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Asset Welfare: A Different Approach in the War on Poverty

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Abstract

This thesis evaluates American asset poverty. By looking at the history of American poverty aid, it posits that asset poverty is not being addressed. Through a careful review of the literature this thesis answers a series of questions that demonstrate the import of the asset dimension of poverty. The current systems of asset based aid are evaluated, and policy recommendations are made for a more adequate national approach to this issue.

Asset Welfare: A Different Approach in the War on Poverty

“No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable.” -Adam Smith

Introduction

There is a problem in America that is not being adequately addressed. The problem is long term poverty. This thesis sets out to evaluate the current status of poverty in America and recommend that poverty be addressed in a different manner. Poverty is a two part problem. The first part is income poverty. The current US aid system targets deficient income. Long term poverty consists of those who are asset poor, and this half of the poverty problem is not being considered in current policy.

The argument presented here is that asset poverty is something America has yet to clearly label, define, or address. This thesis is structured in the following way: the development and scope of the problem are explained in the Background section. The questions that surround asset poverty are evaluated by a review of the selected literature on the topic. The status of asset based aid and recommendations for a new policy are in the Current Systems and Recommendations section. The Limitations of this report are explicitly stated in their own section, and a final Conclusion section sums up the arguments presented here.

Background

History of the American Poverty Problem

In 1964, President Lyndon B. Johnson first touted the “War on Poverty” as a step in his quest to form the “Great Society” (Johnson, 1964). Around this same time, Mollie Orshansky, then an employee of the Social Security Administration, created the headcount measure of poverty known today as the Poverty Line. She published a 124 dimensional matrix of poverty

measurements in the 1965 Social Security Bulletin. Her calculations were based upon the Department of Agriculture's 1955 Household Food Consumption Survey and the economy food plan. The Department of Agriculture (DOA) developed four food plans that priced the staples needed to feed a family based upon income. The cheapest of these plans is the economy food plan, which, as described by the DOA, was “designed for temporary or emergency use when funds are low”. Based upon the Consumption Survey, a family of four typically used about one third of its income for food. Orshansky's measure takes the price of the economy food plan for a family of four and multiplies it by three. This is the static number said to be the income poverty line. A family of four who makes below this level of income is identified as poor. For different sized families the number is divided accordingly. Currently the poverty line for a family of four is about \$20,000 a year. Orshansky originally designed this measure as an indicator of who had an inadequate level of income, positing that “if it is not possible to state unequivocally 'how much is enough,' it should be possible to assert with confidence how much, on an average, is too little” (Orshansky, 1965). In the four decades since Orshansky published her results, the income poverty measure has changed very little. It was changed in 1968 to be indexed by the Consumer Prices Index instead of the per capita economy food plan as a means to adjust for changing standards of living.

In 1992 the National Academy of Sciences (NAS) was commissioned to evaluate the current poverty measure. The study concluded in 1995, and it contained eight specific recommendations for a new measurement. The recommendations provided guidelines for creating, implementing, updating, and standardizing the new measurement. The extended resources that a family needs were to be included in this new, more complete measure of poverty. These resources were in addition to the food budget that is the current base for poverty line determination.

We propose that the poverty-level budget for the reference family start with a dollar amount for the sum of three broad categories of basic goods and services: food, clothing, and shelter (including utilities). The amount should be determined from actual Consumer Expenditure Survey (CEX) data as a percentage of median expenditures on food, clothing, and shelter by two-adult/two-child families. This sum should then be increased by a modest additional amount to allow for other necessities. The allowance for "other expenses" is intended to cover such goods and services as personal care, household supplies, and non-work-related transportation. However, it does not include such non-discretionary expenses as taxes and child care and other costs of working, which are treated as deductions from income. (NAS, 1995)

The report highlights the recommendation for a poverty measure that is more inclusive of the different types of needs a family faces.

The NAS study indicated that the current poverty thresholds were underestimating the true level of poverty due to their sole reliance on food expenditure. Unfortunately, the NAS recommendations were put on a political back burner and were not used for determining a new poverty measure. This may have been in part due to political concerns that a new poverty measure would raise the poverty rate, and would therefore reflect poorly upon an administration's political tenure as a time when the poverty rate increased.

The underestimation in the current thresholds may undermine the current aid system as the poverty line is the focus of income supplementing aid. If the income poverty line underestimates the true measure of poverty, helping families to reach that mark will not help them overcome poverty. Raising income might help in the short term to improve the basket of goods a family can buy, but in the long run those families will still be trapped in poverty.

To reach a permanently higher level of consumption the poor must be able to acquire a foundation from which to work. This foundation can be built from a stock of assets. These assets give the poor options about income decisions, as they can rely on their assets to garner more income. An example of an income generating asset would be human capital. Increased education leads to increased income, and therefore education is an asset that can be used in the long run to increase the income level of a household. These kinds of assets act as stepping stones to reaching higher levels of consumption in the future. This type of growth, spurred by asset accumulation, is not, and never was, the focus of American poverty aid. This makes the current aid system appropriate for helping with income shocks in the short term, but does not help households to grow in the long run and achieve an overall higher level of non-poor consumption.

The idea of short term income supplementing aid grew out of a time in American history when savings or asset building was not thought to be the best solution for household growth. There was an ideological shift in the '50's and '60's when the income poverty line was developed. This shift was due in part to the economic thinking of John Maynard Keynes. Prior to the Great Depression the prevailing economic model was the classical model of economic growth, which focused mainly on the expansion of the economy due to increasing the level of savings. After the Depression, Keynes put forth a theory that touted consumption as the engine of a thriving economy. As savings and consumption are the competing uses of an individual's income, these two economic theories can conflict. Both theories accurately explain the economic phenomena they address, however, the phenomena experienced in the short run, explained by Keynes, and that of the long run, explained by the classicals, are sometimes in opposition. The problem addressed by Keynes is how long is the long run? He demonstrated that for the benefits of systems focusing on the long run to be realized, too long a time span would have to pass due to sticky prices and

business cycle fluctuations. This led to a shift in focus from long run savings driven policies to short run consumption maximizing ones.

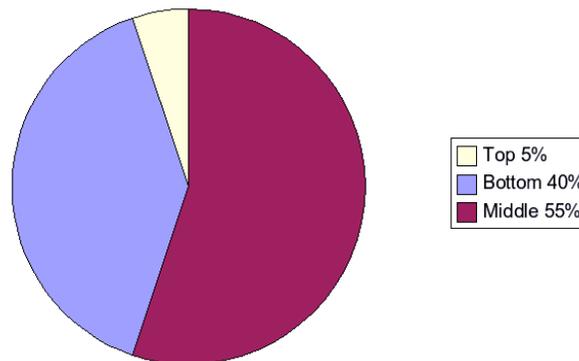
This consumption focused thinking resulted in an income based poverty aid system for two reasons. The first reason is poverty may have been thought to be only a short run phenomenon due to short term income shocks. The economy in the '50's and '60's was booming, and the thinking was that a family would need help getting back on their feet, not finding their footing in the first place. If a head of a household lost their job, or a mother needed additional help supporting her children's consumption needs, a small boost in their income until this shock was overcome was thought to be the answer to these problems¹. The second reason for an income measure is that supplementing income, which gives a family the ability to consume at a higher level, may have been thought to allow for the overall growth of the economy, because it would increase consumption spending. This expansion would then trickle down to all Americans, increasing everyone's standard of living. As will be explained shortly, this has not been the case in America.

More recent economic thinking has led to a new focus on savings, which may have more of an influence on growth than Keynes proposed. These new trends oppose the short term focus of today's welfare systems. Asset poverty has been dramatically increasing in America, due in part to the consumption driven economic thinking of yesterday. The resurgence of savings as a factor in economic growth theory has yet to bring attention to the American asset poverty problem. Therefore, income aid is still the focus of American welfare systems while the larger problem lies in the growth of asset poverty.

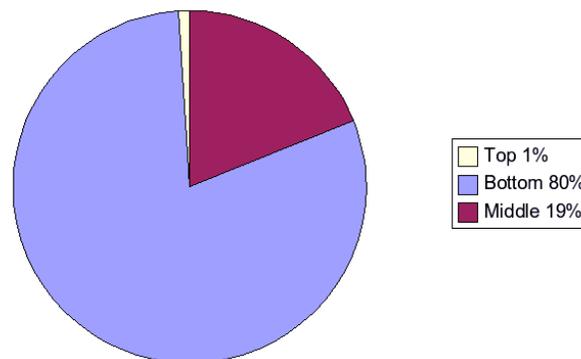
The Asset Poverty Problem

The income gap has been decreasing in America, but the asset gap has been growing. Michael Sherraden explains this nicely: “The richest 5 percent of Americans receive about the same income as the bottom 40 percent, but the richest 1 percent own more assets than the bottom 80 percent” (1990). To illustrate, the following pie charts show the American population and the relative income and asset gaps to which Sherraden alludes. The yellow sliver in the figures below is the top portion of the population that garners the same income (Figure 1) or holds the same assets (Figure 2) as the blue section representing the bottom portion of the population.

**Figure 1:
The Income Gap**



**Figure 2:
The Asset Gap**



These figures highlight a serious wealth distribution problem facing America. The short run focus on consumption growth, mentioned above, has led to a focus on income, since income is the direct determinate of a family's consumption today. A long run focus on consumption would reveal the problem the asset gap is causing for the American poor. The poor are barely able to garner an

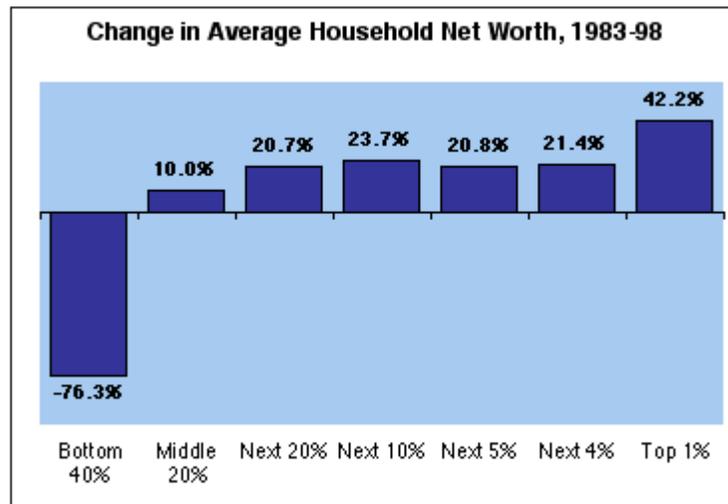
income that would allow them to meet their consumption needs today. Current aid systems help with this dilemma. However, with such a large disparity in asset distribution, the poor are stuck – barely able to meet consumption needs today, and facing the same problem tomorrow if they are unable to acquire some of the asset “pie” for consumption growth. To reach the base level of wealth that should be associated with one of the most prosperous nations in the world, the American poor have a large asset gap to cross.

When focusing on how to measure the asset gap in America, researchers have focused on the net worth of households. These wealth measurements assess those portions of the asset base that can be given monetary value, excluding the assets which are difficult to appraise, such as social or human capital assets. Even with this exclusion, the measure of wealth is most likely still very accurate. This is due to assets generating other assets. For example, a house would be included in a monetary assessment of wealth. Homeownership gives the owner access to the community and neighborhood surrounding the house, which would be considered social assets. By only measuring financial assets the depiction of wealth is still accurate because those with monetary assets will have access to the other less monetarily quantifiable assets.

Research that has evaluated the asset gap in America has been focused mainly on monetary assets. The data reported here, and most of the statistical data in this paper, is therefore based upon financial assets. However, estimating and evaluating the gap for other types of assets are important aspects of assessing the true disadvantages facing the asset poor. The asset gap that this section focuses on reflects the change in American wealth that has occurred over the past three decades due to an accumulation of new technologies and a shift from an industrial economy to a service driven economy. These dramatic changes in the American economy have not benefited all Americans equally. In the 1990's almost 33% of the wealth in America was held by only the richest

1% of Americans. From 1983 through 1998 the wealthiest 1% of Americans saw a rise in wealth of 42%, the poorest 40% saw a decline in that same period of 76% (Wolff, 2000). This is shown in the following figure (Figure 3).

Figure 3:
The Change in
Net Worth, 1983
through 1998



Source: Edward N. Wolff, "Recent Trends in Wealth Ownership, 1983-1998," *Levy Institute Working Paper No. 300, Table 3 (Levy Economics Institute: April, 2000)*.

The income gap has declined in recent years, in part due to the technology boom of the 1990's, but the wealth gap has widened. The top 10% of Americans, almost exclusively, have been the ones to see the tremendous economic benefits of the recent technological boom. The wealth gains that have come from the dynamic new American economy have been for those already at the top of the wealth scale. The poor have seen both a loss in wealth and a decline in income benefits with recent welfare reform policies². These losses have not been reflected in current poverty statistics because the measure of poverty in America is inadequate. The static income measure does not distinguish the different dynamics of poverty, and therefore those that are eligible for aid are only measured as income poor, not asset poor. Determining who in America is asset poor is essential for developing a new way to address poverty in America.

Questions Answered by a Review of the Literature

Who are the Asset Poor?

The asset poor in America are hard to identify for two reasons. First, there is not an official measure of asset poverty. Second, assets are not clearly defined. Assets can consist of every resource to which a family has access to, or could be only the resources that can be given monetary value. For example, education is referred to as an asset because additional education can garner additional income. However, evaluating an individual's accumulated earning power from education is quite hard to do, and almost impossible to appraise on a national level. This identification problem has been approached by a number of individuals and organizations. Some of the most significant work in this area has been performed by Edward Wolff.

The work that Wolff and his colleagues performed analyzing the distribution of wealth among Americans from the 1980's through the 1990's lead them to develop an asset poverty line. This line is based upon the net worth of households. Net worth is defined by Wolff as “the current value of all marketable assets less the current value of all debts” (2001). Wolff defines his asset poverty line as a family holding a current stock of financial assets that, if liquidated today, would allow the family to live at the income poverty line for three months. The choice of three months was an arbitrary median in the 2.2 to 4.2 month average job search time calculated by the Federal Reserve Bank over the period of 1967-2002 (Caner and Wolff, 2004). Using this definition of the asset poverty line, Wolff calculated the asset poverty rates for the Panel Study of Income Dynamics data from 1984 to 1999. He calculated the rates for net worth (NW), net worth minus home equity (NW-HE), liquid assets (Liquid), and a value of \$5,000. The \$5,000 rate is not based upon the asset poverty line, but a direct measure of an asset stock of less than \$5,000; in other words it is the rate of Americans with assets worth less than \$5,000 at the time of measurement.

These results are presented in Table 1.

	<i>NW</i>	<i>NW-HE</i>	<i>Liquid</i>	<i>5,000</i>
1984	26.35	42.65	41.83	53.50
1989	27.08	41.32	38.85	48.15
1994	26.08	40.49	37.83	43.12
1999	25.88	41.13	41.65	46.40

Table 1: Overall Asset Poverty Rates (Headcount Index). (Table 2A Caner and Wolff 2004)

The rates Wolff calculated show an asset poverty rate of about 26%, using the net worth measure, and about 47% for families with asset holdings worth 5,000 dollars. The percentage of those who would not be able to sustain themselves at the income poverty line if they lost their jobs (again assuming it takes three months to locate a new job) is distinctly higher than the 10.88%³ income poverty rate calculated for the same period.

Wolff went on to calculate the asset poverty gap ratios for the same data set. The gap was calculated using the Foster, Greer, and Thorbecke measure adjusted for assets. The Foster-Greer-Thorbecke measures are

$$P_0 \equiv \frac{1}{\sum_{i=1}^n w_i} \sum_{i=1}^n w_i \{V_i < PL_i\}, \quad \text{and} \quad P_1 \equiv \frac{1}{\sum_{i=1}^n w_i} \sum_{i=1}^n \frac{w_i \{V_i < PL_i\} (PL_i - V_i)}{PL_i},$$

where P_0 is the headcount asset poverty rate and P_1 is the asset gap ratio. The value of $\{V_i < PL_i\}$ takes the value of 1 if the wealth of household i V_i is less than the asset poverty line for that family PL_i , and a value of 0 if the family is not asset poor. The weight of household i is w_i . Caner and Wolff describe these measures in non-mathematical terms as follows: “In words, the headcount index gives us an estimate of the share of households that would live at poverty standards for three months if forced to liquidate all wealth and consume the proceeds. The poverty gap ratio measures

the per-household amount of wealth that would be needed to bring all asset-poor households to the asset poverty line, measured as a share of the asset poverty line” (2004). The results of the gap calculations are reported in the following table.

	<i>NW</i>	<i>NW-HE</i>	<i>Liquid</i>
1984	61.51	84.99	33.28
1989	75.66	93.72	30.72
1994	89.35	112.82	30.75
1999	82.30	108.74	32.30

Table 2: Poverty Gap Ratios (P_1 Index) for the Sample of all Households. (Table 2B Caner and Wolff 2004)

The gap index for a given year represents the inequality of asset wealth and how large the asset problem is for the poor. To illustrate these empirical results with a concrete example take a family of four that is income poor by 1999's measure. The income poverty line for this family was \$17,020 a year. To live at the poverty line for three months in 1999 a family this size needed \$4,255. The gap measure indicates that where a family needed \$4,255 worth of assets to be at the asset poverty line they were short, on average \$4,203.30⁴.

The research done by Caner and Wolff also identified the characteristics of those who were asset poor in the data they used. They found the indicating factors of asset poverty to be race, age, education, marital status of household head, and homeownership. Over the span of time they studied, the contributions to asset poverty increased from those who do not having a college degree, are a 35 to 49 year-old household head, are a childless non elderly couple, or are an unmarried elderly person. Also, the asset poverty of homeowners increased. The contributions decreased from those who are college graduates, elderly and married, black heads of households, single mothers, and married with children. The transitions in and out of asset poverty Caner and

Wolff found were characterized by changes in the value of assets and lifetime events, such as changes in marital status, homeownership, and business ownership. They found that a decrease in asset value was more dangerous for slipping into asset poverty than accumulating debt (Caner and Wolff 2004).

The characteristics and rates shown by Wolff and his colleagues clearly identify a large asset poverty problem in America that is not being addressed. The asset poverty rates and gaps are very large in comparison to the income rates and gaps. If the current system helped the poor to overcome the asset gap, the rates of asset poverty would not be as high. The asset gap exists in America, and it demonstrably affects some segments of the population more than others. The following sections address why assets are so important to overcoming poverty.

Why are Assets Important?

The importance of assets has been extensively studied by the foremost authority on asset poverty, Michael Sherraden. Sherraden in his early work argues that assets provide “household stability; promotion of orientation toward the future; greater focus and specialization; enhancement of personal efficacy, social power, and political participation; and passing on economic and social advantage to offspring” (Sherraden, 1991). He further develops the notion of assets providing an important component to a family's welfare. In 1996 he and Gautam Yadama studied the effects of assets on attitudes and behaviors. Their work demonstrates the social importance of asset holdings. Those without assets are at as much of a social disadvantage as those who are income poor. The study found that assets are correlated with better long-term planning, greater work effort, and improved social connections. They report that their results support “the proposition that assets have a positive effect on expectations and confidence about the future; influence people to make specific plans with regard to work and family; induce more prudent and protective personal behaviors; and

feed to more social connectedness with relatives, neighbors, and organizations” (1996). Their study took longitudinal data from the 1967-1972 Panel Studies of Income Dynamics because data on attitudes and behaviors was not collected after 1972. Using LISREL based regression techniques they found correlations between savings and three of the positive attitude and behavior variables. They also found that “the savings and house value effects on attitudes and behaviors occur beyond the effects of income” (Sherraden and Gautam, 1996). This study is especially notable for its demonstration that those without assets did not show the positive attitudes and behaviors associated with bright future prospects.

The social importance of assets that has been exhibited by Sherraden and Gautam is indicative of the overall sense of well being that can be garnered from asset accrual. Those without assets lose this wellness and lack the stability needed for further future building. The importance of assets is reason enough for everyone to accrue some form of asset base, but, as the the next section will demonstrate, there is even more reason for the poor to build this base.

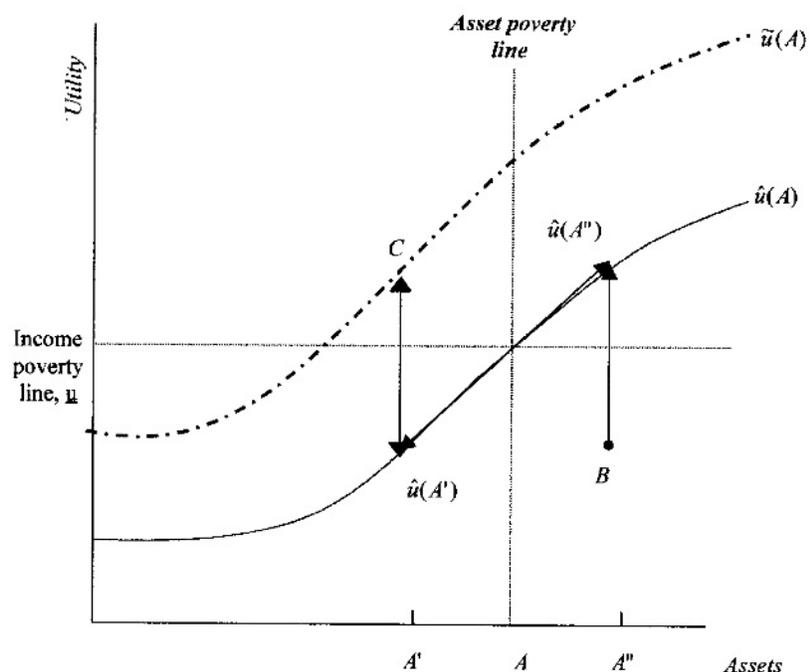
Why Should the Poor Save?

To demonstrate the importance of savings for the poor, two studies are presented in this section. The first is a theoretical model indicating that assets are needed to decrease long term poverty and help the poor overcome poverty traps. The second is the result of the case studies used throughout this thesis that here corroborate the theoretical model. The combination of the model and the case study results show that the poor must use a combination of income and assets to overcome poverty and achieve long run economic stability.

In a recent study, Carter and Barrett (2006) took an asset approach to the economics of poverty traps and redefine the Foster-Greer-Thorbecke class of poverty measures in terms of

assets. What this distinction does is allow for a two-dimensional model of the current state of poverty in terms of both assets and income. What Carter and Barrett (2006) show is that when this type of poverty distinction is made, a difference is revealed between long term poverty, or those caught in a “poverty trap”, and short term poverty, or those who have fallen below the poverty line only temporarily. Those who fall below a critical level of both income and asset wealth are trapped in poverty and can not attain the level of resources needed to rise to a higher consumption level. Those who only fall below one dimension of poverty in a given time period are able to regain the ground they lost or “get ahead” in terms of consumption level. The Carter-Barrett model addresses both dimensions of a two dimensional problem. Both the asset poor and the income poor struggle, but when a family is both asset and income poor they become trapped. Carter and Barrett illustrate this poverty trap with the graph below (Figure 4). Those who fall in the quadrant with asset and income levels both below their respective poverty lines are at risk for becoming trapped in long term poverty.

Figure 4:
The Carter-Barrett Model
Showing Poverty Traps and
Poverty Transitions



The Carter-Barrett model identifies the families most in need of aid, and suggests that a two dimensional aid system is needed. The truly poor need help attaining both income and assets to overcome poverty.

The study points out problems with relying solely on an income measurement of poverty. The income poverty line does not address the issues of time or poverty transitions. Any group classified as poor with the static poverty line approach consists of both those who are structurally poor and those who are stochastically poor. The stochastically poor are the families who drop below the poverty line for a temporary period due to bad luck or downward fluctuations in the business cycle. They are the subgroup who, given enough time, will transition out of poverty. The structurally poor are those who remain permanently impoverished. Carter and Barrett explain why this distinction is important for a true measure of the welfare of a society. With a headcount measure of poverty – a snapshot in time of the number below the poverty line – the percentage of the population in poverty could be a minority who experiences poverty indefinitely and intensely, an unfortunate subgroup of the population, or it could instead reflect a group of transitory members who will shortly transition out of poverty. The headcount measure is insufficient for measuring the true well being of a nation because it does not make a distinction between distributed poverty and subgroup poverty. Distributed poverty occurs when all members of the society experience poverty a certain percentage of the time. Distributed poverty would be preferable to having a disenfranchised subgroup who experience poverty all the time, for the overall welfare of the society.

A measure of poverty that can indicate the structurally poor is needed to highlight those that are the most in need of aid. Carter and Barret (2006) have shown that a dynamic asset approach would indicate those who are of a “club” or subgroup that are unable to rise out of

poverty. Using a convergence controversy in the model for the macroeconomic growth of nations, they demonstrate that nations are left behind in growth similarly to the poor who are left behind at the poverty line. The model they have adapted shows that not all nations converge to the same steady state growth rate. The model Carter and Barrett build is one where a section of the poor do not converge to a growth rate that generates a large enough income stream or asset base to attain a non-poor level of consumption. This group is argued to be those who lack both a minimum level of income and assets and without help will remain persistently poor.

The implication of the Carter-Barrett model is that asset poverty must be addressed to overcome long term poverty. Overcoming long term poverty by asset building has been demonstrated in the research done by Michelle Miller-Adams. Some of her results are presented here, as these case studies demonstrate the effectiveness of asset building aid at overcoming long term poverty. Her results are used in other sections as well to further demonstrate the results of asset aid in America.

In the book Owning Up (2002) Michelle Miller-Adams portrays how micro credit and asset management groups that target the poor help them acquire the assets they need to move out of poverty. She defines assets more broadly than only financial streams other than income. The four types of assets she lays out are economic, human, social, and natural assets. Economic assets include the financial equity usually attributed to the term assets. Human assets are those intangibles that make a person more marketable like education, skills, and talent. Social assets are networks of people that a family can rely upon in times of need. Natural assets are land and resources needed for survival. These four types of assets can allow a person or family to survive unexpected hardships by giving them a network of assets to rely upon. When aid programs look at the bare minimum required for survival, assets are often overlooked.

Miller-Adams' findings demonstrate how asset based aid programs are crucial for those who desire to build a non-poor future. She uses cases studies from five different organizations across the country that work to help the poor acquire assets. The programs that Miller-Adams uses as examples of how asset based aid can impact the lives of the poor show vividly that this type of aid program works in the long run. Every family in the case studies presented showed a steady improvement in their standard of living through solid asset building after coming out of public aid. The welfare gained through asset building is invaluable to a family that has never felt economic stability. Miller-Adams stresses the importance of addressing the housing gap that is growing in America between the poor and the rich. A home is one of the main sources of stability for a family. A home can be used as collateral for loans, and it can confer a safety net in the event of an economic crisis.

In Owning Up Miller-Adams finds that asset based aid is needed in conjunction with income supplementing aid in order for the poor to achieve long term economic stability. She reports that a family relies upon its assets when it faces economic trouble. Asset based aid is not widespread, but in the few places where it is available, this type of aid makes a major difference in the quality of life for the poor. Miller-Adams' research concludes that widespread (public) asset based aid would bring long run stability to a significant portion of poor Americans. This is consistent with the model built by Carter and Barrett (2006), which implies that raising income to the poverty line does not enable the asset poor to rise out of poverty. Assets must be supplemented along with income for those caught in a poverty trap. An asset based aid system is a way for this unfortunate group to achieve long run economic stability. The importance of assets to overcoming long term poverty has been demonstrated. However, for the poor to build an asset base they must overcome many hardships. These hardships are explained in the next section.

Why is it Hard for the Poor to Save?

The main problem preventing the poor from rising out of poverty is their lack of assets and limited ability to acquire assets. These constraints are the result of a combination of structural and social barriers in American society. While these barriers can be overcome, it is often a very difficult process. Income is a factor that influences a family's ability to acquire assets. However, supplementing a family's income may not be the best way to improve their ability to acquire assets.

Asset accumulation by the poor can be limited by a variety of problems associated with low income households. One major factor is limited human capital. A recent study on the financial knowledge of the low-income population (Zhan, Anderson, & Scott, 2006), shows that the lack of financial management human capital prevents the poor from acquiring and managing assets. Financial management human capital refers to the basic knowledge of financial institutions and programs available to the poor. The lack of knowledge about American financial systems prevents the poor from gaining access to credit, taking advantage of public benefits programs in place to help low income families, and setting up basic financial accounts needed for large transactions and future asset accrual. These knowledge gaps are a crucial factor in the asset gap between the poor and non-poor in America.

Financial literacy contributes to how a family takes advantage of the financial institutions in place to help them manage assets. Good financial asset management leads to asset growth and overall economic growth and well being. The public programs in place for asset management are underutilized by the poor. The marginal returns of well-managed assets are higher for those with fewer assets than those who have more. Put another way, those who would benefit the most from good asset management are the asset poor. The asset poor do not take advantage of financial institutions and asset management programs due to lack of information and structural forces

preventing them from being able to acquire assets.

Programs have been enacted to raise the financial literacy rates of those most in need of financial help. The study by Zhan et al. (2006) reports that the measure of the benefit gained from these programs in the past did not account for the characteristics of the participants that were helped by such programs and did not accurately measure knowledge gain because the results were based upon self-assessment. Zhan et al. (2006) conducted further tests that assessed the characteristic indicators for benefiting from financial knowledge building programs. The 2006 study did not rely on self-assessment of knowledge, but demonstrated improvement in financial management and sustainability by the poor due to financial knowledge building programs. The test assessed the knowledge of the poor about predatory lending practices, public and work related benefits, savings and investing, banking practices, and credit use and interest rates. Zhan et al. (2006) found that those who benefited the most from financial knowledge building programs were married with limited English proficiency and formal education. The study found that financial knowledge education programs greatly help low-income families understand the public and private benefit programs available to them. The knowledge of the financial system and asset management options for the participants increased overall by 37% due to the training program. Increased education about the financial system improves the access and ability of low income families to save for their future. The study points out that those with low income who receive public assistance through Temporary Assistance for Needy Families (TANF) are feeling pressure to be self-reliant in the areas of savings and asset management, due to implementations of the TANF program. The burden for education is placed upon social workers who have an intimate knowledge of the financial programs available to low income families, "An important role for social workers therefore is to promote programs that improve the financial knowledge and skills necessary to most

effectively manage the limited resources that recipients generally have as they exit welfare and transition into employment” (Zhan et al. 2006). The authors encourage social workers to advocate financial education for those with low incomes. The results of their study show the positive impact financial education programs have on low income asset management. The increased access to savings plans that comes out of this type of education could dramatically help the plight of those who want to rise out of poverty.

The poor have limited knowledge of financial management as shown in the 2006 study. Improving financial knowledge improves their chances for acquiring and maintaining assets. This lack of knowledge is a strong barrier preventing the poor from attaining assets, and it contributes directly to their lack of economic mobility. Financial management programs and microcredit schemes for the low income/low credit are shown to improve the chances of becoming economically mobile.

Educational barriers are only one of the problems the poor face to getting the aid they need to overcome poverty. The connotations of receiving aid in America may prevent the poor from attaining help. Research done by Robert Moffitt has shown that the current aid system holds a certain “stigma” that prevents the poor from utilizing the resources available to them. This acts as a barrier to acquiring asset as well as income based aid because any type of aid system is currently portrayed as a “hand-out” in American culture. A small shift in the way the asset based systems portray themselves may resolve this problem, but this discussion is left for a later section.

The current welfare system in America has been shown to be underutilized by those who need aid. This is due to the negative connotations that are associated with collecting monetary aid in American society (Moffitt, 1983). Moffitt posits that welfare may have disutility for some individuals. The disutility gives rise to a utility function that has both positive and negative

components from welfare. The positive aspect of receiving welfare acts to supplement a family's income, allowing them to reach a higher level of utility due to an expansion of their budget constraint. The negative aspect contributes a disutility as a family receives more welfare due to the "welfare stigma". The implication of Moffitt's stigma model is that families who are eligible for welfare do not enroll in the program because the negative impact of the welfare stigma on their utility overwhelms the positive impacts of an increase in income (Moffitt, 1983).

Moffitt presents a cohesive theoretical model of the welfare stigma which he supports with data from the 1976 Michigan Panel Study of Income Dynamics (PSID). The model shows that a welfare beneficiary could have a flat disutility arising from being on welfare, or a variable component that would increase the disutility with the increase of accepting a larger welfare benefit. This model is supported empirically by the demonstration that 45% of those eligible for welfare in the group studied did not enter the welfare program. An assumption that Moffitt makes about the characteristics of the welfare population does not seem entirely accurate, as it does not accurately depict hardship. Moffitt posits that those on welfare are either those with a low stigma or a low labor supply curve. He does not take into account that some welfare recipients may not have an alternative choice in the labor market. His study does not differentiate the different benefits that may accompany welfare. A larger stigma may be due to participation in multiple programs (both Aid to Families with Dependant Children (AFDC) and Medicaid for example). The stigma associated with different aid programs is not taken into account. If AFDC has the same stigma as Medicaid, for example, or if participating in both programs contributes to a larger stigma, is also not addressed. As with any model, some of the real world situations the poor are actually faced with when choosing to accept welfare are excluded from the model. However, Moffitt does find that the participation in government programs is lower due to some form of negative feedback

from being on the programs themselves. Moffitt's model indicates that American society instills the notion that accepting aid is wrong, even for those who desperately need it.

The education and stigma barriers to asset accrual presented here are in addition to the traditional hardship barrier that prevents the poor from accumulating savings because they must meet daily needs. If the choice is between saving a dollar to eat tomorrow at the loss of eating today, the poor will not save. The consumption needs of today must first be met before asset accrual can lead to a higher level of consumption tomorrow. This is demonstrated in the case studies by Miller-Adams, as well in the model of asset poverty presented in Sherraden's book Assets and the Poor (1991). There must be a minimum level of consumption needs met before savings will occur (Sherraden, 1991). Also, Sherraden points out that welfare eligibility requirements entail asset restrictions. If a welfare recipient is able to save a small amount they will lose their benefits. This is a large disincentive to the poor saving for their future (Sherraden, 1990). This leads to the question, if these barriers to saving were removed, will the poor indeed save?

Will the Poor Save?

The question answered in this section highlights a stereotype that the poor do not save due to some inherent difference in their ability to think of their futures. This stereotype is incorrect because if the barriers to saving are removed the poor are just as likely as the non-poor to save for their futures. This is demonstrated in the work of Sherraden, Yunus, Miller-Adams, and Zhan et al.

To reiterate, the results that Zhan et al. found when they enhanced the financial knowledge of the poor was that lack of knowledge acts as a barrier to using the asset programs available to the poor. When the knowledge barrier was removed, the poor saved and invested. This empirical evidence that the poor will save if the disincentives to using the financial systems are removed attests to the fact that the poor have no inherent lack of future orientation.

In his 1991 work, Sherraden reports that the poor, if given the chance, will save for their future, and then use their savings in economically productive ways. The growth of a family's wealth is dramatic with even small investments in savings. He reports that when minimum consumption needs are met and the poor are given access to credit or financial accounts they will save, and the returns they see to small investments have a large impact on their orientation towards future asset development. This result aligns with the increasing marginal returns to assets that Zhan et al report for those who have few assets. Sherraden also finds that when the poor are given access to credit their default rate is lower than that of borrowers who banks usually label as lower or medium risk (Sherraden, 1991). This aligns with the results that Muhammad Yunus has found with his work lending to the poor.

Yunus started the Grameen Bank over thirty years ago in Bangladesh as a microcredit resource for the poor. This initiative has fostered similar organizations around the world that offer small loans to poor high risk individuals and groups. The default rates have been very low and the results have been life changing for those who have been offered such services. The Grameen Bank reports a 98% repayment rate on the high risk loans it gives out (Yunus, 2006). This is similar to the results experienced by the small American microcredit movements.

The microcredit organizations that Miller-Adams profiles in her case studies report default rates of about 7%-10%. Her findings indicate then when savings programs are made available to the poor they will take full advantage of them. More of her results are detailed in the next section, as she specifically studies the organizations that are cropping up in America to help the poor save.

The empirical results show that when the barriers are removed and the poor are given access to savings and investment programs they will save and accrue the assets they need to overcome long term poverty. The answer to this section's question is unequivocally yes.

Summary of Questions

To review the arguments presented by this review of the literature:

The poor will save as shown by empirical evidence from organizations focusing on increasing asset accrual by the poor. There are hardships that the poor face to accruing assets, but they need to acquire some form of asset base to overcome poverty traps and find long term economic stability. It is also essential that the poor acquire some form of asset base due to the importance of assets to overall well being and future orientation. The asset poverty problem needs to be addressed because there is a large rate of asset poverty in America. Recommendations for addressing the asset poverty problem are in the next section.

Current Systems and Recommendations

What is being done to Alleviate Asset Poverty?

There are small grassroots level organizations that are beginning to take hold in America and help the needy acquire assets and build brighter futures. There are also policy initiatives that have started to advance the asset poverty issue at the national level. To give an overview of these initiatives the case study results of Miller-Adams and a report on the welfare asset reforms are presented in this section.

The five organizations Miller-Adams looks at in her case studies are Neighborhoods Incorporated of Battle Creek Michigan, The Watershed Research Project and Training Center in Hayfork California, The Private Industry Partnership of Wildcat Service Corporation, Iowa's Institute for Social and Economic Development (ISED), and The Corporation for Enterprise Development (CFED). These case studies demonstrate different approaches to helping the poor. Each focuses on helping the poor establish some kind of asset. The Neighborhoods Incorporated

program helps poor communities band together to form social ties, promote homeownership, and rebuild neighborhoods. This helps the poor to acquire and maintain their own homes, which are an extremely valuable asset. The Watershed Project helps the residents of Hayfork build the human and social assets they need to deal with the dwindling natural resources that their lumber-based local economy depends upon. The Private Industry Partnership (PIP) helps low income and former welfare recipients gain human capital assets by offering training programs and job-finding assistance. The Institute for Economic Development helps those with low incomes start micro-enterprises and expand their economic options. Miller-Adams reports that the Aspen Institute estimates that more than 2 million low-income Americans currently run their own micro-enterprises. These micro-enterprises have limited access to the commercial banking sector and are greatly helped by organizations like the ISED. The CFED is also an organization geared towards helping the small businesses of low income entrepreneurs. Miller-Adams reports that 72% of the low income business owners helped by these micro credit organizations saw income gains that allowed them to move out of poverty. One woman who was able to start her own business with the help of Iowa's Institute for Social and Economic Development (ISED) talked about how as a former welfare recipient she was afraid of taking out a loan for the fear of going into debt. She learned how to acquire and manage credit through the business planning programs of ISED, and was able to responsibly manage the debt she needed to expand her business (Miller-Adams, 2002).

Microcredit for business is not the only role that financial institutions are playing in helping the poor acquire assets. There are many programs set up across the country in banks (two mentioned are Fannie Mae and Bank of America) and non-profit groups like the Center for Community Self-Help that encourage and increase home ownership among the poor. However, a problem lies in the deteriorating neighborhoods where low-priced homes are located. Those who

do own a home in these neighborhoods find themselves holding declining assets (Miller-Adams, 2002). As the property value in a neighborhood declines, homeowners have no incentive to invest in maintaining their homes, and the neighborhood gets trapped in a downward spiral of lost property value. Miller-Adams explores the efforts of Neighborhoods Incorporated in Battle Creek, Michigan. Neighborhoods Incorporated lends to high risk communities for home investment. This organization requires the communities to which it lends work together to revitalize their neighborhoods. This builds a strong social community with both social assets and the asset of homeownership.

Moving from the local to the national level, small parts of the Clinton administration's Welfare Reform consisted of asset building initiatives. In Clinton's 1994 welfare reform proposal the asset limits on welfare recipients were increased and Individual Development Accounts (IDAs) were created (Sherraden, 1996). IDAs are special matched savings accounts available to the low-income, and they are exempt from the welfare asset limits. Similar to the accounts that encourage savings and investment at the higher end of the income scale, like 401(k) programs, IDAs have been shown to greatly encourage asset building in a cost effective manner. In 2000, Mark Shreiner analyzed the costs and benefits of IDA programs. He established seven groups of stakeholders in an IDA program and then, based upon the estimated change in value of their resources due to the IDA program, analyzed the costs and benefits to each group. The seven stakeholders were IDA participants, non-participants, the federal government, state and local governments, employees of IDA programs, private donors, and society as a whole. He found that the overall benefits to participants, employees, and society as a whole outweighed the costs to those who matched the IDA funds (Shreiner, 2000). The CFED, which catalogs the financial services available to the poor by state and nationally, reported that since the IDA initiative was started over 50,000 people have

been helped to build assets for their future. Though this is a great accomplishment at encouraging asset building by the poor, much more can be done.

What More can be Done?

The current movement for asset building initiatives for the poor is very much at the grassroots level. Even the government supported IDAs are helping only a fraction of the population they were designed to reach. The 50,000 people helped by IDAs seems like a large number, but considering that about 26% of the American population is asset poor (roughly 156,000,000 people), 50,000 people is extremely small for a government sponsored program. The low impact problem seems to be two-fold. The IDA programs are not standardized nationally, nor are they advertised or promoted. Thirty states have IDAs available through their Temporary Assistance for Needy Families (TANF) programs. However, they are not a part of the standard benefits, and participants must know about them and perform additional steps to set up an account.

The IDA and other types of asset building programs could greatly benefit from national attention to the asset poverty problem. One way to do this would be to establish a standard measure of asset poverty. Once an asset poverty line was established the government could begin collecting asset poverty statistics along with the plethora of income poverty information gathered nationally by government census agencies. Also, government attention to asset poverty could take the form of a savings and future building initiative. Savings plans are indigenous to American ideology and can be traced back to programs like the Homestead Act and the New Deal. Programs about asset building for the future would be seen as non-partisan plans for growth. If this type of attitude was associated with these programs, the “hand-out” stigma of current welfare systems would be alleviated. Based upon these types of measures, policy could be written to make a positive impact on the asset poverty problem.

Policy Recommendations

To begin alleviating widespread asset poverty, the government must bring attention to and adequately address this issue. A place to start that would utilize already established financial channels would be government-backed microcredit. The government could insure high risk, low interest rate loans similar to those given out by the Institute for Economic Development (IFED). This would allow banks to offer loans to low-income and low-credit clients without the risk of losing the investment. There would need to be restrictions on the loans in order to ensure the low default rate that current microcredit institutions are seeing. Reasonable restrictions would be a mandatory financial management class or some form of businesses proposal plan to acquire the loan. Even with small restrictions these types of programs could make a big difference to a larger portion of the asset poor than are currently being helped.

IDA programs are very much still in their infancy, but their potential has been demonstrated. A universalist savings initiative from the government in the form of IDA access for those who have no other matched or interest bearing accounts (401(k)'s or high yield CD's) would result in a long run aid system that would not have a "hand-out" stigma. A start could also come in the form of an automatic IDA accompanying welfare benefits or Earned Income Tax Credits (EITC). A portion of welfare benefits or of the income tax credit could be automatically deposited in a government matched IDA. This would promote the use of these kinds of accounts and automatically build an asset base for those who have none. Another universalist type of measure would be an education program for schools to promote savings practices in youth.

The organizations that have been founded in the US to promote asset accrual for the poor need help and support. This could come in the form of government subsidies to organizations for establishing in states that lack asset building aid programs. This could lead to a standardization of

the aid available across the nation. A standardized asset aid system would solve a large part of the information problems because the same programs would be available everywhere. They could then be universally promoted and endorsed.

Limitations

The argument and policy recommendations presented here are supported by the current research being done on the topic of asset poverty. However, much work and research still needs to be done in this field. An analysis of the costs of the policy recommendations made here was not performed, and would be necessary before any such recommendations were to become policy. Further research into why the indicators for asset poverty include race, age, and gender may benefit a targeted plan to eradicate asset poverty. More research needs to be done in the fields of growth and the savings versus consumption and convergence controversies. Growth theory has an impact on asset poverty policy because it can underscore the need for national concern for this issue.

Conclusion

This thesis has found that a larger portion of Americans are asset poor than are income poor. The economic models and empirical research into long term poverty establish that persistent poverty and poverty traps are asset based phenomena. Assets are essential for both the present and future well being of a family and their long term economic growth. This problem has garnered very little national attention and the current systems for poverty aid are only income based. The question of whether or not poverty is multi-dimensional has been answered. Questions about how to address the asset dimension are still developing.

Answers to the questions surrounding the issues of American asset poverty have only begun to evolve. Yet the answers already demonstrate that this is a serious economic challenge for

America. Long run poverty undermines the “Land of Plenty” notion that is a large part of the American Dream. All citizens should have the opportunity for long term economic stability. In order to achieve this goal asset poverty must be alleviated.

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Notes

- 1 This did not reflect the black community that was only then emerging from the bonds of slavery and segregation that had prevented them from acquiring a piece of the American economic pie. This emerging population of workers would need more than some temporary assistance in income in order to build the asset base they needed to catch up with their white counterparts.
- 2 This refers to recent welfare reforms that have cut benefit amounts and imposed time limits on welfare recipients.
- 3 Average income poverty rate calculated by author from online US census data from 1984 through 1999. See: <http://www.census.gov/hhes/www/poverty/histpov/hstpov13.html>
- 4 $4255/82.30 = 51.70 \Rightarrow 4255 - 51.70 = 4203.30$