POLICY BRIEF

CENTER FOR THE NEW ECONOMY
CENTRO PARA LA NUEVA ECONOMIA

Pathways out of Poverty: Asset Building in Puerto Rico

Executive Summary

Traditional social welfare policies focus on providing a monthly income flow to support a minimum level of consumption. However, as Michael Sherraden, one of the leading experts on welfare policy in the United States, has stated, "very few people manage to spend their way out of poverty." Poverty is overcome by savings, investment and asset accumulation rather than through spending and consumption.

Asset accumulation is particularly significant because assets have important welfare effects in addition to deferred consumption. Research in the United States shows that assets have significant positive non-economic effects on children, families, and neighborhoods. In general, there is growing evidence that assets are associated with greater household stability, higher educational attainment, local civic involvement and increased levels of health and satisfaction among adults. Assets are also associated with decreases in both marital dissolution and intergenerational poverty transmission.

Contrary to popular belief, asset accumulation by households is not the product of what is left over after consumption is subtracted from income. In a high consumption society like Puerto Rico, savings often enter households as assets *from the beginning* because the tax system is structured to facilitate and subsidize asset accumulation by middle and upper class households. As we will explain below, the Puerto Rico tax code already provides incentives for homeownership, college education, business ownership, investments and retirement that disproportionately benefit the upper socioeconomic classes. Thus, in Puerto Rico we have policies that encourage asset-building for the non-poor but not for the poor. The relevant policy question is: Why not expand asset accumulation programs to include the poor as well?

In this policy brief we offer a brief summary of the asset building approach to social policy, review the arguments in favor of implementing asset building policies to reduce poverty, analyze current incentives in the Puerto Rico tax code that favor asset accumulation by the non-poor, and offer some policy recommendations to promote asset accumulation by the poor in Puerto Rico.

What is Asset-Building?

The concept of asset building has been defined in various ways. For purposes of this paper we will use the definition adopted by the New America Foundation, one of the leaders in the field of asset building policy and research, which has defined asset building as "public policy and private sector efforts to enable persons with limited financial resources to accumulate and preserve long-term, productive assets—savings, investments, a home, post-secondary education and training, a small business and a nest-egg for retirement."[1]

These policies are based on concepts of savings, investment and asset accumulation rather than on the concepts of income, spending, and consumption that direct current policy. According to Sherraden:

> The major reason for this proposed policy shift is that income only maintains consumption, but assets change the way people think and interact with the world. With assets people begin to think in the long-term and pursue long-term goals. In other words, while incomes feed people's stomachs, assets change their head.[2]

Asset building policies for the non-poor have a long history in the United States. These policies have spurred the creation of a variety of institutional structures which facilitate wealth accumulation by the non-poor. Sherraden's point is that the poor have few such structures within which to accumulate assets and that government policy should focus on creating those structures instead of merely transferring a monthly allowance to finance consumption. His proposal is to stimulate wealth accumulation by the poor as a means for them escape poverty, bearing in mind that "wealth is not income, spending and consumption, but rather savings, investment and accumulation of assets."[3]

A Short History of Asset-Based Policies in the United States

Initiatives to encourage asset accumulation by individuals have been suggested since the founding of the United States. For example, Thomas Paine, in his 1797 pamphlet *Agrarian Justice*, proposed the creation of a national fund from which each citizen would be given an asset pool. Every citizen, Paine argued, had a right to a stake of fifteen pounds sterling at the age of 21 and also to the sum of ten pounds sterling per year during life after reaching fifty years of age. Paine's system of stakeholding would apply to both men and women and would be financed through a 10% tax on inheritances, so the wealth of one generation could endow the next.

Other historic initiatives to expand asset-holding include the Homestead Act of 1862, the creation of the Federal Housing Administration (FHA) in 1934 and the GI Bill of 1944. The Homestead Act was the first asset-based welfare policy in the United States. This Act facilitated the transfer of land to pioneers who went west, claimed their stake and worked the land. Under the Homestead Act and subsequent land acts over 200 million acres of public lands were transferred to farmers, ranchers and timbermen.[4]

---

[1] This definition is from the asset building website sponsored by the New America Foundation at http://www.assetbuilding.org/AssetBuilding.

[2] Michael Sherraden, *Assets and the Poor: A New American Welfare Policy*, (New York: M.E. Sharpe, Inc., 1991) p.6.

[3] Id.

[4] Id. at 191.

The Federal Housing Administration was created to broaden homeownership in the United States. Through its mortgage insurance and other financial products, it has played a major role in expanding the homeownership rate in the United States, which was 68% in 2002.[5]

The GI Bill offered veterans returning from the battlefields of World War II grants for training and higher education, loans for financing new businesses, and mortgages to purchase homes. Between 1944 and 1956 the federal government spent $14.5 billion to benefit almost 8 million veterans.[6] By any measure, the GI Bill of 1944 was one of the most successful asset-building policies in the United States.

More recently, federal asset building initiatives have focused on providing tax incentives for home ownership and retirement. For fiscal year 2005, the tax expenditure value of the deductibility of mortgage interest on owner occupied housing was $69.740 billion, while the exclusion of capital gains on home sales cost the U.S. treasury $21.490 billion in forgone revenue. On the other hand, tax expenditures for retirement (net exclusions of pension contributions associated with employer plans, 401(k) plans, IRAs and Keogh plans) were estimated at $150 billion for FY 2005.[7] Over 90% of these benefits accrued to households with incomes in excess of $50,000.

The Importance of Assets

Thus, the federal government has implemented a series of policies which directly or indirectly subsidize or otherwise encourage the non-poor to acquire and accumulate assets throughout their lifetimes. The importance of these asset building initiatives is that they have created structures through which savings "enter households as assets from the beginning".[8] These policies, however, often do not reach the poor. In general, social welfare policies for the poor do not stimulate savings and often discourage it.

The Intellectual Debate: Asset Building to Reduce Poverty

It is not easy to appreciate the innovative nature of asset building policies for the poor without a sense of the state of the intellectual debate about welfare policy and poverty theory and why asset building is different. Sherraden devotes a substantial part of his book to this analysis and we offer a brief summation here.

Sherraden begins his discussion by pointing out that while professors, politicians, and sociologists spend significant time and effort conversing about welfare, "we do not know very well what welfare *is* or how families achieve it."[9] There are, however, plenty of theories of poverty and social class. These theories can be broadly classified in two groups, individual behavior theories and structural theories.

> In brief, individual-level theories suggest that undesirable or unproductive behaviors cause poverty. On the other hand, structural theories suggest that circumstances of poverty cause behaviors; that is apparently dysfunctional behaviors are adaptations to poverty. At the extreme, both types of theories are highly normative. Intertwined through the writings of individual behavior theorists is the moral judgment that people who are doing poorly are deficient

[5] Reid Cramer, *Net Worth at Birth: Creating a National System for Savings and Asset Building with American Stakeholder Accounts*, New America Foundation Asset Building Program Working Paper, (Washington, DC: New America Foundation, March 16, 2004) p.7.
[6] Id.
[7] Id.
[8] Sherraden, *Assets and the Poor*, *supra* note 2 at 177.
[9] Id. at 35.

> in ability, training or morality and should pick themselves up and do better. And intertwined through the writings of structural theorists is the moral judgment that the current social structure is poor and should be changed.[10]

Underlying all these theories, however, is the unchallenged assumption that income and consumption are the appropriate benchmarks by which to measure household welfare. Sherraden instead proposes a broader, more dynamic, integrative theory of welfare that circumvents the individual versus social structure duality and takes into account the effects of asset accumulation. This theory has two main features:

> First, it would view household financial welfare as a long-term dynamic process rather than a cross-sectional financial position at a given time. Assets capture this long-term dynamic quality better than income because assets reflect lifetime accumulation. Second, the theory would propose that more than consumption is involved in household financial welfare, possibly much more. In other words, according to this viewpoint, assets yield positive welfare effects that income alone does not provide, effects in addition to deferred consumption.[11]

Sherraden's suggestion is that assets have a variety of important economic, psychological and social effects. "Simply put, people think and behave differently when they are accumulating assets, and the world responds to them differently as well."[12] We explore these effects in the following section.

Positive Welfare Effects

According to Sherraden, asset accumulation could be expected to be associated with:

- **Improving household stability** – Assets cushion income shocks associated with events such as illness, divorce or sudden unemployment, which may throw people into income poverty. In addition, assets reduce liquidity constraints by opening access to credit. When assets are present there is less turmoil in the household until sufficient income can be reestablished, because assets stabilize income.
- **Creating an orientation toward the future** – Assets by nature are future-oriented, in the financial realm they connect the present with the future. Ownership of assets fosters long-term thinking. In simple terms, when assets are present, people begin to think in terms of assets. For example, "if a young mother owns her home, she begins to pay more attention to real estate values, property taxes, the cost of maintenance and so forth. If she has a certificate of deposit, she is more likely to pay more attention to interest rates and what makes interests go up and down. If she owns 25 shares of IBM stock, she is more likely to pay attention to news about IBM, the computer business in general, the stock market and alternative investment options."[13]
- **Stimulating the development of other assets** – Assets influence the behavior of the people who own them. If they own physical assets they will take care of them and try to improve them. If they own financial assets, they are more likely to educate themselves about investments and learn about the market and investment management, that is, they increase their intellectual capital. In addition, assets have returns that can beget other assets (education and training) or provide a larger income stream in the future.

[10] Id at 36-37.
[11] Id at 44.
[12] Id at 148.
[13] Id. at 155.

- **Enabling focus and specialization** – People in poor households spend their time doing a diversity of tasks because they do not have enough assets to enable them to focus and specialize. According to Sherraden, poor people "forego opportunities for specialized education and training because they have to feed their families. In economic terms, specialization yields a division of labor and comparative advantage, but asset-poor households do not have much opportunity to develop a comparative advantage."[14]
- **Providing a foundation for risk taking** – In general, a household with more assets can diversify its holdings and protect itself against the consequences of taking a loss. In other words, with more assets, the ability to take financial, psychological and social risks is enhanced.
- **Increasing personal efficacy** – Assets can be a source of empowerment. They allow and provide a measure of security, strength and control at least over some aspects of our daily lives. In short, assets can enable people to emerge from the mindset of dependency and serve as a counterbalance to learned helplessness and feelings of powerlessness.
- **Increasing social influence** – According to Sherraden, who draws on sociology and other research, assets yield social status effects in addition to economic well-being. In addition, assets can provide social capital returns in the form of access to powerful networks, contacts, and information. In Sherraden's terms, "in a wealthy family, 'phone calls are made' to open doors, bend rules and move to the head of the line."[15]
- **Increasing political participation** – With a stake in the system, it pays to keep track of what politicians are doing. In general, people can no longer afford to live in segregation and it makes sense to "join the system." In countries with larger informal sectors, "joining the system" "means participating in the formal economy, starting to pay taxes and otherwise playing the full role of citizenship."[16]
- **Enhancing the welfare of offspring** – Households with enough assets to avoid worrying about daily survival are better at endowing children with human assets, including nutrition, good health care, better educational opportunities and sophisticated acculturation. These human capital assets enhance the welfare of offspring throughout their lifetime. In addition, Sherraden emphasizes the "intergenerational connection" via the transmission of physical assets, "that income and consumption cannot provide."[17]

These nine "welfare effects" are what economists label positive externalities associated with asset accumulation. The core idea is that assets contribute positively to household welfare in both economic and non-financial terms, by essentially increasing the stock of human capital available to the household. This increased stock of human capital allows individuals to have a better chance of taking advantage of life's opportunities and of overcoming structural limitations imposed by the society at large. Therein, in those improved life chances, is where we find the genuine benefit of asset accumulation.

Justice/Fairness Arguments in Favor of Asset Building

---

[14] Id. at 159.
[15] Id. at 164.
[16] Robert Cornell, *Asset Building and the Escape from Poverty: A New Welfare Policy Debate*, paper published by the Local Economic and Employment Development Program of the Organisation for Economic Co-Operation and Development, p. 13.
[17] Sherraden, *Assets and the Poor*, *supra* note 2 at 166.

In addition to the welfare effects set forth above, arguments in favor of asset building policies can be based on justice and fairness grounds. From a philosophical perspective, as Yale Law School professors Bruce Ackerman and Anne Alstott noted in their 1999 book *The Stakeholder Society*, asset building recognizes that "no person is inherently better than any other, and thus everyone has a right to a fair share of initial resources with which to begin and plan her adult life, regardless of whether her parents were rich or poor, frugal or improvident."[18] After all, we would be appalled if rich people had more votes than the poor, or vice versa, based solely on socioeconomic status. In the same way that one-person one-vote is indicative of political equality, providing every citizen an equal chance to accumulate assets expresses equality of opportunity.

Second, asset building respects individual liberty by allowing persons to use their assets as they see fit. No citizen is obligated to save or accumulate assets or, if she does, to justify her plan to use them to a government bureaucrat. Asset holders then are not only equal but free to pursue their interests in the way that makes sense the most to them. Their failures and their achievements are their own.

Other Arguments in Favor of Asset Building

Encouraging asset building by the poor would represent a new approach to welfare policy in Puerto Rico. In general, welfare policy in Puerto Rico traditionally has focused on the issue of income distribution. If we employ the often used metaphor of a ladder, traditional welfare policy addresses the question of how far apart are the rungs in the ladder. The usual answer is to reduce the distance between the rungs by providing income supports for the poorest, while mostly ignoring the working poor. These policies have been successful in reducing extreme poverty in Puerto Rico but have been unsuccessful in reducing broad-scale structural poverty. Today 44% of Puerto Rican families and 58% of their children live in poverty.

Asset building, on the other hand, addresses issues of opportunity, that is, it focuses on the question of who occupies which rung of the ladder and the related issues of social mobility within and between generations. Unlike traditional approaches to social welfare, it seeks to provide all citizens not with a temporary palliative but with the means to genuinely take advantage of their talents and move up the ladder for good.

Spreading asset ownership will also serve as a powerful new engine of economic growth and employment, as generations of young Puerto Ricans invest in their education and start new business ventures. Of course, many will fail and still others will make foolish decisions with their assets. But many others will not. Over the long-term, this increase in entrepreneurial activity will pay off, with a net positive effect on economic and social life. In addition, as the private sector grows, there will be less pressure on government to provide employment to hundreds of thousands of Puerto Ricans.

Finally, asset building could be a powerful tool in changing the nature of the increasingly inflexible class structure that is emerging in Puerto Rico: a lower class destined to dead-end jobs and rampant unemployment, an upper class of professionals enjoying unprecedented prosperity, and an enormous middle class trapped in the swampy quagmire of economic stagnation. Social policy thinking in Puerto Rico has not caught up with this emerging reality. On one hand, we offer generous subsidies and tax breaks to foreign capital and to those in the

---

[18] Bruce Ackerman and Anne Alstott, *The Stakeholder Society*, (New Haven, CT: Yale University Press, 1999) p. 32.

upper class (preferential capital gains, 10% on dividends etc.). On the other, we offer some meager help to the underclass. To the vast working middle class in between we offer nothing. Asset building can change this social dynamic by breaking the cycle in which inequality of outcomes in one generation becomes inequality of opportunity in the next because assets can be conveyed from one generation to another over time through inheritance and, therefore, can help reduce the transmission of poverty across generations.

Incentives for Asset Accumulation by the Non-Poor Already in Effect in Puerto Rico

The Puerto Rico Internal Revenue Code already contains numerous incentives for asset accumulation by the non-poor. Set forth below is a partial list of exclusions and deductions that promote asset accumulation by the non-poor in Puerto Rico.

Exclusions from Income

1. Annuities – Amounts received under an annuity contract are excluded from the taxpayer's income until the cost of purchasing the annuity contract is fully recovered.
2. Gifts and Inherited Property – The value of this kind of property is excluded from income.
3. Interest Income – Interest generated from the following sources is excluded from income:
    a. Obligations issued by the United States government, any state or political subdivision thereof;
    b. Obligations issued by the Commonwealth of Puerto Rico, any municipality or agency thereof;
    c. Various kinds of mortgages originated in Puerto Rico; and
    d. Bonds and other obligations issued to raise funds for the construction of facilities to be leased to the government of Puerto Rico for use as hospitals or hospices.
4. Pensions and Social Security – Income received from private and public pensions is excluded, subject to certain age restrictions. All federal social security payments are excluded from income.
5. Capital Gains – Capital gains are excluded from ordinary income and taxed at a special rate of 5, 7 or 10% depending on the applicable rule.
6. Capital Gains on Sale of Principal Residence – Capital gains up to $150,000 realized on the sale of the taxpayer's principal residence are excluded from income.

Deductions from Income

1. Capital Losses – Subject to certain restrictions, both short and long term capital losses are deductible from income.
2. Interest Paid on Mortgage for Principal Residence – Mortgage interest is fully deductible from gross income.
3. Interest Paid on Student Loans – Interest paid on student loans is 100% deductible in Puerto Rico.
4. Contributions to Pension or Retirement Plans – Contributions to government pension or retirement plan are fully deductible from income.

5. Contributions to Individual Retirement Accounts – Are fully deductible up to $4,000 per person ($8,000 for married couples filing jointly).
6. Interest Paid on Car Loans – Interest paid on car loans is deductible up to $1,200.

It is evident that the Commonwealth government has implemented a series of policies which directly or indirectly subsidize or otherwise encourage the non-poor to acquire and accumulate assets throughout their lifetimes. The importance of these asset building initiatives is that they have created structures through which savings enter affluent Puerto Rican households as assets from the beginning because the tax system is purposely structured to facilitate and subsidize asset accumulation by middle and upper class households.

Policy Recommendations: What Can the Government Do?

As we have seen, the Puerto Rico tax code provides special favorable treatment to interest, dividends and capital gains derived from different kinds of investments. These policies tend to disproportionately benefit high income individuals with disposable income available for investment.

However, these policies often do not reach the poor. In general, social welfare policies for the poor do not stimulate savings and often discourage it. Government can change this situation by implementing policies that provide incentives and encourage poor individuals to start accumulating wealth. Set forth below is a set of recommendations for local policymakers to promote asset building by poor households in Puerto Rico.

Individual Development Accounts (IDAs)

IDAs are bank accounts that have the following characteristics:

- They are savings accounts; in which
- Savings by the account holder are matched up to a certain amount by the financial institution offering the account or by a third-party community organization; and
- In order to receive the matching deposits, account holders usually agree to:
    - Participate in financial education classes;
    - Save a minimum amount each month; and
    - Use the money saved only for education, downpayment on a first home or to capitalize a small business.

IDAs were developed in the late 1990s as an alternative to help poor people, specially the working poor, to start saving and building assets. Today, institutions in more than 40 states and Puerto Rico offer IDAs of some type.

We suggest that financial institutions in Puerto Rico offer IDA accounts with the following characteristics:

- Account holders will be required to save a minimum of $10 a week.
- Financial institution will match up in a 2 to 1 ratio up to $1,040 per year.
- Withdrawals after three years will be permitted for (1) the downpayment on a first home, (2) education or vocational training, or (3) starting a small business.

Enact Legislation Granting Favorable Tax Treatment to all IDAs in Puerto Rico

Individual Development Accounts are a powerful incentive to join the financial mainstream and start building up assets. However, in the absence of specific tax-legislation exempting income, interest and matching deposits from taxation, these accounts may lose their attractiveness to many potential savers because they would taxed on income they could not access for, in many cases, years. Many states have enacted this type of legislation to exempt qualified IDAs from state tax.

Grant a Tax Credit to Financial Institutions that Match IDA Deposits

Today, institutions in more than 40 states and Puerto Rico offer IDAs of some type. However, finding institutions to provide funds for the matching deposits has proven to be a challenge. In fact, many participants in a national IDA conference in New Orleans last year indicated that the unwillingness of financial institutions to match savings is one of the obstacles to offering IDAs in a massive scale. From a financial institution point of view, this makes sense (at least in the short term) because banks are not in the business of giving money away for free. Establishing a tax credit would provide strong incentives for financial institutions to market and sell IDAs.

In order to facilitate the expansion of IDAs to a significant scale, the government of the Commonwealth should consider providing a tax credit to reimburse financial institutions for matching funds they provide to qualified persons savings in an IDA, up to a specified dollar amount (for example, $1,000) per person per year. The proposal is to reimburse financial institutions for matching funds they provide to qualified persons saving in an IDA. The credit could be designed to phase-in after a certain number of IDAs have been established (say 50 or 75 accounts) at the financial institution and to increase gradually with the number of accounts until it reaches a cap.

Establish a Puerto Rico Earned Income Tax Credit

Despite the fact that the EITC is the most successful anti-poverty program in the U.S., residents of Puerto Rico are unable to participate because they do not file federal income tax. The last 30 years have seen a Puerto Rican society where over 60% of the population is under the federal poverty line. Moreover, only 46% to 48% of the working age population is currently employed. Such staggering statistics merit new ways of addressing issues of employment and poverty alleviation.

To this end, CNE commissioned an in-depth study to determine the possibility of actually doing something like this locally as well as the potential benefits of such a program for the poor in Puerto Rico.

The study is based on the premise that Puerto Rico has to overhaul its anti-poverty strategy, moving away from programs that create dependency towards programs that promote self-sufficiency. Current government welfare programs are particularly ill-designed for working poor families. Moreover, regressive excise and Social Security taxes are detrimental to low-income families trying to make ends meet.

In our opinion an Earned Income Tax Credit Program is a promising route towards improving the standard of living of Puerto Rico's low-income working families. Such a program would counteract regressive excise taxes as well as other regimes, such as sales and value added taxes.

It would also break with dependency by promoting work. In fact, studies for the United States show that the EITC promotes labor force participation, and that it could be more effective than the minimum wage in reducing poverty.

An EITC for Puerto Rico fits well within various efforts now taking place in the government, including the Special Communities Program, the Workforce Investment Act, Temporary Assistance for Needy Families, and continuing efforts from the Treasury to reduce tax evasion.

Lessons learned from the last 25 years of the EITC program in the U.S. will be a valuable resource for the implementation of the program in Puerto Rico and can serve to address, early on, issues related to misreporting of income or other discrepancies. Some of the specific findings for Puerto Rico in the study are:

- The credit proposed in this study could increase employment by 20,000 workers and would benefit about 160,000 families and 289,000 children, most of whom are now living in poverty ;
- Employment outlets for these families could involve large government infrastructure programs such as the proposed Port of the Americas, the revitalization of urban town centers, the proposed Convention Center, and other projects within the Special Communities Program. The tourist and service industries, as well as self-employment, are other employment options for this population. Employment opportunities may be enhanced through training opportunities from the Workforce Investment Act and Welfare Reform programs;
- An EITC for Puerto Rico could lift low-income single mothers with one and two children from poverty and could reduce the poverty gap of married couples with children by at least 5 percent ;
- The credit would cost from $162 million to $183 million depending on the labor force reaction. A conservative estimate of $132 million will be returned to working families in the form of refunds; and
- Finally, taxpayers should have the option of splitting the refund into two accounts (a regular account and a savings account) in order to foment savings.

Enact Legislation Establishing Puerto Rico Stakeholder Accounts

In 2004 CNE published a Policy Brief that proposed the creation of Puerto Rico Stakeholder Accounts (PRSAs), based on the Child Trust Fund initiative of the UK and the New America Foundation proposal for American Stakeholder Accounts, for the benefit of the island's future generations. The paper outlined not only the philosophical and theoretical imperatives behind the idea of "stakeholding" but also presented an initial blueprint for the implementation of such a program in Puerto Rico. Based on an analysis of various proposals and the cultural characteristics and economic situation of Puerto Rico, Puerto Rico Stakeholder Accounts could have the following features:

- Participation would be universal – All children of U.S. citizens and permanent residents born in Puerto Rico would be eligible. This structure reduces administrative costs by eliminating the need to develop and enforce other eligibility criteria.
- Accounts would be set up at birth with an initial government seed deposit of $500, with an additional payment of $1,000 for children born to parents living under the Federal Poverty Line.

- Additional government deposits would be linked to educational achievement and community service – PRSAs are designed to allow children to build a modest asset pool that can help them invest in their future, but they are also intended to provide a clear sign to every child that the broader community has made a long-term investment in them. The deposit of funds directly into the account of every child would send a strong message and the timing of deposits has the potential to provide positive reinforcements. Therefore, the series of deposits would correspond to strategic points in a child's life cycle.

  (1) In addition to the seed deposit, the government would make further payments into each child's PRSA through two merit deposits linked to educational achievement:

    (a) $500 upon the completion of grade school in Puerto Rico and

    (b) $1,000 upon the completion of high school in Puerto Rico

  (2) An additional set of government contributions would be made available to reward any participant who performs at least 100 hours of community service in Puerto Rico. The PRSA proposal allows for up to two $500 community service deposits. The idea is to reinforce the mutual connection between the account holder and the greater community.

- Parents, friends, family and beneficiaries would be able to contribute up to $4,000 a year between them – $4,000 is the current maximum contribution to IRAs under the Puerto Rico tax code. This limitation on voluntary contributions to PRSAs is necessary to limit inter-vivos gifts (and the corresponding deduction in their tax returns) by high net worth individuals.
- Funds would not be available to beneficiaries unless they satisfy all of these requirements:

  (1) Beneficiaries must be at least 18 years of age;

  (2) Have obtained a high school diploma or GED; <u>and</u>

  (3) Lived in Puerto Rico for at least 10 years since his/her birth

- After submitting satisfactory evidence of compliance with the requirements stated above, funds can be used by beneficiaries for vocational training, post-secondary education, homeownership, small business capitalization, or retirement (rollover into an IRA) – The fundamental idea of stakeholding is to give each person equal respect by providing an opportunity to develop their own talents as they deem appropriate.
- Accounts would be offered and managed by private financial service providers in accordance with regulations to be issued by the government.
- Beneficiaries would have the option to change providers at any time.
- All accounts providers must offer a basic stakeholder account which will be invested in equity index funds, subject to certain risk controls.
- Additional types of accounts may be offered by the market.
- Annual account management fees would be capped at a specific percentage of the account balance – In the alternative, financial service providers could be entitled to a one time tax credit for each stakeholder account they manage to help offset administrative and overhead costs. The tax credit would be equal to the present value of the estimated costs of managing one basic PRSA for 18 years. We recognize that any stakeholding program that relies on private providers of financial services needs to

ensure charges and fees are set at levels that offer good value for savers while also allowing efficient providers to make adequate returns. The British government has determined that a 1.50% fee is reasonable for financial service providers in England. A similar 1.50% cap in Puerto Rico would have to be validated after consultation with local financial service providers. The tax credit proposal is an alternative to avoid charging fees to the beneficiaries that could be attractive to local account providers.

- All income and capital gains accruing to the beneficial owner of the PRSA would be exempt from individual income tax.

Revise Asset Limits in Social Welfare Programs

Under current law, eligibility for many social welfare programs is linked to asset holdings. In many cases, program regulations set forth extremely low asset limits in order to qualify for program benefits. The application of low asset limits constitutes an enormous disincentive for saving and accumulating wealth. These limits are usually quite low, for example, the family asset limit to qualify for the Nutritional Assistance Program is $2,000. The Government of Puerto Rico has the authority to set and modify asset limits for the TANF and Nutritional Assistance programs and government-financed health insurance. Specifically, program regulations should be amended to state that restricted assets, such as IDAs, should be disregarded in determining compliance with asset limits.

Change the Mode of Payment of the Nutrition Assistance Program and TANF Program Benefits

Puerto Rico, like most other states, pays welfare benefits in the TANF program and the Nutrition Assistance Program electronically through an electronic benefits transfer (EBT) system. Unfortunately, the way the EBT system has been set up in Puerto Rico, and in most states, has minimized the extent to which electronic transfer could be utilized as an entry point to banking. Puerto Rico does not establish bank accounts for benefit recipients. Instead, Puerto Rico uses a private contractor to provide beneficiaries with debit card-based access to the amount of benefits they have been allocated while the actual funds are held by the Commonwealth government in a pooled account. Switching from an the EBT system to an electronic funds transfer (EFT) system whereby each recipient has its account could reduce administrative costs for the Commonwealth government and facilitate the introduction of a significant number of unbanked recipients to the financial mainstream and start them on the road to accumulating wealth.

Conclusion

The promotion of asset building and wealth accumulation is a matter of basic fairness. As we stated above, both the federal and Puerto Rico tax codes provide substantial tax incentives for homeownership, college education, business ownership, investments and retirement that disproportionately benefit the upper socioeconomic classes. In addition, recent research shows that assets have significant positive non-economic effects on children, families, and neighborhoods. By establishing policies that encourage asset building by the poor and lower middle classes, they will be able to partake for the first time in the kind of social and economic returns generated by these policies. Asset building could have a powerful effect by leveling up the playing field across social classes.