Three Strategies to Expand the Middle Class

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Millions to the Middle

Three Strategies to Expand the Middle Class

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About Demos

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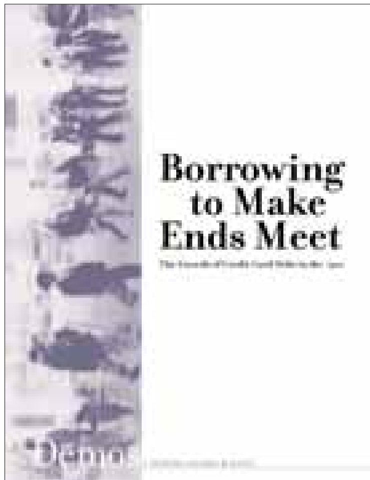

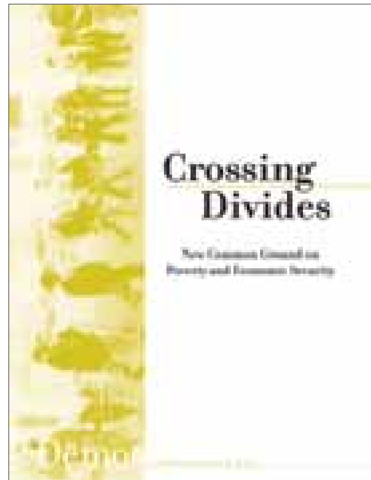

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Executive Summary

Throughout its history, America has taken great leaps forward to support the creation of a strong middle class. That middle class has been the backbone of a strong American democracy. Today, however, broad structural changes in the economy and labor market are thwarting the growth of the middle class. Three decades ago, individuals could work their way into the middle class. Today, the proliferation of low-wage service jobs puts millions of families at risk of never making it to the middle class. The largest growing occupations in the economy are and will continue to be dead-end jobs, offering low wages and little or no benefits. Access to higher education is more important for securing a middle-class lifestyle than ever before, yet soaring costs and anemic federal aid has left many qualified students without the opportunity to reach for a better life. Finally, the American dream of homeownership and asset accumulation remain elusive for far too many families. Lacking the wealth or savings to weather economic downturns, millions of families are going into debt simply to make ends meet.

This report takes a long-term view to expanding the middle class and creating more security among those who do achieve a middle-class life. Looking ahead to where the United States should aspire to be a decade from now, we advance policy proposals that would be phased in over time and are bold enough to fully meet the challenges at hand. Our agenda focuses on three strategies that have historically been pivotal to the expansion of the middle class. First, we advocate major new investments in higher education to ensure that anyone who wishes to improve their future economic prospects has the ability to do so. Second, we propose new initiatives aimed at expanding home ownership far beyond its historic high of recent years, so that all working Americans have the opportunity to build wealth through a home. And third, we outline a major effort to ensure that all working Americans have adequate income to meet their basic living expenses. In each area, we envision an important role for private or nonprofit organizations. The public sector should not be expected to act alone to grow the middle class, and taxpayer dollars should be leveraged as creatively as possible.

What each of these strategies has in common is that they empower individuals to advance themselves through self-improvement and hard work. The three strategies work in combination with one another to help people to move up the ladder of economic opportunity and, in turn, pass on opportunity to their children. Education is critical to increased earnings which, in turn, are essential for accumulating assets. Assets are vital to family security and retirement—and also a key to upward intergenerational mobility.

COMMON SENSE VALUES

Despite the polarized debate about economic opportunity, most Americans share a set of common sense values in this area. The policies we propose to grow the middle class are rooted in values which have been widely shared since the founding of the Republic. They include:

- ✓ **Work Should Be Rewarded.** Few virtues are respected more by Americans than the willingness to work hard to get ahead. Yet today, millions of Americans who work full-time and even overtime find that they cannot cover their basic living expenses or afford to make key investments in their future. *We must ensure that anyone who works full-time will be rewarded with a minimally decent standard of living—one that reflects the true cost of living in different parts of the United States.*
- ✓ **Self-improvement Should Be Possible.** The United States has historically been a nation of self-improvers, where those who make the effort to invest in their own future—especially through education—garner rewards for doing so. Yet today, a great many Americans do not have the opportunity for self-improvement through higher education and, instead, often find themselves stuck in dead-end jobs. *We must ensure that anyone who wishes to invest in their future through college or vocational training will not be stopped by financial barriers.*
- ✓ **Thrift and Planning Should Be Encouraged.** Sacrificing and saving today for a brighter future tomorrow—for example, by stretching to buy a home—has long been another key ingredient in the American formula for middle class success. Yet today, too many Americans are moving in the opposite direction—struggling with few assets and accumulating high burdens of personal debt. *We must create a society where all Americans have the ability to put away savings for the future and where everyone has a chance to own a home.*

POLICIES TO GROW THE MIDDLE CLASS

The United States has made huge steps forward in the past in expanding the middle class. In the three decades following World War II, tens of millions of households moved securely into middle-class prosperity. Never before, in any country in history, had the standard of living been improved so quickly for so many people. This didn't "just happen." Public policy played a key role in a range of ways in the rise of America's new middle class during the postwar years. We can replicate this success in the 21st century by national action in three areas.

1. Expanding Access to Higher Education

Education is a key to middle-class security in an economy where most of the good jobs require at least some college. It is also a foundation for a strong democracy. Yet as college tuition has soared, rising faster than both inflation and family income, more students can't afford college. In the 2001-02 school year, over 400,000 *college-qualified* high school graduates from low- and moderate-income families did not enroll in a four-year college, and 168,000 did not enroll in any college at all. These statistics translate into frustrated dreams today and a weaker middle class tomorrow. America needs bold new efforts to increase access to higher education, particularly to 4-year institutions.

- We propose the *Contract for College*, a dramatic expansion of investments—in partnership with the private and nonprofit sectors—that will give millions of young people a shot at middle-class success by doubling the percentage of college-qualified students from low- and moderate-income families who enroll and complete degrees at 4-year colleges.

2. Boosting Home Ownership and Savings

Homeownership and savings have historically been pivotal to securing a place in the middle class, and that will remain true in the decades ahead. Today, however, between 25 and 40 percent of U.S. households have little or no wealth. While home ownership rates are at an historic high point, nearly a third of Americans still don't own their own home and many who do have virtually no equity in their homes. One problem is housing prices that have gone through the roof in recent years; another is the difficulty of saving money for a down payment, especially on the part of younger people. We propose several steps to renew this core pillar of the American dream:

- Make the mortgage interest deduction refundable to assist low-income families, and also create other new incentives that would double the rate of homeownership for low-income working families within the next five years.
- Create a matching savings program to help low-income families save toward a down payment on a home. First time homebuyers earning less than $50,000 should receive a $1 for $1 match, up to $7,500, for monies saved toward a down payment. Contributions by private or nonprofit entities would be matched at the same rate, up to $2,500. The homeownership down payment assistance subsidy would have a maximum benefit of $10,000 and would allow first-time homebuyers to accumulate $20,000 toward a first-home purchase.
- Provide each newborn child with an asset account endowed with $6,000 at birth—money that will ensure that everyone has a better chance of becoming a middle-class asset holder earlier in life.

3. Closing the Gap Between Wages and the Cost of Living

As many as a third of working Americans are not earning enough money to meet the basic economic needs of themselves or their family. The earnings gap has been worsening in recent years and the situation may well get worse. Our plan to solve this problem builds on two existing policies with bipartisan support—the minimum wage and the Earned Income Tax Credit—and is phased in over a ten-year period. The plan has two components:

- Eliminate poverty among full-time workers by raising the minimum wage to $8.40 and indexing it to inflation.
- Replace the Earned Income Tax Credit with a more generous Working Families Tax Credit with a maximum annual benefit of $15,000 to assure that most full-time workers earn enough to provide a minimally decent life for themselves and their family, as measured by the true cost of living where they reside.
- Create a Federal Office of Living Standards to assess the income needs of households in different parts of the U.S. and set guidelines for policymakers.

CONCLUSION: AFFORDING A STRONGER MIDDLE CLASS

Helping millions of Americans reach the middle class will require rearranging national priorities. The investments we propose are not out of line with investments made during the great period of middle-class expansion in the early postwar period. In the long run, these earlier investments more than paid for themselves by helping to fuel decades of dynamic economic growth. In addition, the cost of the bold new initiatives we propose for expanding the middle class are small compared to the tax cuts enacted by the Bush Administration, which will total more than $2 trillion by 2010. We advocate the rollback of selected portions of these tax cuts to help fund middle-class expansion. We also advocate reallocating some of the tax expenditures that now subsidize home ownership and home improvement for wealthy Americans who do not need the government's help to be financially secure.

Ultimately we see no real alternative to dramatic action if the United States wishes to retain its signature strength as nation—that it is a land of middle-class opportunity. Absent a renewed commitment to this ideal, new economic frustrations and social tensions could deeply compromise the American way of life.

Introduction

Widely shared middle-class prosperity is a signature strength of American society. It has made the United States the most hopeful and dynamic country on earth, and it is a foundation of strong democracy. Expanding and protecting the middle class must be an overriding national priority.

Yet today, the American Dream is in trouble. Too many people who play by the rules and do everything right find that they cannot climb into the middle class—or stay there. As a result of major economic changes over the past three decades, the traditional routes to a secure middle-class life are less easy to travel than in the past. Many jobs do not pay enough to cover basic living expenses, much less allow workers to save money and build assets for the future. A college education has become ever more critical to moving up the income ladder—even as it's also become less affordable. Homeownership, a historic stepping stone into the middle class, remains an impossible dream for millions and, instead of building wealth, many households are mired in high-interest debt.

America's economy has been an awesome engine of wealth creation in the past two decades, but the new prosperity has disproportionately gone to top earners. Between 1979 and 2000, the middle fifth of households saw income gains of just 15 percent—compared 53 percent for households in the top 5 percent. The bottom fifth of households did even worse, with income gains of just 9 percent during this period.[1] By 2001, 29 percent of households were still taking in $25,000 or less in annual income—earnings that, in most cases, do not stretch far enough. In 1999, at the height of good times, as many as a third of U.S. households with children under 12 were not earning enough income to meet their basic economic needs such as food, clothing, rent, and transportation. And, according to much research, social mobility—the very essence of the American idea—has stagnated or declined in the United States, with many young people struggling to replicate their parents' standard of living. For example, young men are earning less in real dollars than their fathers did at their age.[2] Princeton economist Alan Krueger recently observed that new economic data "challenge the notion that the United States is an exceptionally mobile society. If the United States stands out in comparison with other countries, it is in having a more static distribution of income across generations with fewer opportunities for advancement."[3]

This isn't how America is supposed to be, and things are likely to get worse. The long-term trends that have moved America toward a postindustrial service economy are here to stay and, in fact, may be accelerating as a greater variety of jobs are outsourced overseas and technological advances facilitate ever more automation of basic tasks. Over the next two decades, forecasters predict that the largest job growth will be in low-wage jobs offering little opportunity for advancement and that do not offer health insurance or pay enough to allow workers to put money toward home equity and retirement savings. Meanwhile, most of the good jobs that are created will require a post-secondary education—at a time when such education is likely to remain out of reach for millions as college tuition costs continue to rise.

Even as structural changes have imperiled the middle-class foundation of a vital American society, national action has been lacking. Many political leaders have been complicit in a massive betrayal of core American values and have yet to reckon with a basic fact of the new economic era—that, for millions of Americans, no amount of individual effort or self-improvement or thrift can secure them a place in the middle class.

TOO MANY PEOPLE WHO PLAY BY THE RULES FIND THAT THEY CANNOT CLIMB INTO THE MIDDLE CLASS.

Political leaders have also failed to acknowledge another basic fact of the new era: that many of the jobs which now pay very low wages are essential to the functioning of the economy and to the high level of services that Americans have come to expect. While such jobs are ideally just a way station to the middle class for most workers, they are important in their own right. Optimally, the people in such jobs undertake them with devotion and pride. Given their significant contribution to both economic growth and quality of life for all Americans, low-wage workers and their families should not be forced to live without some of the key necessities of life.

Dramatic new public policy initiatives aimed at moving many more working Americans into the middle class and increasing opportunities to do even better are long overdue. Such initiatives should be rooted in mainstream American values and be able to command strong public support over the long term. They must also move far beyond incremental measures, and be of sufficient scale to permanently address the economic insecurities of what is now a vast number of U.S. households. Government must play a central role in creating the conditions where all individuals can realize their potential, but other major sectors of our society also must do their part. New public sector resources should be used creatively to leverage the resources of business, community groups, philanthropists, and religious organizations.

REBUILDING THE OPPORTUNITY LADDER

This report takes a long-term view to expanding and strengthening the middle class. Looking ahead to where the United States could be a decade from now, we advance policy proposals that would be phased in over time and are big and bold enough to fully meet the challenges at hand. In imagining the future, we have looked to the past for insights—and specifically to the early decades of the postwar era, where policymakers helped to orchestrate a historic expansion of the middle class through broad initiatives that enjoyed strong bipartisan support and wide public approval. While understanding that conditions have changed radically over the past four or so decades, our agenda draws on the impressive postwar policy record for guidance and inspiration. We have crafted our initiatives with an awareness of current public attitudes. The proposed agenda is firmly rooted in a core set of American values that enjoy robust public support.

Our agenda focuses on three strategies that have historically been pivotal to the expansion and protection of the middle class. First, we advocate major new investments in higher education to ensure that anyone who wishes to improve their future economic prospects has the ability to do so. Second, we propose new initiatives aimed at expanding home ownership far beyond its historic high of recent years, so that all working Americans have the opportunity to build wealth through a home. And third, we outline a major effort to ensure that all working Americans have adequate income to meet basic living expenses. What each of these strategies has in common is that they empower individuals to advance themselves through self-improvement and hard work. The three strategies work in combination with one another to help people to move up the ladder of economic opportunity and, in turn, pass on opportunity to their children. Education is critical to increased earnings which, in turn, are essential for accumulating assets. Assets, and the economic cushion they provide, are vital to security both in one's working years and in retirement. Assets are also a key to upward intergenerational mobility.

Dramatic investments in assets, education, and income would help usher in a new era of middle-class expansion and security. But much more needs to be done beyond these three areas and our agenda here is not meant to be comprehensive. Ensuring affordable healthcare is an especially critical issue that we do not address, as is the need for more widely available early childhood education and care. We also have not addressed the all-important challenge of how to create a more robust and equitable economy through monetary and fiscal policies that deliver the high growth rates and tight labor markets needed to raise wages for all.

BUILDING THE MIDDLE CLASS: LESSONS FROM THE POSTWAR YEARS

The United States has previously made huge steps forward in expanding the middle class, and we can do so again. In the three decades following World War II, tens of millions of households moved securely into middle-class prosperity—typically on the paycheck of a single earner. Never before, in any country in history, did the standard of living improve so quickly for so many people. This didn't "just happen." Public policy was instrumental in the rise of America's new middle class during the postwar years. Beyond broad economic policies that nurtured tight labor markets and strong labor unions, three strategies played a key role in the great middle-class expansion and remain relevant today:

- *Investments in Higher Education*—Government provided massive new support for higher education, most notably through the GI Bill which provided a free college or graduate school education to all veterans, and through the rapid expansion of the state university system, which offered low-cost or no-cost education and training to millions of Americans. In 1950, only 6.2 percent of Americans over 25 had attained a bachelors degree; by 1980, 16.2 percent had.[4]
- *Subsidies for Home Ownership*—Various public policies helped to increase the number of Americans owning a home during the early postwar years, including assistance with down payments through the GI Bill, government initiatives to enable more people to get mortgages, the home mortgage interest deduction, and large-scale subsidies for new suburban housing development through public investments in roads and other infrastructure. In 1950, 55 percent of Americans owned a home. By 1980, 64 percent did, and these homes were increasingly detached single-unit homes.

- *Support for Income Growth*—Another key feature of the early postwar decades was that wages and after-tax income advanced steadily for all groups of workers, more than keeping up with the cost of living. Public policies that contributed to this included a minimum wage that reached a historic high in 1968, fiscal and monetary policies designed to keep the economy hot and ensure a tight labor market, and laws that facilitated union organizing.

The policies of the early postwar period that built the middle class were flawed in that they did not extend to all Americans. Non-whites were excluded from many of the opportunities created by the federal government, especially in the area of home ownership. The legacy of past exclusion continues to powerfully shape opportunity—with many non-whites born to households with limited family assets and coming of age in urban or rural areas that are geographically removed from good schools and economic opportunity. At the dawn of the 21st century it is all too easy to predict the life chances of a child simply by knowing his or her zip code. In building tomorrow's middle class in a country that will be majority non-white by mid-century, it is crucial to address the legacy of past exclusion. New policies for growing the middle class must be maximally inclusive, and a key challenge for policymakers is to address a skew in opportunity along racial lines that promises to grow even more acute in the decades ahead.

SOCIAL MOBILITY—THE VERY ESSENCE OF THE AMERICAN IDEA—HAS STAGNATED OR DECLINED IN THE UNITED STATES.

AMERICAN VALUES, UPWARD MOBILITY

Postwar efforts to build the middle class were rooted in widely shared American values. If you worked hard, you could get ahead while building a future for your children. Such values must also be central to any new agenda to raise millions to the middle class. A close reading of public opinion suggests that a strong majority of the public believe that the path to a better life lies in hard work, self-improvement, and thrift for the future. Most Americans agree that those who embrace these virtues should be rewarded with a decent life. The notion of reciprocity is centrally important here: As the pollster Daniel Yankelovich and others have pointed out, the majority of Americans believe that what you put out in life should reflect how much you get back.[5]

Today's economic situation is fundamentally out of sync with key American values and the notion of reciprocity. New policy initiatives are needed to close a growing disconnect between effort and reward, and to ensure that the aspiration to move into the middle class through effort remains realistic and achievable. The United States must recreate the conditions whereby motivated individuals can reliably secure a decent life for themselves and their families. The initiatives we suggest are guided by the following values-based propositions:

- *Work Should be Rewarded*. Few virtues are respected more by Americans than the ability to work hard for what one wants. Yet today, millions of Americans who work full-time and even overtime find that they cannot cover their basic living expenses or afford to make key investments in their future. The income initiative in our policy agenda aims to ensure that anyone who works full-time will be rewarded with a minimally decent standard of living. That standard will reflect the true cost of living in different parts of the United States.

- *Self-improvement Should be Possible*. The United States has historically been a nation of self-improvers, where those who make the effort to invest in their own future—especially through education—garner rewards for doing so. Yet today, a great many Americans do not have the opportunity for self-improvement through higher education. Instead, individuals who are motivated to increase their earning power and employment prospects often find themselves stuck in dead-end jobs. Our education initiative is designed to ensure that no one who wishes to make an investment in their future through college or vocational training will be prevented from doing so by financial barriers.
- *Thrift and Planning Should be Encouraged*. Sacrificing today for a brighter future tomorrow has long been another key ingredient in the American formula for middle-class success. Stretching to buy a home and paying off the mortgage over a long period of time has been a chief means of building wealth for Americans over the past half-century. Even though homeownership is currently at a historic high of 68 percent, nearly a third of households do not own a home and are not building wealth for the future. Too many Americans are moving in the opposite direction—toward long-term burdens of personal debt, often at very high interest rates. Our asset-building plan seeks to extend homeownership to millions of working Americans and also enable all young Americans to start out life with some assets.

AFFORDING A STRONG MIDDLE CLASS

The United States must rearrange national priorities to afford major new efforts to expand and protect the middle class. The investments we propose will come at a time when the U.S. faces major budget deficits and rising burdens for its entitlement programs for seniors. However, additional expenses will be necessary. In considering the cost of major new efforts to expand and strengthen the middle class, several points must be kept in mind.

First, the investments we propose are not out of line with investments made during the great period of middle-class expansion in the early postwar period. That era saw very high levels of investment through direct spending on the GI Bill, new tax expenditures through the more widely used home mortgage deduction, massive infusions of federal and state money into both the public and private university system, and the large-scale public investments in the infrastructure needed to convert open space into suburban communities. These investments more than paid for themselves by helping to fuel decades of dynamic economic growth.

Second, new resources to grow and protect the middle class can be found within existing spending. There are major inequities in how current public subsidies are now distributed across income groups. This is particularly notable in the area of tax breaks—what the scholar Christopher Howard has called the "hidden welfare state." Annual tax expenditures subsidizing home ownership and home improvement, retirement savings, and healthcare total several hundred billion dollars a year. Most of these tax expenditures benefit Americans who are already in the middle class or above. In some cases, we propose redirecting some of these subsidies to those seeking entry into the middle class.

Third, the investments needed to expand the middle class and ensure economic security for all working Americans are small compared to the tax cuts enacted by the Bush Administration, which will total over $2 trillion by 2010. Rolling back portions of those tax cuts would generate significant new revenues. More generally, if federal spending

returned to levels that prevailed during the Reagan Administration—roughly 22 percent of GDP, as opposed to 20 percent today—significant new resources would be available to pay for the agenda we outline in this report.

Fourth, by providing the right incentives, government can creatively leverage resources from business and NGOs and make taxpayer dollars stretch further. The public sector should not be expected to solve problems alone, nor can it. Through matching grants and other mechanisms, government can catalyze major new initiatives by the private and nonprofit sector to help all Americans realize their potential for advancement and economic success.

Fourth, and finally, there is no real alternative to dramatic action if the United States wishes to retain some of its signature strengths as nation, including widespread economic opportunity and mobility, relatively high social cohesion, and high levels of public optimism about the future. Quite apart from the equity challenges inherent in today's economy, these strengths are likely to be tested by demographic changes that will create a very different America. There is potential for serious tensions between the largely white retired Boomers—who will wield enormous political clout—and an increasingly non-white labor force that is footing the bill for entitlement programs for these seniors. Likewise, the United States now has the highest percentage of foreign-born residents in a century, and it is hard to overestimate the challenge of integrating these immigrants into the economic and social mainstream. The correlation between race and economic status, already a very visible and troubling aspect of American society, could be become an even larger feature of national life in the decades ahead. Absent a renewed commitment to making America a truly middle-class nation—with real opportunity for anyone who works hard—new economic frustrations and social tensions could deeply compromise the American way of life and weaken our democracy.

PUBLIC POLICY PLAYED A KEY ROLE IN THE RISE OF AMERICA'S NEW MIDDLE CLASS DURING THE POSTWAR YEARS.

CONCLUSION: A LONG-TERM VISION

More than three decades after the onset of de-industrialization, the United States is now well into a new economic era. While structural limits on opportunity and security have at times been obscured, such as during the recent boom, they are increasingly inescapable. As of yet, policymakers have not risen to this challenge—and the American Dream now stands at risk.

In this report, we have on the one hand sought to think outside the confines of the current policy debates to lay out a bold vision of a society with higher levels of opportunity, mobility, and security. On the other hand, we have put forth a vision that is respectful of the values that most Americans bring to debates on equity. Our proposals will be politically difficult to achieve in the near term, but they are very much in keeping with core American values and, if implemented, can be expected to command strong public support over the long term.

In addition, there is a very good reason to lay out big policy proposals that may be hard to accomplish any time soon: Those who care about building a fairer society must have a vision of what they ultimately hope to achieve if they are ever to have a chance of realizing that vision.

Leveling the Playing Field: Expanding Access to Higher Education

Today thousands of students are being denied access to postsecondary education simply because it is unaffordable. Thousands more enroll but drop out before obtaining a degree. In the 2001-02 school year, over 400,000 *college-qualified* high school graduates from low- and moderate-income families (those with incomes below $50,000) did not enroll in a four-year college, and 168,000 did not enroll in any college at all.[6] Unless immediate steps are taken to reverse this trend, over the decade 4.4 million qualified students will not attend a 4-year college and 2 million will not attend any college at all. The wide disparities in access to higher education run counter to our values of fairness, equal opportunity and upward mobility. In 1965, with the creation of the Higher Education Act, our nation set out to ensure that any student who wanted to pursue a college education should have the opportunity, regardless of family income. While we've never fully delivered on that promise, we are now losing ground. Our plan will increase access to higher education, particularly 4-year institutions, by expanding grants. Specifically, our plan will:

- Double the percentage (from 21 percent to 42 percent) of *college-qualified* students from low- and moderate-income families who complete degrees at 4-year colleges.
- Reduce the average amount of student borrowing to half its current level, from $18,900 to $9,000.

OVERVIEW OF THE PROBLEM

The opportunity to pursue higher education has historically provided both economic and social benefits for American society. Colleges and technical training ensure the vitality of the American economy, by helping to produce an educated workforce to meet the demands of employers. Second, obtaining a college degree has played a primary role in the upward mobility that has come to define the American experience. Third, higher education helps promote the well-educated and knowledgeable citizenry that is vital to a healthy democracy.

As college tuition has more than doubled, rising faster than both inflation and family income, more students are being denied the opportunity to reap the social and economic benefits of higher education. While young people are going to college at higher rates than ever before, wide disparities in access and completion remain. The enrollment gap between low-income families and high-income families is as high as it was three decades ago. And the racial gap in who goes to college has actually widened. Many hardworking students are

being priced out of pursuing and completing higher education—a fundamental component to upward mobility and opportunity in American society. And those who do enroll are leaving college with unprecedented levels of debt, often without a degree in hand.

Over the last 20 years, federal financial aid has steadily shifted away from grant-based aid to a predominantly loan-based system. As a result, borrowing has become the most common way for students to finance their education. In 2002, the average undergraduate debt was $18,900.[7] After graduation, this works out to a monthly average payment of $182, or 9 percent of the typical graduates' income. A full third of students who left school without completing a degree had borrowed between $10,000 and $20,000.[8] Just over a quarter of undergraduate borrowers reported using their credit card to help pay for college. The student loan burden is taking on toll on young adults' lives: almost 1 in 5 significantly changed their career plans because of students loans; nearly 40 percent delayed buying a home and just over 20 percent reported their debt burden caused them to delay having children.[9]

AS COLLEGE TUITION HAS SOARED, MORE STUDENTS CAN'T AFFORD COLLEGE.

The last two decades have greatly heightened the demand for a highly educated workforce—and the earnings differential between those with and without college degrees has widened substantially (see Table 1). A college degree has become what the high school diploma was thirty years ago—the surest pathway to the middle class. Two years of post-secondary education is now considered the minimum level of education necessary for success in this economy. A worker with a bachelor's degree now earns about 70 percent more than a worker with only a high school diploma. Over a lifetime, that wage gap will add up to over $1,000,000. Those with "some college" earn more than those who only complete high school.

Table 1. Median Annual Earnings of All Wage and Salary Workers Ages 25-34 (in 2000 dollars)

	Males			*Females*		
	High School Diploma	*Some College*	*Bachelor's Degree or Higher*	*High School Diploma*	*Some College*	*Bachelor's Degree or Higher*
1971	$ 36,935	$38,947	$ 45,219	$15,656	$17,942	$29,345
1981	29,898	31,849	38,691	16,055	19,776	24,777
2000	26,399	31,336	42,292	16,573	21,597	32,238

Difference between earnings of high school and college grads

	Males	*Females*
1971	$ 8,284	$13,689
1981	8,793	8,722
2000	15,893	15,665

Source: From the National Center for Education Statistics, based on data from US Department of Commerce, Bureau of the Census. March Current Population Surveys, 1972-2001.

The major reason for lower enrollments in 4-year institutions among qualified students from low-income families is the level of *unmet need* they face in attending college. Unmet need is the amount needed to cover expenses after all loans, grants and work study wages are accounted for. On average, the annual unmet need of low-income families has reached historic levels. In 1999, the average low-income family faced $3,200 in unmet need for a public 2-year institution; $3,800 for a public 4-year institution; and $6,200 for a private 4-year institution. Unmet need has forced low- and moderate-income students to abandon the most successful recipe for obtaining a college degree: full-time, on-campus study.

As a result of unmet need, the *highest* achieving students from poor backgrounds attend college at the same rate as the *lowest* achieving students from wealthy backgrounds.[10] Or to put it more coarsely: the least bright wealthy kids attend college at the same rate as the smartest poor kids.

- Gaps in enrollment between low-income families (below $25,000) and high-income families (above $75,000) are as wide as they were three decades ago.[11]
- Although roughly three-quarters of high school seniors continue their studies, only half receive a degree five years after enrolling and only a quarter receive a bachelor's degree or higher. Students from low-income families complete degrees at a much lower rate than their wealthy counterparts: only 21 percent of low-income students who enroll in college will complete a bachelor's degree—compared to 62 percent of high-income students who enroll.[12]
- The degree completion rate is much more disparate as a percentage of *all* students, not just those who enroll. Forty percent of students in the top income quartile graduate with a 4-year degree compared to only 6 percent of students in the lowest quartile.[13]
- One-third of college entrants drop out before their second year. First generation college students are about twice as likely as students with college-educated parents to leave a four-year college before their second year.[14]
- The gap between college enrollment among whites, blacks and Hispanic students has widened over the last 30 years:
    - In 2000, the enrollment gap between white and black students was 11 percentage points, up from only 5 percentage points in 1972.
    - The enrollment gap between white and Hispanic students was 13 percentage points in 2000, up from a 5 percentage point gap in 1972.
- Financial barriers prevent 48 percent of college-qualified high school graduates from low-income families from attending a four-year college; 22 percent will not attend any college at all. The percentages are similar for students in moderate-income families with household incomes less than $50,000.[15]

Academic preparation is also critical to ensuring that lower income students enroll and complete college degrees. But the growing disparity between enrollments and degree completion is occurring during a time when academic preparation for college has steadily risen

among low-income students. More than half of high school seniors in households with incomes below $36,000 have completed college preparatory courses—up from just over one-third in 1987. Nonetheless, racial and class disparities continue to result in fewer low-income and students of color who are prepared for higher education.

The current access problem will be further strained as the largest generation since the Baby Boomers begins to age out of high school. The traditional college-age population is projected to grow by 16 percent between 2000 and 2015.[16] This generation will be more ethnically diverse, better prepared for college, and more likely to have financial need for college. By 2015, 80 percent of the college-age population will be non-white; almost 50 percent will be Hispanic. Left unchecked, the disparities in educational opportunity could severely threaten our social cohesion, dividing the country into a well-educated, white minority and an under-educated non-white majority.

Impact on Economic Growth. Having fewer highly trained and educated workers dampens the economic productivity and growth of the nation. By one estimate, narrowing the gap in the college participation rate would add $250 billion in gross domestic product and $85 billion in tax revenue.[17]

Ensuring that all qualified students can pursue education beyond high school is critical for maintaining the vitality of the American labor force. Nearly 60 percent of jobs today require some college.[18] Over the next decade, six of the ten *fastest* growing occupations require an associate or bachelor's degree.[19] At the same time, job growth predictions also show that the *largest* growth in jobs over the next decade will be in the low-wage sector—those not requiring any post-secondary training.

NO ONE WHO WISHES TO MAKE AN INVESTMENT IN THEIR FUTURE SHOULD BE PREVENTED FROM DOING SO BY FINANCIAL BARRIERS.

Still other studies show that the looming retirement of the Baby Boomers will result in a major shortage of skilled workers.[20] The reason is simple: unlike the Boomers who achieved higher levels of education than their parents and grandparents, successive generations have gotten about the same amount as their parents.[21] As the labor force is expected to grow far less in the next 20 years than it did in the last two decades, there may be a shortage of workers with at least some college education.[22]

The current growth in outsourcing of service sector jobs may threaten the potential for young, educated workers to find jobs to match their skills set. At this time, however, the scope of the effects on economic growth and job creation caused by outsourcing is unclear and widely debated.

Whether or not the economy will generate enough jobs for college graduates is up for debate—and is something of a red herring in the debate over access to higher education. What's important—and what needs to be fixed—is who gets to compete for the best jobs in America. Currently, young adults from modest backgrounds, as well as young adults of color, are much less likely to enroll and complete degrees at 4-year universities. As a result, the playing field is far from level.

Policy Proposals

The policy proposals outlined here are aimed squarely at boosting the college enrollment and degree completion rates of low- and moderate-income students. First and foremost among these goals is to ensure that *college-qualified* students of lesser means have the same opportunities to attend 4-year institutions as college-qualified students from wealthier families. The second major goal is to reduce the amount of borrowing necessary for financing college.

REINVENT THE FEDERAL FINANCIAL AID SYSTEM: THE CONTRACT FOR COLLEGE

Provide a comprehensive and guaranteed federal student aid package that covers a percentage of the full-cost of attendance (tuition, fees, books, room and board) based on the student's family income. The aid package will be a mixture of grants, loans and work-study with grants providing the bulk of aid for students from low- and moderate-income families. The *Contract for College* would also encourage more employers and NGOs to help Americans afford higher education.

Policy Rationale

The high level of unmet need among lower income students reflects a fundamental shift in our nation's priorities for ensuring access to higher education. In the 1970s and 1980s, most aid programs were designed to increase access among students who otherwise would be unable to afford to enroll. Over the last decade, aid programs have increasingly focused on merit-based awards, as opposed to need-based, and on reducing the financial burden on middle-income families. In 1980, grants comprised 52 percent of federal aid; loans, 45 percent. By 2000, grant aid made up only 41 percent of federal aid and loans had increased to 58 percent. Similarly, state aid also shifted: in 1981, 91 percent of state aid was need-based. By 1999, need-based aid had dropped to 78 percent.

The country's primary vehicle for making college affordable for low-income families—the Pell Grant—has steadily lost its purchasing power. The program, originally intended to meet at least 75% of a students' cost of attendance, has never been fully funded to achieve this goal and has failed to accommodate rising tuition prices. As a result, the purchasing power of the Pell Grant has dramatically eroded. In 1976-1977, Pell Grants covered 94 percent of the average price at a 2-year college and 72 percent of the average price of 4-year college. Today, the average Pell Grant covers 68 percent of the average price of attending a public 2-year institution and 34 percent of the costs at a four-year college. In order for the maximum Pell award to cover the same share of costs at public four-year institutions as it did in 1977, it would have to rise from $3,750 to around $7,000.

Finally, the current federal aid system is not designed to provide early and certain knowledge about the amount and type of support available to students. The amount of grants, loans or work-study hours often varies during each year of study, creating both confusion and uncertainty among families and students about the financing of their education. Currently, about a third of students who leave school without completing a degree have borrowed more than $10,000 in student loans.[23] The new *Contract for College* will provide each student with a guaranteed amount of financial aid for all four years of college using a mixture of federal grants, student loans and work-study.

Policy Design

The *Contract for College* would unify the existing three strands of federal financial aid—grants, loans and work-study—into a coherent, guaranteed financial aid package for students. Grants would make up the bulk of aid for students from low- and moderate-income families. The *Contract* will recognize the important value of reciprocity—so part of the *Contract* for every student will include some amount of student loan aid and/or work-study requirement. The *Contract* is designed to re-orient federal aid back to a more grant-based system and ensure that students from all financial backgrounds have upfront knowledge and understanding of the amount and type of financial aid that will be available during their entire course of study.

The key design elements to the *Contract for College* are featured below, including how existing federal policy and programs will be refashioned under the *Contract* system.

- The grants provided under the *Contract* would replace the current Pell Grant system and would operate in much the same manner, with two exceptions. The first is that the *Contract for College* should be funded as an entitlement. One of the major deficiencies of the Pell Grant program is that it has been consistently underfunded, resulting in lower grant amounts than the maximum allowed by the law. The second is that the grants will not be "one size fits all" as is the case under the current Pell Grant system. The amount of the grant will be based on the cost of attendance at the public institution in which the student chooses to enroll.
- The federal student loans provided through the *Contract* will be implemented through the Direct Student Loan Program, phasing out the Federal Family Education Loan Program (FFELP) which relies on private lenders and requires federal subsidies to ensure the lenders' profitability. Switching to the Direct Loan Program will allow the loan system to offer income-contingent repayment options and eliminates the additional cost of providing subsidies to private lenders. By switching all federal loans to the Direct Loan Program, it's estimated that the federal government would save over $4.5 billion per year.[24]
- The amount a student can borrow through the federal student loan program will be determined by the costs of attendance minus the grant and work-study aid available to the student. Of course, with the enhanced level of grant aid, many families will no longer need their children to take out loans to help pay for college. For students from families whose income is high enough to make them ineligible for grant or work-study aid, the annual maximum loan amount will be $10,000 in unsubsidized loans.
- Students will be awarded aid for enrollment in any two- or four-year public institution. The amount of the total aid package will be based on the tuition, fees, room and board and book costs provided by the college in which the student plans to enroll. Students who choose to live off-campus will receive the equivalent to those choosing to live on-campus. Students wishing to enroll in private institutions will be provided a financial aid package equivalent to the average costs at a 4-year public university. Dependent and independent students will treated the same under the *Contract*.

- To encourage private and nonprofit entities to help low-income Americans with the full costs of higher education, the new system will match gifts or grants by private or nonprofit entities up to $2,000 annually. For example, if a private college offers a scholarship of $1,500 a year, the government will match the college's investment. Or, if a business sets up a fund to help local high school graduates attend college, the recipients of such gifts would also receive a match for gifts up to $2,000. To further advance the goal of catalyzing new investments in higher education by businesses and philanthropies, we also propose creating the Contract for College Fund, a national trust that would actively seek out and match such investments.
- An important component in designing this program is to ensure that families have early knowledge of the financial resources available to their children to attend college. At the start of the program, all households with students in the 8th grade and above will receive their *Contract for College* that estimates their aid package using the average cost of attendance at public 4-year institutions. Alerting students and parents about the amount of student aid available will help increase the expectation that attending and completing college is a realistic goal.

While each student's final *Contract* will be based on the institution costs where the student chooses to enroll, we can use the average cost of attendance for 4-year colleges to model the type of aid students at different income levels will receive under the *Contract*. According to the College Board, the average total cost of attendance for one year at a public 4-year university was $12,196 for the 2003-2004 school year. This cost includes tuition, room and board, books and transportation.

The model below is for illustrative purposes. An actual plan would include more gradual phase-outs between each successive income level. It would also incorporate the likely grants by employers or NGOs and government matches, which are difficult to anticipate at this point.

The Contract for College

Based on the average annual cost of attendance at 4-year public colleges (approx. $12,000)

Household Income below $25,000	
Grant to cover 75% of costs	$9,000
Work-study	1,500
Subsidized loan	1,500
Household Income $25,000-49,999	
Grant to cover 65% of costs	$7,800
Work-study	1,500
Subsidized loan	2,700
Household Income $50,000-$74,999	
Grant to cover 55% of costs	$6,600
Work-study	1,500
Subsidized loan	3,900
Household Income $75,000-$99,000	
Grant to cover 40% of costs	$4,800
Work-study	1,500
Subsidized loan	2,350
Unsubsidized loan	2,350
Household Income above $100,000	
Unsubsidized loan	$10,000

Public Opinion Analysis: College Affordability, Access and Value

According to extensive polling by Public Agenda on public attitudes toward higher education, Americans now view going to college as a critical piece of achieving the American dream.[25] Six in 10 parents consider a college education to be "absolutely essential" for their child. Parents rank a college education as the most important factor for success in life, with black and Hispanic Americans much more likely than white parents to believe a college education is paramount for success in life. The importance parents place on sending their kids to college is matched by their worries about the cost of tuition, and two out of three Americans believe the government should play a major role in making college more affordable.

Importance of College. Americans are somewhat conflicted about the importance of a college degree. On the one hand, nearly two-thirds say a person can be successful in the workforce without a college degree. On the other, 60 percent of parents believe it is essential for their child to attend college. Parents also believe that a college education is the most important thing for young people to succeed, more important than a strong work ethic, getting along well with others or learning on-the-job skills. Hispanic parents are the most likely to believe a college education is important to success in life—65 percent compared to 47 percent of black parents and almost one-third of white parents. Most Americans agree that a college education is more important than it was a decade ago, and 2/3 strongly agree that it is as important as a high school education used to be. Today, 75 percent of Americans agree that a society can never have too many college graduates.

Affordability and Cost. Half of all parents are very concerned about being able to save enough for their child's education. Yet most believe that if someone wants to go to college they can find a way to pay for it, even if they have to go to school and work at the same time. But again, people are conflicted about the opportunity available to qualified students. When asked whether the most qualified and motivated people have an opportunity to attend college, 45 percent say that the vast majority have the opportunity, and 47 percent say that there are many who do not have the opportunity.

People point the finger at colleges for the rising costs associated with higher education. Over 80 percent agree that colleges could be doing more to control costs, and 60 percent believe colleges can reduce costs without sacrificing the quality of education students receive.

Specific Proposals. When presented with four different choices, most Americans believe the government should provide more tax breaks to families and provide more opportunities for student to work for their financial education. About half of all Americans think the government should provide more grants directly to students.

Expanding the Dream: Boosting Home Ownership and Asset Accumulation

Sacrificing today for a brighter future tomorrow has long been a key ingredient of middle-class success. Home ownership and savings form the core of middle-class security—and help fuel middle-class optimism and self-improvement. As Michael Sherraden wrote in *Assets and the Poor*, "Income may feed people's stomachs, but assets change their heads." Home equity and savings nest eggs provide a buffer against hard times, and increase household economic stability. The effects of asset holding on children is significant. Family wealth is one of the strongest predictors of how well children will do in their lives.[26]

Asset-based policies that encourage retirement savings, investment, and homeownership have been hugely successful in strengthening the middle class. Too often, however, these policies fail to reach young Americans and low-income working families trying to gain entry to the middle class. Our plan will expand homeownership and asset protection policies among low- and moderate-income households as well as put forth a bold plan to ensure that all children have a stake in the American dream. Specifically, we propose to:

- Create new incentives through tax policy that would double the rate of homeownership for low-income working families.
- Provide every child with an endowed asset account at birth.
- Enact an aggressive asset-protection policy to protect against usurious interest rates that endanger successes in asset accumulation.

OVERVIEW OF THE PROBLEM

Too many Americans lack the assets they need to move toward middle-class security—and the situation has been getting worse in recent years. Millions of Americans have neither savings nor significant home equity. Homeownership rates are at a historic high—nearly 70 percent—but many younger Americans and low-income workers find themselves priced out of the market by housing costs which have soared much faster than inflation in recent years. The California Association of Realtors estimates that just 23 percent of California households can afford to buy a median-priced home. Ownership rates for minorities lag far behind those of whites—46 percent for Hispanics and 48 percent for African-Americans. Many households that do own homes spend so much on large mortgages, with the interest frontloaded, that they are unable to save for other purposes and

remain very vulnerable to an economic setback. Financial hard times can lead to a downward spiral for asset-poor households, who often turn to credit cards and other high-cost forms of borrowing to make ends meet.

During the 1980s and 1990s, the asset poverty rate grew while the income poverty rate modestly decreased. In fact, between 1983 and 1998, according to economist Ed Wolff, the bottom 40 percent of households experienced a 76 percent *decrease* in their household net worth.[27] Recent estimates reveal that 1 out of 4 households are asset poor, compared to 12 percent of households that are officially income poor according to the U.S. Census Bureau. Stated differently, 25 percent of households would be unable to meet their needs for three months at the federal poverty level if they were to lose their source of income. (A slightly different asset poverty measure indicates that 40 percent of households are asset poor.) Racial differences in asset poverty are staggering. In 1998, 42.6 percent of African-Americans and 49.8 percent of Hispanics were asset poor, compared to 20.5 percent of whites.[28]

HOME OWNERSHIP AND SAVINGS ARE THE CORE OF MIDDLE-CLASS SECURITY.

At the same time that millions of households cannot build the assets they need to secure a middle-class life, Americans at the top of the economic ladder have been accumulating more wealth than ever. The top 1 percent saw their household net worth increase by 42 percent in the 1980s and 1990s—nearly four times the gains experienced by the middle 20 percent of households. In 1999, the top 1 percent of households owned 38 percent of all national wealth, up from 20 percent in 1979.[29]

Further eroding opportunity for millions of Americans to enter the middle class are heavy burdens of high-interest debt. During the 1990s, American households experienced a dramatic rise in consumer debt. Between 1989 and 2001, the average household experienced a 53 percent increase in credit card debt, with very low-income families (those earning less than $10,000) experiencing a 184 percent rise in debt. Households earning between $10,000 and $24,999 experienced a 42 percent increase in credit card debt.[30] (Table 1) More alarming are usurious interest rates in the high 20 percent range as well as fees of $30 and higher. In 2003, the credit card industry reported $19 billion in consumer fee income alone, making fees a significant drain on family budgets.

Table 1. Rise in the average amount of household credit card debt, 1989 to 2001 (in 2001 dollars)

Earned Income	*1989*	*2001*	*Change 1989-2001*
All Indebted Families	$2,697	$4,126	53%
<$10,000	646	1,837	184%
$10,000-$24,999	1,578	2,245	42%
$25,000-$49,999	2,435	3,565	46%

Source: Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the '90s (Demos).

Fringe banking services such as payday loans, check cashing services, and money transfer services siphon billions of dollars out of low-to-moderate income communities. It is estimated that payday lenders alone extracted $2.4 billion in fees in 2002.[31] In addition to these practices, predatory mortgage lending costs consumers $9.1 billion each year in the form of equity stripping, higher interest rates, and excessive foreclosures.[32]

Policy Proposals

The federal government helps Americans build personal wealth in a variety of ways, most notably with tax breaks related to home ownership and retirement savings. However, most of this assistance goes to people who are already doing well. For example, nearly 90 percent of the mortgage interest deduction benefit accrues to tax filers with adjusted gross income over $50,000, and wealthy homeowners are even able to deduct mortgage interest on a second residence. Meanwhile, tens of billions of dollars in tax breaks to encourage retirement savings go to Americans whose significant net worth already guarantees a secure retirement.

The policy proposals set forth in this section are aimed at helping those seeking entry into the middle class by increasing homeownership rates among low- to moderate-income families, as well as encouraging personal savings and protecting assets from usurious practices. Historically, government help has been pivotal to expanding asset ownership among Americans. However, in recent years, community development corporations and other nonprofit groups have dramatically increased their role in helping more people buy homes and save money. Our proposals envision both an expanded role for government and new efforts to catalyze investments in asset building by the private and nonprofit sectors.

THE WORKING FAMILIES HOMEOWNERSHIP BOOST ACT

Make the mortgage interest deduction refundable to assist low-income families in building wealth; cap the benefit level of the deduction to $10,000 annually for future home purchases and index the level to inflation.

Policy Rationale

Federal efforts to promote and subsidize homeownership mostly benefit Americans who need little assistance in joining the ownership class. In 2003, the federal government spent $110.5 billion in homeownership incentives—more than half of which was for the home mortgage interest deduction. The bulk of these tax expenditures accrue to wealthier families.[33] In fact, the bottom 60 percent of households receive only about 5 percent of the tax incentives in this area.

Policy Design

The goal of the mortgage interest deduction should be to provide homeownership subsidies for all Americans. Low-income working families are often excluded from current subsidies because their tax liability is not large enough to make use of the home interest tax deduction, which is not refundable. With minor revisions to the deduction, billions of dollars can be used to subsidize homeownership for those most in need, and such an effort can be partly funded by shifting resources away from subsidies for higher income tax filers who need little or no incentive to purchase a home.

The mortgage interest deduction should be capped at $10,000 annually for all new home purchases and the deduction should be made refundable to assist working families in building wealth. This would mean cash back at the end of the year for families who owe very few taxes but have mortgages. These refunds, in turn, could be used to help build greater equity.

To keep up with inflation, the cap level should be indexed each year. Indexing the cap would allow the value of the deduction to rise as costs increase. This would ensure that low-income working families who enter into homeownership are able to fully benefit from the deduction year after year.

THE FIRST-TIME HOMEBUYER DOWN PAYMENT ACT

Create a matched savings account to help low-income families save for a down payment on a home.

Policy Rationale

One of the most significant obstacles to purchasing a first home is the ability to save enough money for the down payment and closing costs, particularly as housing prices have rapidly increased. Young Americans struggling with student loans and credit card debts find it especially difficult to put aside the funds needed to make the all-important life investment of purchasing a home. To encourage working Americans to purchase a first home, incentives are needed to help people save for a down payment.

Policy Design

First-time homebuyers earning less than $50,000 should receive a $1 for $1 match for monies saved toward a down payment, up to $7,500. (The match would be phased out gradually for those making up to $100,000.) Contributions by private or nonprofit entities would also be matched at the same rate, up to $2,500. The homeownership down payment assistance subsidy would carry a maximum benefit of $10,000, and would allow first-time homebuyers to accumulate up to $20,000 toward the purchase of a first home.[34]

- *Down Payment Accounts* would be established through the tax code and deposits up to $10,000 would be nontaxable.
- Deposits, matching funds, and investment earnings should accrue tax-free.
- All withdrawals of deposits, match funds, and interest from *Down Payment Accounts* would be tax-free and could only be used as a down payment for a first home.
- All money accrued in *Down Payment Accounts* would be disregarded in determining eligibility and benefit levels for means-tested programs.
- *Down Payment Accounts* would be regulated under the same structure as tax-preferred retirement savings accounts such as 401(k)s. These accounts would be held by any entity that can hold a 401(k).

BORROWER SECURITY ACT

Ensure that the nation's lending industry provides credit to individuals on fair and responsible terms, preventing the wealth-stripping effect of abusive lending practices.

Policy Rationale

Personal debt can stand as an insurmountable obstacle to Americans wishing to build assets and secure a place in the middle class. As credit card debt levels have soared, many Americans—especially young people—are diverting more money to servicing these debts and saving little or nothing for the future. The predatory practices of credit card companies and other lenders have aggravated this situation by making it easier for American to get into serious debt and harder for them to get out, thanks to high interest rates, fees, and penalties.

Although usury laws are on the books in some states across the country, they are rendered useless by deregulation of the credit industry. Deregulation of the industry began in 1978 with *Marquette National Bank of Minneapolis vs. First Omaha Service Corp.* and con-

tinued with *Smiley vs. Citibank* in 1996. Taken together, the two Supreme Court rulings allowed national banks to charge credit card customers the highest interest rate permitted in the bank's home state, with fees defined as interest for the purposes of regulation. As a result, national banks physically moved their credit card operations to states, such as South Dakota and Delaware, that have no usury limits.

The consequence of deregulation has been pervasive usury among credit card companies, with devastating effects on the ability of Americans to accumulate and protect financial assets. And usurious interest rates are not unique to the credit card industry. The entire credit industry is engaging in usurious practices. The payday loan industry charges some of the highest interest rates of any type of creditor, with rates as high as 400 percent annual percentage rate not uncommon. Through refund anticipation loans (RAL), the tax preparation industry is also engaging in usurious lending behavior. According to a recent study, estimated annualized interest rate costs of RAL in the Washington, DC area reached as high as 250 percent. The three largest players in the tax preparation industry—H&R Block, Pacific Capital, and Household Financial—earned $357 million in fees from RAL in 2001.[35]

Policy Design

The *Borrower Security Act* would serve to reign in usurious practices of the entire credit industry while also guaranteeing lender profit and credit availability.

- The annual rate of interest that can be charged to a consumer should not exceed 14 percent or 3 times the Prime Rate, whichever is higher.
- Any late fee or charge that a credit issuer imposes due to the failure of the borrower to make a payment on or before the due date for such payment may not exceed $15.

CHILDREN'S SAVINGS ACCOUNTS

Provide every newborn child with an endowed asset account.

Policy Rationale

Assets change the way people think about their future, helping to instill a greater sense of optimism and financial responsibility. To grow and protect the middle class, it is vital that all young Americans start life with some assets and develop a keen understanding of the benefits of saving and investing by the time they become adults. Even modest wealth endowments at birth would have a dramatic impact on the financial well-being of future generations. Millions of young Americans who now come of age in households with zero or negative wealth—and little reason to imagine that their futures will be much different—would instead reach adulthood with a small nest egg of their own that they have learned to manage. These funds will provide a major psychological edge for young Americans, making the challenges of affording college or buying a first home seem more feasible. As importantly, asset accounts will help orient them early on to the essential middle-class habit of saving and encourage their desire to become financial stakeholders in American society.

Our plan to build assets for future generations revolves around establishing *Children's Savings Accounts*. The initiative builds on recent policy proposals and research by the Center for Social Development, the Corporation for Enterprise Development, the Institute for Public Policy and Research in the United Kingdom, and, most recently, the New America Foundation.[36]

Policy Design

The *Children's Savings Accounts* will be provided at birth for each child. For families earning less than $50,000, a deposit of $6,000 by the federal government will be made into each account. Families earning between $50,000 and $75,000 would receive a $3,000 deposit. For families earning between $75,000 and $100,000 the endowment would be phased down to $1,500. Voluntary contributions no greater than $1,000 per year can be made, regardless of income.

- All amounts in *Children's Savings Accounts* would be disregarded in determining eligibility and benefit levels for means-tested programs.
- Contributions by private or nonprofit entities up to $1,000 a year would be matched by government on a $1 to $1 basis. Thus, for example, a community foundation seeking to help local children build assets would see its investments go substantially further, while some employers might contribute to the *Children's Savings Account* of employees' children as a new kind of fringe benefit.
- For children born before this initiative is enacted, a phase-in period will be established during which accounts can be opened. These children would be ineligible for government deposits.
- Funds would be made available at the age of 18, contingent upon graduation from high school or successful attainment of a GED.
- Withdrawal of principal and accrued interest would be tax-free.
- Withdrawals can be used for any purpose.

Public Opinion Analysis: Assets and the American Dream

Homeownership. A majority of Americans view becoming homeowners as a key investment and see lack of affordable housing as a major problem in their community. At least 7 in 10 adults support a variety of policy measures to address the lack of affordable homes with roles for the government, private and nonprofit sectors.[37] Despite the problem of affordability, owning a home is still a very powerful part of the American Dream. Nine in 10 working families who live in metropolitan areas (with earnings under $54,000) and are currently renters would like to own a home. Eight in 10 (85 percent) expect someday to be homeowners. When asked which should be a higher priority, increasing the number of affordable apartments or the number affordable homes to buy, even renters say "affordable homes" by a two-to-one margin (61 percent to 29 percent).

Role of Government. While most people believe it is important for government to address the lack of affordable homes, many Americans also are concerned about the effectiveness of government programs in this area. A recent poll found that 82 percent of likely voters think it is important that Congress provide adequate funding for low-income housing.[38] Another poll found almost equal support for local and national governments to help solve the problem through a variety of mechanisms, including aid to non-profits to build more housing and tax credits to public servants, such as police officers and teachers, to help them save toward a down payment to purchase homes near the communities where they work.[39] However, the public views the agency charged with developing affordable housing for low-income families, the Department of Housing and Urban Development (HUD), unfavorably—just ahead of the Internal Revenue Service, which ranked last.

Children's Savings Accounts. Poll after poll reveals the common notion that the current generation is in jeopardy of being worse off than the previous generation. But there is very little information about how the public views the concept of providing universal accounts at birth. Focus group research conducted by the Corporation for Enterprise Development (CFED) revealed that intergenerational benefits of asset-building are likely to be seen by the parents of savers in the same way as it is seen by the kids of savers. In other words, parents are more conscious of how they themselves are saving and investing when their children are also saving for the future.[40]

Making Work Pay: Closing the Gap Between Wages and the Cost of Living

Work is the path to success in America. It is a core value of our society that everyone who can work, should work—and that there will be rewards for this effort. Yet today, this hallowed ideal of national life is deeply compromised. As many as a third of working Americans are not earning enough money to meet the basic economic needs of themselves or their family. Millions of workers who are putting in more hours of work than ever find themselves either unable to ascend to the middle class—or hard pressed to stay there. The earnings shortfall has been worsening in recent years and there are no signs on the horizon that it will abate anytime soon. As a result, Americans are saving less and borrowing more to make ends meet. Our plan aims to restore the value of work and builds on two existing policies with bipartisan support—the minimum wage and the Earned Income Tax Credit. Specifically, we propose to:

- Eliminate poverty among full-time workers, as measured by the federal poverty line, by raising the minimum wage and indexing it to inflation.
- Create a Working Families Tax Credit to ensure that most full-time workers earn enough to provide a minimally decent life for themselves and their families, as measured by the true cost of living where they reside.

OVERVIEW OF THE PROBLEM

In the United States today, a quarter of all workers make $8 or less an hour. Nearly a third of households take in less than $25,000 a year in income.[41] This kind of money is simply not enough to cover such basic items as housing, child care, and transportation in many areas. The earnings crisis in America has been documented by research that compares wages with the cost of living in different communities across the United States. It is also reflected in polling data over recent years in which roughly a third of Americans report that they don't make enough money to meet their basic needs.

These real-world sources of data underscore the irrelevance of the federal poverty index to the experience of real working people trying to get by. For example, according to *Hardship in America*, a study by the Economic Policy Institute, the minimum cost of living in Chicago,

Illinois for a single parent with two young children was $35,307 a year in 1999. This figure assumes a bare-bones family budget, including only $737 a month for housing and $351 for food. However, even this no-frills annual budget was 263 percent of the federal poverty line. While the same family could live more cheaply in other communities, such as Little Rock, Arkansas ($25,809), other communities—such as Nassau-Suffolk counties on Long Island, New York—were substantially more expensive ($48,606).[42]

The gap between earnings and the cost of living in America has resulted in lower savings and rising debt among working families. Between 1989-2001, credit card debt grew by more than 40 percent among households earning less than $50,000. Very low-income households were hit the hardest: their credit card debt nearly tripled over the decade.[43]

The earnings gap is unlikely to be closed any time soon. Indeed, the most extensive research documenting the gap is based upon data collected at the height of the most recent economic boom, in 1999. The reality of economic hardship for so many working people during the very best of times shows that absent major public policy intervention, the American economy cannot be expected to deliver a minimally decent life to all those who work. A basic disconnect exists between a U.S. economy that produces a high number of low-wage jobs and a society where the cost of living has risen considerably in many areas, driven by the increased prices for housing and healthcare. This disconnect may well worsen in coming years, as labor markets continued to become more globalized and as technology allows more jobs to be automated. While new investments in education and job training, as well as support for small businesses and entrepreneurship can reduce some of the earnings gap, there is little in the foreseeable future that will change a basic reality of American life today: Millions of working people who are trying their best are not able to keep food on the table or a roof over their heads.

AS MANY AS A THIRD OF WORKING AMERICANS ARE NOT EARNING ENOUGH MONEY TO MEET THEIR BASIC ECONOMIC NEEDS.

Current public policies fall far short of addressing the earnings crisis. The minimum wage, instituted in 1938, has failed to keep pace with inflation and doesn't protect against poverty. Even two-income families where both adults are working full-time and earning 50 or 75 percent more than the minimum wage, are not meeting their basic needs in many parts of the United States. The EITC, perhaps the most successful anti-poverty program ever, also is inadequate. While the EITC was significantly expanded in the 1990s, its payout levels are not generous enough to help many of its recipients meet the true cost of living in their area. The EITC also provides very little help to individuals or couples without children, and thus doesn't aid millions of working people struggling in the low-wage economy.

The United States is at a fork in the road. The vast scope of the earnings crisis means that incremental changes to current income policies affecting working Americans will do little more than make a small dent in the problem. And recent experience suggests that little relief will come from even the most positive macro-economic policies. Major new policy initiatives are required.

Policy Proposals

The policy agenda outlined here has two goals: first, to ensure that no adults working full-time jobs will fall below the federal poverty line. And second, to achieve the more ambitious goal of ensuring that most working adults can meet their minimal financial needs.

RAISING THE MINIMUM WAGE AND INDEXING TO INFLATION

Raise the minimum wage through graduated increases through 2010. Index to inflation.

Policy Rationale

The Federal minimum wage was introduced in 1938—initially pegged at $.25 an hour—in order to guarantee a minimally decent level of income for all those who work. Both the scope of employees covered, along with the value of the minimum wage, was significantly expanded during the 1960s—with bipartisan backing from Congress. However, during the 1980s and 1990s, the minimum wage failed to keep up with inflation. The value of the minimum wage is 30 percent below it peak in 1968, and 24 percent lower than it was in 1979.[44] The minimum wage was last raised in 1997, to $5.15. A subminimum wage of $4.25 was introduced at the same time, covering employees under 20 during their first 90 days of employment.

Assuming a full-time work schedule of 40 hours per week and 50 weeks a year, a minimum wage job at the current rate of $5.15 an hour brings in an annual income of $10,300. This wage is enough to elevate a single individual over the 2003 federal poverty threshold of $9,310. But it is does not achieve that goal for a single parent with two children (threshold: $15,670). In addition, a two-parent family with three children where both adults are working full-time and earning the minimum wage also falls short of earning enough to cross the federal poverty threshold ($20,500 vs. a threshold of $22,030).

Over the coming decade, the largest job growth will be in low-paying jobs. Such jobs are essential for the functioning of the economy, as well as to the level of service than many Americans now expect in different areas. Such jobs are also the only option available to millions of adults who do not have the education to compete for better jobs or do not live in areas where better jobs exist. Many states and localities have already raised the minimum wage in recognition of these facts. Thirteen states already have minimum wages set well above the federal level.

Research shows that a higher minimum wage does not result in lost jobs, as many have warned. For example, there is no evidence that the four states that have recently increased their minimum wage to over $7 per hour—Alaska, Connecticut, Oregon, and Washington—have suffered job losses as a direct result of this step. This research confirms earlier work by economists David Card and Alan Kruegur.[45]

Policy Design

In an era where all able-bodied adults are expected to work—including single parents with children—a reasonable goal of the minimum wage is to ensure that anyone who works full time does not fall below the poverty line. To achieve this, we propose to:

- Phase in an increase of the minimum wage to $8.40 an hour by 2010, a level that will ensure that a full-time working parent with two children will not fall below the projected federal poverty line in that year of $16,850.

- Index the new minimum wage to inflation so that workers' wages keep up with the cost of living.

THE WORKING FAMILIES TAX CREDIT

Replace the EITC for low-wage earners with a Working Families Tax Credit that provides more generous credit amounts to all full-time workers—with benefits pegged to the real cost of living based on family size and geographic location.

Policy Rationale

The Earned Income Tax Credit was introduced in the 1970s to supplement the incomes of low-wage workers with children. It was expanded dramatically in the 1990s, becoming America's single most effective anti-poverty measure and one that has enjoyed broad bipartisan support because it rewards work. Sixteen states have also enacted EITCs. In 2003, families with any earnings up to $33,692 were eligible for some amount of credit, with a maximum credit available of $4,204. Total federal spending for the EITC was about $35 billion in 2004. Yet despite the expansion of the EITC in recent years, it still falls far short of alleviating the income shortfalls faced by low-wage workers and suffers from several flaws. First, the credits available to filers are too small to close the gap between low wages and high living costs—and would remain so even with a healthy increase in the minimum wage. While the EITC does succeed in lifting many households above the poverty line, it is not generous enough to enable households to meet their basic income needs as measured by alternatives to the federal poverty threshold. For example, in 2003, a single parent with two children who works full-time, year-round with no vacation at a minimum wage job would have been eligible for the maximum EITC credit of $4,204—bringing their income to $15,124. But if they lived in Little Rock, Arkansas, they would still face an annual income shortfall of $10,000 in trying to meet a no-frills family budget. In other areas, such as Chicago or suburban Long Island, New York, their shortfall would be twice or three times as great.

A second major weakness of the EITC is that it offers negligible benefits to childless workers. In 2003, only childless workers with adjusted gross incomes of less than $11,230 could file for the EITC, and the maximum benefit was $382. A third weakness of the EITC is that its benefits do not take into account geographic variations in the cost of living. In rural Mississippi, where a single parent with two children needs an annual income of $22,000 to meet basic family needs, a $4,204 tax credit closes a third of the shortfall from a minimum wage job. In Seattle, where the same family needs a basic income of $34,000, the maximum EITC payment closes only a fifth of the gap.

To appreciate the modest nature of the income subsidy of the EITC, compare two Americans: first, a maid with three children who earns $11,000 a year and receives the maximum EITC payment of $4,204. And second, a lawyer who makes $350,000 a year, has a $4,500 a month mortgage, receives health insurance benefits worth $6,000 a year, and puts aside $15,000 a year in tax-free retirement savings—all for a de facto subsidy to their income of roughly $21,000 a year. The wealthy lawyer is getting five times as much help from the government as the struggling maid.

Policy Design

In an era where low-wage work is a permanent fate for millions, there should be a more generous subsidy to ensure a minimal basic income for low-wage workers and create more parity in tax expenditure benefits across income groups. The EITC should be replaced with a Working Families Tax Credit with the following attributes:

- The new tax credit would offer a maximum income supplement of up to $15,000 per year to all workers over the age of 18 and under the age of 65 who worked 35 or more hours a week during 44 weeks in a given year (1,540 hours per year). The

Working Families Tax Credit would work much as the current EITC, except that it would be more generous and payments would be pegged to local living standards. For example, a single parent with two children in Little Rock with a full-time job at $8 an hour, or $16,000 a year, would receive a refundable tax credit of roughly $9,000 to enable them to meet their estimated cost of living in Little Rock of $25,000. The same parent living in Nassau/Suffolk County and earning $10.50 an hour, or $21,840 a year, would receive the maximum credit of $15,000 a year—which, unfortunately, would still leave them with a significant shortfall of income given estimated living costs at roughly $46,000 annually. Individual workers without children would be treated in the same way as parents under the Working Families Tax Credit, with benefits determined by geographic location and, for married or co-habitating individuals, total household income.[46]

- The Working Families Tax Credit would be designed to encourage full-time work. However, it would recognize the difficulty that many people have in securing or keeping full-time employment and would reward all work, up to a point. All individuals, with the exclusion of students, would be eligible for a lifetime total of 5 years of part-time worker credits under the Working Families Tax Credit. In order not to provide any incentives for working less, these credits would be lower than those available for full-time workers, with their generosity reflecting annual hours worked. For example, a parent with two children living in Little Rock who only worked 1,000 hours a year at $9.00 an hour, for a total of $9,000 a year, might get 50 percent of the difference between their earned income and their minimal basic income, or an $8,000 credit. However, if they worked more hours—1,250 in a year, earning $11,250—they might get 75 percent of the difference between their earned income and their minimal basic income, or $10,312.
- The size of tax credits under the Working Families Tax Credit would be based on the local cost of living, as determined by the Federal Office of Living Standards (see below).
- The Working Families Tax Credit would interact with Temporary Aid to Needy Families in the same way that the EITC now interacts with TANF.
- The Working Families Tax Credit would be administered by the IRS, just like the EITC.

THE FEDERAL OFFICE OF LIVING STANDARDS

Create a Federal Office of Living Standards to collect and analyze data to determine real costs of living and create codes for different geographic locales that will be used to determine benefits under the Working Families Tax Credit, as well as other social policy.

Policy Rationale

The Federal poverty threshold is now the dominant measurement of economic well-being among low-income Americans. However, much research has demonstrated that the minimal cost of living is much higher in every part of the United States than the threshold—and, in many cases, dramatically higher. For this reason, the federal poverty threshold is best understood as a crisis-level minimal floor of economic sustenance, as opposed to a measurement of sustainable economic well-being.

In recent years, nongovernmental organizations have developed sophisticated research models that capture the true of cost of living in hundreds of U.S. communities. Some state and local governments have adopted such models to inform social policy and economic planning. The stage is now set for the federal government to develop its own approach to measuring the true cost of living in communities nationwide—with the specific goal of determining credit levels under the Working Families Tax Credit.

Policy Design

The federal government should become the authoritative source of information about the true cost of living in America, distilled down to every imaginable household configuration and zip code.

- Create a nonpartisan National Commission on Living Standards that would develop a methodology for measuring the true cost of living in communities across the United States.
- Create a Federal Office of Living Standards that uses the methodology, collecting and analyzing a wide range of data to determine the true cost of living for different household types in every zip code in the United States.

Public Opinion: Income, Work, and Personal Responsibility

Most Americans believe that everyone who can work should work, and that harder work will increase one's chances of a better life. However, there is wide disagreement in the public about whether hard work alone guarantees economic success and a decent life. Despite these disagreements, the public has been strongly supportive of policies that ensure a decent return from work, including the minimum wage and the Earned Income Tax Credit.

Importance of Work. Polls have repeatedly shown that many in the public believe that individuals should rely on their own effort to move ahead in life. Surveys show strong support for the emphasis on work within welfare reform, including work by parents with young children. A 2002 poll found that 82 percent of Americans believed that the success of welfare should be judged by how successful it was in moving people into work. The next most important outcome was increasing the skills and ability of welfare recipients to get good jobs.[47]

Help From Government. Despite widespread distrust of government and an emphasis on individual effort, over 80 percent of Americans agree that "the federal government should do everything possible to improve the standard of living of all Americans."[48] An overwhelming majority of Americans also agree that government should help low-income workers enter and stay in the workforce with assistance for job training, childcare, and healthcare.

Minimum Wage. Polls consistently show that the Americans strongly support raising the minimum wage. In 2002, 77 percent of voters favored increasing the minimum wage from $5.15 an per hour to $8.00 per hour. And 79 percent favored regularly raising the minimum wage to keep up with inflation. The public rejects many of the common economic arguments used by opponents against raising the minimum wage. Sixty-nine percent of people disagree that "raising the minimum wage would make it harder for low-wage workers to find jobs, because employers would hire fewer people."[49] Additionally, the public sweepingly rejects the argument that raising the minimum wage would cause low wage earners to lose jobs because employers would be unable to afford the higher salaries.[50]

Tax Credits. There is little information on public opinion toward tax credit policies for low-income families. In April 2001, Peter D. Hart Research conducted a poll specifically to gauge support for tax credits including the Earned Income Tax Credit (EITC), the child tax credit, as well the general concept of refundable tax credits for low income Americans. Forty-three percent of voters are very or fairly familiar with the term "earned income tax credit." After describing the EITC to respondents, 66 percent describe their reaction to the EITC as very or somewhat favorable. Support for the policy extended across the political and income spectrum, although Republicans (55 percent) were less supportive than Democrats (74 percent) or Independents (68 percent). Fifty-nine percent of Americans with household incomes of over $75,000 favored the policy, while 74 percent of those with incomes of less than $30,000 responded favorably to the EITC.

Appendix

Cost Estimates and Revenue Sources. The sections below estimate the costs for the proposals presented in this report, as well as select revenue sources, with the exception of the Working Families Tax Credit, which we are not equipped to assess at this time. These estimates also do not include the costs of matching the contributions by private or nonprofit entities, given the difficulty of predicting how large those contributions might be. Unless otherwise noted, the cost estimates reflect the *annual* cost of each proposal.

Higher Education Proposals

THE CONTRACT FOR COLLEGE

Provides grants, loans and work-study aid to students that will cover the full cost of attendance (tuition, fees, books, room and board). The combination of aid varies according to family income, with students from low- and moderate-income households awarded a larger percentage in grant aid.

Estimated Cost: **$48 billion, annually**

Revenue Sources

The higher education proposals will be funded using a combination of collapsing existing federal programs as well as through new revenue sources. Specifically, our proposal will reallocate the current federal spending on all federal student aid programs to fund the new *Contract for College* system, including the higher education tax credits. We will preserve the TRIO and GEAR-UP programs which support early college motivation and preparation efforts.

After reallocating money from existing spending on higher education programs, our cost estimates show an additional $30 billion will need to be raised either through tax increases or through cuts to other programs.

Table 1. Annual Estimated Costs of Contract for College

Grant Aid	$39 billion
Work-Study Aid	$9 billion
Administrative Costs of Direct Loans	$166 million
Total Spending	**$48 billion**

Table 2. Revenue Sources for Higher Education Proposals

Revenue from Existing Programs:	
Existing Pell Grant Expenditures	$11.7 billion
Existing Higher Education Tax Credits (Lifetime Learning Credit and HOPE Scholarship Credit)	$5.4 billion
SEOG (Supplemental Educational Opportunity Grants)	$9 million
LEAP (Leveraging Educational Assistance Partnership)	$1 million
Total Revenue	**$18.1 billion**
New Revenue Needed	**$29.9 billion**

Homeownership and Asset Building Proposals

The Working Families Homeownership Boost Act

Make the mortgage interest deduction refundable; cap the benefit level of the deduction at $10,000 for new mortgages and index the level to inflation.

***Estimated Cost:* $8.5 billion, annually**

The First-Time Homebuyer Down Payment Act

Creates a matched savings program to help low-income families save toward a down payment on a home.

***Cost:* $8 billion, annually**

Children's Savings Accounts

Provide each newborn child with an endowed asset account at birth.

***Estimated Cost:* $19.4 billion annually**

Table 3. Estimated Annual Costs of New Homeownership Incentives and Children's Savings Accounts

The Working Families Homeownership Boost Act	$8.5 billion
The First-Time Homebuyer Down Payment Act	$8 billion
Children's Savings Accounts	$19.4 billion
Total Spending	**$36.3 billion**

Table 4. Revenue Sources for New Homeownership and Asset-Building Incentives

Revenue from Mortgage Deduction Cap:	$11.5 billion
Total Revenue	**$11.5 billion**
New Revenue Needed	**$24.8 billion**

Income Proposals

RAISING THE MINIMUM WAGE AND INDEXING TO INFLATION

Raises the minimum wage through graduated increases through 2010. Index to inflation.

Estimated Cost: **None. The cost is borne by employers.**

THE WORKING FAMILIES TAX CREDIT

Replace the EITC for low-income earners with a Working Families Tax Credit that provides more generous credit amounts to all full-time workers—with benefits pegged to real costs of living based on family size and geographic location.

Estimated Cost: **Undetermined.** Estimating the cost of providing credits based on family size, composition and geographically specific costs of living would require significant statistical modeling beyond the scope of this report. The Center for Economic Policy Research has recently begun an intensive research project designed to help estimate the costs associated with providing tax credits based on individual family size, earnings and costs of living.

THE FEDERAL OFFICE OF LIVING STANDARDS

Create a Federal Office of Living Standards to collect and analyze data to determine real costs of living and create codes for different geographic locales that will be used to determine benefits under the Working Families Tax Credit, as well as other social policy.

Estimated Cost: **$100 million**

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