers contribute FICA/payroll taxes that go directly to fund benefits to current retirees and other beneficiaries. When today's workers reach retirement, they in turn will expect tomorrow's workers to contribute taxes sufficient to fund their promised benefits.

This "pay-as-you-go" scheme worked fine in a world of large families and short life-spans, a world in which markets were perceived to have failed and there were fewer individual choices. Social Security effectively responded to the needs of that world. But as we know the world is very different today. Americans enjoy the blessing of long life: by the year 2050 more than one-fifth of the population will be over age sixty-five. Americans have chosen to have smaller families: birth rates today are just over half what they were during the peak of the Baby Boom. These two facts put a severe strain on our system of retirement security. In 1960, there were over five workers for every beneficiary. Today there are three and a half workers per beneficiary, and by 2030 there will be just over two. Because of these changing demographics, the program faces an unfunded liability of approximately $3.2 trillion (present value), or the difference between what is being promised under current law, and what we have the capacity to fund under current payroll tax rates.

Absent fundamental reform, the Social Security actuaries report that keeping the current program in tact will require the government to raise payroll taxes by some 50% (from their current level of 12.4% to more than eighteen percent), cut benefits by some thirty percent, cut other government spending, or borrow the necessary funds. Under such circumstances, rates of return for workers—already low—will fall further, and most beneficiaries would have to live well past the average life expectancy simply to get back what they had paid into the system.

The coming demographic shift of the baby boom retirements and the aging of America generally will present funding challenges not only in Social Security, but in Medicare, in private
pension systems, and every other method that our society uses to care for our citizens as they age.

Social Security's benefit formula is intended, in part, to reduce the risk of old-age poverty among low-income workers. But accumulating evidence suggests that Social Security is not nearly as redistributive as many people believe. Also, low-income households own few assets outside of Social Security and thus are disproportionately affected by the benefit cuts that will occur under current law. Absent reforms, current law will be able to finance only about 70% of currently promised benefits, pushing many low-income households into poverty.

Three factors offset much of the intended redistribution within the current Social Security system. First, lower-income individuals tend to have shorter life expectancies. As a result, low-income workers spend a greater portion of their lives contributing to Social Security and a smaller portion collecting from it. Under the current system, they have no ownership of their contributions or benefits.

Second, Social Security's spousal benefit redistributes money from single individuals and two-earner couples to one-earner couples. The program is structured, in this and many other instances, to redistribute income from single earners and working couples with less to couples in which one spouse can afford not to work. But because low-wage earners are more likely to be single or divorced, they are less likely to receive a spousal benefit. The highest risk of poverty in old age is faced by divorced, separated, or never-married women.

Third, many people never become eligible for Social Security benefits because they do not have enough years of contributions to earn their own benefits. Current Social Security rules require a worker to pay into the system for roughly 10 years before gaining eligibility for retirement benefits. Needless to say, the options of raising taxes or drastically reducing promised benefits disproportionately affect the poor and low-income workers who contribute to the system. But there is another path toward reform that would better protect low-income individuals and families and offer the opportunity to accumulate wealth for the first time in the program's history: the creation of voluntary personal retirement accounts (PRAs) can serve as a mechanism to pre-fund a portion of future Social Security benefits.

Nearly two dozen other countries—from Chile to the United Kingdom—have reformed their public pension systems in such a manner, and it has had demonstrably sound success in terms of fiscal solvency and raising the living standards among the elderly.
And here in the United States, over the past decade we have seen three bipartisan commissions created specifically to study long-term Social Security reform options, and all three have recommended that some form of private sector investment was necessary not only to restore the program's solvency, but also to provide better equity to future generations.

PRAs would provide low-income workers with retirement income on top of a strong safety net benefit that would sustain them better than the current system and would allow them to transfer their savings to their children. They also leave their children without a leg up. Unlike upper middle and upper income earners, they cannot pass on to the next generation what they have put into social security. Since the lower third does not live as long, they lose out on their investment and their children are not given the opportunity to use their inheritance to improve their own condition in life.

Many personal account plans—such as those proposed by President Bush's Commission to Strengthen Social Security—actually increase the progressivity of the guaranteed benefit and reduce poverty among the elderly. Income from personal accounts, in addition to guaranteed benefits for those most in need, can significantly change the lives of low-income workers when they retire.

These accounts are not intended for those at or near retirement, but for younger workers. Young workers would put a small part of their payroll tax in investment plans similar to the accounts that federal employees now use for their own retirement. The money in these accounts would belong to workers, not to the federal government, giving workers the opportunity to save.

There is no greater lesson to be learned in the Social Security debate than that of Ms. Oseola McCarty. Ms. McCarty spent her entire life laundering shirts, never earning more than $9,000 a year. At the age of eighty-seven she was in a position to donate $150,000 to the University of Southern Mississippi to provide scholarships for deserving African-American students. How was this woman of such modest means able to save so much? Her answer: "It was the magic of compound interest." Beginning at the age of 8, Ms. McCarty put away a little each week and compound interest did the rest. I am truly convinced that this can work for every American.

It is inevitable that without significant reform, because of its pending bankruptcy, future workers will pay even higher payroll taxes, retirees will receive further decreased benefits, and people
will have to retire later. Low income workers will have little ability to improve the economic status of their families across generations if they are taxed more while working and receive less in retirement. Further income redistribution, significantly increasing taxes on high income earners, will not fix the system—it is not enough. Means testing social security not only acts as a deterrent to investment and savings, it is not enough to save the current system.

We must work to improve the lives of our children and grandchildren by empowering retirees to pass a "nest egg" on to next generation. Personal retirement accounts will allow low-income retirees to have an improved standard of living in retirement rather than the subsistence living they now have.

**Home Ownership**

For most Americans, the avenue to wealth creation—from generation to generation—is through the front door of their first home. Owning their own home is the signal that they have made it into the economic mainstream. And for most, it will be the largest single asset they have in their lives. In fact, home equity makes up the largest share of most Americans' net worth. Following home ownership are savings accounts and then interest-earning assets in money market funds and municipal bonds.

Home ownership is critical to the strength of our communities and to the financial foundation of American families. For most Americans, the current system of buying and financing a home works. But for too many the dream of having one's own home seems hopelessly out of reach. It is important that as we look at ways to improve the asset base of low-income Americans, we look especially carefully at opportunities for home ownership.

As previously discussed, IDAs can be expanded to help more American families save for the down payment on a home. However, I think that much more can be done to empower hard working low-income families to realize their dreams of home ownership and to revitalize many of our struggling communities where home ownership rates are low. Home ownership strengthens our communities by increasing individual commitment and by allowing owners to build a foundation for personal wealth.

It is often home ownership that anchors the financial stability of American families and the civil stability of our communi-

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7. *Id.*
ties. Our challenge is to make the American dream of home ownership accessible to all Americans.

There are already many programs and tax credits that encourage home ownership because there is a bipartisan consensus in support of home ownership, whether it is through down-payment assistance programs sponsored by local governments or the federal income tax deduction for mortgage interest. Through deposit insurance and the Federal Home Loan Bank system, Congress has provided avenues of funding for institutions with government charters. Similarly, Congress chartered two government sponsored enterprises, Fannie Mae and Freddie Mac, to make home ownership possible for more Americans by creating an efficient secondary mortgage market to increase the funding available to lenders. The Federal Housing Administration (FHA) has also helped more families purchase homes by lowering the amount required for down payment.

President George W. Bush also proposed an initiative during his campaign to allow low-income families to use up to a year's worth of rental payments to make a down payment on a home of their own. In addition, he has proposed an "American Dream Down Payment Fund," to provide a matching grant to a low-income family that is qualified to buy a house but who cannot cover the entire down payment. In many cases, this assistance can make the difference on the margin and provide another family with the opportunity to achieve the dream of home ownership.

Home Investment Partnership (HOME) programs are also key components to neighborhood revitalization. HOME makes grants available to local governments that provide affordable housing for low-income renters and owners through new construction, rehabilitation, and property acquisition. I have cosponsored legislation in the Senate to make these programs more flexible and encourage the removal of regulatory barriers that often add to the costs of a home.

**ACCESS TO CAPITAL**

I also introduced the American Community Renewal and New Markets Empowerment Act. This comprehensive bill, which includes IDAs, creates economic incentives for investment in low-income communities, and enhances educational, home own-

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ership, and affordable housing opportunities in those communities.

Finally, the Community Development Block Grant (CDBG)\(^9\) program provides flexible federal funding to local recipients, who select the most appropriate programs to fight poverty or spur economic development in their communities.

**CONCLUSION**

I believe that Democrats and Republicans, liberals and conservatives, can agree on the importance of creating wealth in low income families and communities as a long term solution to fighting poverty. My attempt in this essay was to lay out some possible policy avenues to explore. I hope that this essay will pave the way to fruitful dialogue in discovering ways we can work together to give more Americans the opportunity to partake in the American dream.

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9. The CDBG program is authorized by Title I of the Housing and Community Development Act of 1974, as amended.