Statement of Fred T. Goldberg, Jr.
Before the Senate Finance Committee
Subcommittee on Social Security and Family Policy

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Mr. Chairman and Members of the Subcommittee, it is an honor to appear before you today on the timely and important topic of "Building Assets for Low-Income Families." I am appearing today on my own behalf and not on behalf of any client or other organization.[1]

Enacting policies that promote asset-building and savings for all Americans is one of the greatest domestic policy challenges – and opportunities – we face today. Mr. Chairman, you have provided much needed and unwavering leadership in this area. Your support of Social Security personal accounts challenges the conventional wisdom of Democrats, while your support of refundable credits to promote asset accumulation through Individual Development Accounts (IDAs) and universal children's savings accounts challenges the conventional wisdom of Republicans. For many of us, you are right and the conventional wisdom is wrong on both counts. While there are important differences on program specifics, we applaud both your policy judgments and your political courage.

I first became interested in – or, as my wife and five children claim, obsessed by – the need for universal policies to promote savings and asset-building by low- and middle-income (LMI) families while serving as Executive Director of the Kerry-Danforth Commission on Entitlement and Tax Reform (1993-1995). Former Senator Kerry had the foresight to recommend Social Security personal accounts long before most elected officials were willing to embrace the idea. Beginning in 1995, I then had the pleasure of working with Senator Kerry and his colleagues on legislation approved overwhelmingly by the Senate (but dropped in Conference) establishing a limited form of children's savings accounts.

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[1] While appearing on my own behalf today, I am currently a partner at the law firm Skadden, Arps, Slate, Meagher & Flom. We represent a large number of financial institutions with interests in policies to promote savings. I also serve on the Board of Trustees of the Corporation for Enterprise Development (CFED) and Doorways to Dreams (D2D), and on the Board of Advisors of Wall Street Without Walls (WSWW). Each of these non-profit organizations is actively involved in promoting asset-based policies on behalf of low income workers and families. Among its many activities, CFED sponsored the pilot program demonstrating the feasibility of Individual Development Accounts (IDAs) and is currently sponsoring a large-scale pilot program testing children's savings accounts. Among various technology-based initiatives focused on savings by low- and middle- income (LMI) families, D2D sponsored a pilot program demonstrating the great promise of the Administration's split refund program. Working with the Federal Reserve Banks, among others, WSWW is actively involved in using current capital market techniques to provide capital for low income communities. In addition to the foregoing, I am currently working with a broad-based coalition whose goal is to help ensure the effective implementation of the split refund initiative.

My route to the Entitlements Commission and asset-based policies came by way of my work as IRS Commissioner (1989-91) and Assistant Secretary for Tax Policy (1992) during the first Bush Administration. While the connection may not be apparent, it brings me to the critical point I wish to emphasize today: based on my experience as IRS Commissioner and Assistant Secretary for Tax Policy, as well as my private sector experience, it is quite clear that the government and the private sector have the administrative systems and infrastructure in place to implement efficient and effective universal policies that will promote asset-building by all Americans, with particular emphasis on LMI workers and families. Making these policies "work in the real world" is not the issue; what's missing is Congressional action.

I would like to comment briefly today on the following topics: why assets matter; the compelling case for refundable tax credits in the context of asset-based policies; and the importance of infrastructure in designing and implementing asset-based policies.

A. Assets Matter. While the focus of your hearing is on asset-building by low income families, I think it is essential to view this issue in the broader context of why assets matter for all Americans. At risk of stating the obvious, assets matter for at least three reasons:

- *National Savings Create Jobs and Opportunity:* At a macroeconomic level, savings promote the economic growth necessary for jobs, improved standards of living and opportunities for all Americans. The paltry rate of private savings is well-recognized and a legitimate cause for concern. Likewise, while tax cuts over the past several years have promoted growth in the face of a weak economy, chronic deficit spending by the Federal government to support current consumption and other recurring costs represents negative savings. This approach may be acceptable in the short term, but it does involve consuming today at the expense of young families and workers, our children and grandchildren.

- *Family Savings Promote Security and Opportunity:* At the family level, assets matter for a host of obvious reasons. What is important in the context of today's hearing is that far too many families lack the assets necessary to provide for their financial security and opportunities for advancement for themselves and their children. This applies not just to families now living in poverty but also to the millions of families who are one lay-off or one illness away from falling from the lower rungs of self-sufficiency and into a morass of unsustainable debt and the ranks of the new-poor. The data is overwhelming (all data as of 2001):[2]

    - *Tax-Favored Retirement Accounts:* More than 75% of families with incomes in the bottom 40% have *no* tax-favored retirement accounts of any kind, and the average account balance among those who do have accounts is less than $10,000.

[2] Data below is from National Academy of Social Insurance, Uncharted Waters: Paying Benefits From Individual Accounts in Federal Retirement Policy, 31-40 (2005).

- *Homeownership:* More than 25% of all families and more than 55% of all non-white and Hispanic families do *not* own their own homes.

- *Asset Poverty:* Taking only liquid assets into account, about 40% of all families lack sufficient assets to meet basic needs at the poverty level for three months in the absence of other income. The percentage would be far higher when measured against liquid assets equal to three months of current earnings.

- *Insurance Against Illness or Disability:* More that 30% of all private sector workers lack any type of paid sick leave or short-term disability benefits.

- *Liquid Investment Assets:* Almost 60% of all families and almost 80% of all non-white and Hispanic families own no mutual funds, stocks or bonds.

- *Credit Card Debt:* By conservative estimates, about 35% of families with incomes between $10,000 and $25,000 carry credit card debt, with an average balance of $2,250; about 50% of families with incomes between $25,000 and $50,000 carry credit card debt, with an average balance of $3,565.

- *The Unbanked:* The size of the "unbanked" population – those who do not have a checking or savings account with a bank or credit union – is estimated to be between 10 and 20 percent of all U.S. families.

Whether it's accumulating assets for a first home, a car to get to work, a computer for the kids, or a "rainy day fund" in case of a lay-off or illness, it is clear that far too many families have insufficient savings.

- *Savings to Pre-Fund Retirement and Health Care Needs:* It is essential that we pre-fund future retirement and health care needs. We cannot wish away the $35.2 *trillion* dollar permanent shortfall in Social Security and Medicare Part A. We cannot afford to ignore the GAO's recent conclusion that, by 2045, federal spending as a percent of the economy on Medicare, Medicaid, and Social Security *alone* will exceed the post-war average for *total* federal tax revenue as a percentage of gross domestic product (GDP).

  In many ways, a key aspect of the current and looming debate over Social Security, Medicare and Medicaid boils down to the following question: should we continue to fund these programs on a pay-as-we-go basis through some combination of benefit cuts and tax increases, or should we move – in one way or another – to a partially pre-funded system that does not rely solely on Trust Fund monies that are borrowed to finance government expenditures on current consumption and other recurring costs. While there are widely divergent views on the proper mix of reforms, it is clear that honest pre-funding, however it is accomplished, must be part of the solution.

B. <u>The Compelling Case for Refundable Credits in the Context of Asset-Based Policies</u>. Any consideration of tax policies focused on asset-building should come to terms with the need for refundable credits.

1. *Refundable Credits*. As this Committee knows, there has been a long-running debate over the wisdom of refundable tax credits. For the most part, the hallmark of this debate has been caricature and heated rhetoric (on all sides) having little to do with the underlying tax policy considerations. It's not a question of "welfare through the tax system" versus "distributive justice." Rather, the issues are far more prosaic and best considered on traditional tax policy and tax administration grounds. Are refundable credits necessary or appropriate to achieve the desired tax policy objectives? Can they be administered efficiently from the standpoint of affected taxpayers and the IRS, taking compliance issues into account? On these grounds, the case for refundable tax credits intended to promote asset-building is compelling.

While more than 90% of all taxpayers have positive tax liability over their lifetimes, 40% of all families and workers do not have positive income tax liability in any given year. This means that non-refundable credits intended to promote savings by LMI taxpayers (*e.g.*, the Saver's Credit under current law) will fail to achieve their stated objective. Moreover, non-refundable credits intended to promote savings violate basic norms of horizontal equity and fail to take account of families living in different parts of the country. Imagine the following families dealing with a non-refundable $500 credit under circumstances where families with incomes under $30,000 don't pay any taxes and therefore do not get the credit, while families with $40,000 pay sufficient taxes to take full advantage of the credit:[3]

> Family A, living in Big City, has income of $50,000 in Year 1, but its income declines to $30,000 in Year 2 because one spouse takes a year off after the birth of a child, or to go to school, or because of an illness.
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> Family B, also living in Big City, has income of $30,000 in Year 1, but its income increases to $50,000 in year 2 because the primary earner gets a raise after completing a training program during Year 1, or because the second spouse goes back to work after a layoff or illness.
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> Family C, also living in Big City, has income of $40,000 in Year 1 and Year 2.
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> Family D, living in Small Town, has income of $30,000 in Year 1 and 2 – the equivalent of $40,000 in Big City.

All four families have the equivalent of $80,000 in income over two years – yet family C gets $1,000 in credits, while families A and B get $500 in credits and family D gets

[3] While not the subject matter of this hearing, these same observations apply to the phase-out of credits.

nothing in credits. This result makes no sense from a tax policy perspective. As Yogi said, "It just ain't fair."

From the standpoint of tax administration, the implementation of refundable credits to promote savings is relatively straight-forward, thanks to current IRS/FMS and private sector technology and existing tax information reporting systems. Moreover, refundable tax credits intended to promote savings do ***not*** pose many of the compliance issues posed by many other provisions of the tax law for two reasons: (i) current information reporting systems generally permit verification of eligibility and (ii) the pool of saved assets in the hands of third parties provides a ready source of funds for IRS collection in cases of inadvertent or intentional non-compliance.

Further, while not refundable credits *per se*, the IDA provisions in the CARE Act benefit low-income families and the ASPIRE legislation benefits children of LMI families without regard to whether the participants have current tax year liability. As such, they represent a major break-through in asset-building policies for low income families. The sooner they are enacted, the better.

2. *Income Exclusions.* While less heated, there is some debate over the relative merits of tax incentives that provide up-front deductions and tax back-end distributions (*e.g.*, traditional IRAs and employer-sponsored retirement plans) versus those that do not provide up-front deductions but do not tax back-end distributions (*e.g.*, Roth IRAs and Section 529 Plans). All else equal, these are equivalent from the standpoint of net tax benefits. From the standpoint of the 40% of all taxpayers with no tax liability each year, however, up-front tax deductions provide no tax benefits while back-end exclusions may be of significant benefit. If the goal is to promote asset-building among LMI families, the no-deduction/future-exclusion is far preferable to a system of current deduction/future tax.

3. *A Trade That's Waiting to Happen.* The Tax Reform Act of 1986 – with PEP, Pease and phase-outs – planted the seeds for a bargain that has bedeviled tax policy for the past twenty years. Republican orthodoxy abhors refundable credits while Democratic orthodoxy demands phase-outs to prevent give-aways to the so-called rich.[4] The net result is that LMI families with no tax liability are left out in the cold; middle income families (especially those in communities with a high cost of living) are phased out; and the truly rich don't receive tax benefits that are meaningless in the scheme of things. In the context of savings policy, using phase-outs and other eligibility criteria creates mind-numbing complexity and discourages private sector financial institutions from marketing saving to potential savers.

The far better approach would be to enact asset-based policies that are truly universal by eliminating phase outs and providing refundable credits. To take one example, as you know, the Saver's Credit is set to expire next year. Recent experience

[4] For what it's worth, I've never understood why a family in Philadelphia is "rich" where one spouse is a teacher and the other is a first responder. Be that as it may, they are likely "phased out" from eligibility for the Saver's Credit, IRAs, the Hope Credit, HSAs, etc.

demonstrates that it is an effective program for those families who are eligible to claim the credit. The kicker, of course, is that very few families are eligible. The credit excludes most LMI families because it is not refundable and imposes punitive marginal rates because it phases out too quickly.

At the same time, the Administration has once again proposed and members of Congress have re-introduced Lifetime Savings Accounts (LSAs) and Retirement Savings Accounts (RSAs), which use the no-upfront-deduction/no-back-end-tax model that is most beneficial to LMI taxpayers. Because there are no phase-outs, LSAs and RSAs do not penalize families with fluctuating incomes and families that live in high cost of living communities.

Tax policy and tax administration would be best served by extending and modifying the Saver's Credit to make it refundable and to make the phase-out more gradual, and by enacting the Administration's LSA and RSA proposals. All of this could (and should) be accomplished on a revenue-neutral basis by repealing the bewildering array of targeted savings incentives and setting the credit and contribution amounts at appropriate levels. Coupled with enactment of the CARE Act's IDA provisions and ASPIRE, the net result would be radical simplification of the tax law and asset-based policies that are truly universal and of greatest benefit to LMI taxpayers.

C. <u>Infrastructure Matters</u>. My final observation has to do with administrative and policy infrastructure, each of which has received far too little attention in the debate over legislation to promote savings, especially among LMI families.

Administrative infrastructure refers to the systems necessary to implement measures under consideration by Congress. If it won't work as a practical matter, why bother. Fortunately, the country now has a remarkable private and public financial infrastructure that can support universal asset policies that were unthinkable even twenty or thirty years ago. Thanks to technology and innovation by the private sector and by government:

- Mutual funds have have seccessfully democratized participation in the capital markets.

- The Federal government's Thrift Savings Plan demonstrates the feasibility of an efficient, low-cost and secure alternative for savings by those not yet ready to participate directly in the private markets.

- The Savings Bond program could be revitalized as yet another alternative.

- A majority of individual tax returns will be filed electronically this year or in the near future.

- In 2003 the IRS and FMS issued more than $206 billion in tax refunds to more than 100 million taxpayers, representing an average refund of more than $2,000, and more than 47 million tax refunds were issued by way of electronic funds transfers to financial institutions.

- At the same time, the EITC has greatly increased the amount of tax refunds going to LMI families. In 2003, about 22 million LMI taxpayers received more than $38 billion in refunds through the EITC, representing an average EITC refund of about $1,700.

These and other aspects of the current financial landscape provide the infrastructure that can be used to implement polices such as the Administration’s split refund proposal, the IDA provisions of the CARE Act, the ASPIRE legislation recently introduced by you and your colleagues, a restructured (and refundable) Saver's Credit, and personal retirement accounts that are enacted as a part of – or as a complement to – Social Security reform. The fact is that we can make these policies work, and work well.

In my view, the keys to a successful and durable policy infrastructure are universality, simplicity and appeal to shared values. It is absolutely clear that the existing administrative structure makes it possible to implement asset-based policies that satisfy these three criteria. It is also clear that these objectives can be accomplished in ways that are fiscally responsible in light of massive deficits and the need to pre-fund future retirement and health care needs. Finally, it is clear that we can choose from numerous specific proposals that – taken together – would achieve truly universal asset-based policies that would be “user friendly” and reflect our shared values.

What is unclear is whether the political process will allow these choices to be made.