

### **POLICY OPTIONS FOR ACHIEVING AN OWNERSHIP SOCIETY FOR ALL AMERICANS**

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In his second Inaugural Address, and elsewhere, President Bush has offered his vision for creating an “Ownership Society” in America. By this he means encouraging more Americans to save in tax-benefited accounts for retirement, college, health care expenses, homeownership, and small business development. Americans who do this, the President believes, will be able to exercise more personal responsibility and better control their and their kids’ economic futures.

Although the goals of promoting ownership should not displace social insurance and other programs aimed at struggling but aspiring Americans, the claim that families benefit from being able to build up assets is compelling. The underlying assumption is that ownership creates stakeholders and expanding opportunities for people to accumulate productive assets has broad social and economic benefits. In fact, the data show that many Americans have experienced the benefits of building assets and associate success and security with the accumulation and holding of financial resources. Yet the specific policy objectives required to fulfill this vision have received less attention. This paper presents a list of policy options to be considered to help achieve a more inclusive ownership society.

We believe that an ownership society is a goal worth achieving, one this nation has embraced in the past through the Homestead Act and GI Bill. However, as shown in the table below, the bottom 60% of Americans own less than 5% of the nation’s wealth. Therefore, the starting point of our nation’s ownership policies must be the majority of Americans who are asset-poor.

The Administration has begun to highlight several policy items designed to help more Americans save and become owners. The challenge appears clear: maximize the number of families capable of building assets and securing their future. Current public policy provides us many tools, but it is imperative that these tools be employed with three overriding principles in mind. First, policies should create opportunity by broadening access to benefits; second, all Americans should be able to participate; and third, benefits should be commensurate and not skewed towards those who already own a lot.

#### **BACKGROUND**

To understand the inherent challenge in creating an inclusive ownership society, it is useful to consider what ownership in America looks like today. Aided by policy incentives, Americans build wealth in both financial and non-financial assets. This past year the homeownership rate exceeded 69%, a historic high. The minority homeownership rate has risen in recent years as well, but continues to lag the overall population. In 2003, almost 50% of minority households owned their own home. In the aggregate, home equity makes up 27% of total assets for all households and the median home value is \$121,000.<sup>2</sup> Home equity plays a particularly important role for many low-income families and minority families. While their homeownership rates are lower, home equity makes up 77% of total assets for lower-income families and 55% of total assets for minority families.<sup>3</sup>

While home equity represents the single largest component of household wealth, families store resources in a variety of other assets, such as bank accounts, stock investments, and retirement accounts. The percentage of families holding assets varies considerably. It is estimated that over 90% of families have money stored in checking or savings accounts, while only 21% own stock directly in a company. Furthermore, 17.1% own shares of a mutual fund, 16.7% own savings bonds, and 28.0% have assets held in a life insurance policy. Meanwhile, over half of all families (52.2%) have a personal retirement account,

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<sup>2</sup> U.S. Market Conditions (2004); Aizcorbe, Kennickell, and Moore (2003).

<sup>3</sup> Di (2003).

such as an IRA or a 401(k).<sup>4</sup> However, the numbers for a defined contribution pension plan are lower and declining: 33.8% of American families own a defined contribution plan.<sup>5</sup>

<b>Percentage of Families Holding Assets by Asset Type<sup>6</sup></b>						
	<b>Stocks</b>	<b>Mutual Fund</b>	<b>Savings Bonds</b>	<b>Retirement Accounts</b>	<b>Bank Accounts</b>	<b>Life Insurance</b>
<u>Percent of income</u>						
Less than 20%	3.8%	3.6%	3.8%	13.2%	70.9%	13.8%
20%-39.9%	11.2%	9.5%	11.0%	33.3%	89.4%	24.7%
40%-59.9%	16.4%	15.7%	14.1%	52.8%	96.1%	25.6%
60%-79.9%	26.2%	20.6%	24.4%	75.7%	98.8%	35.7%
80%-89.9%	37.0%	29.0%	30.3%	83.7%	99.7%	38.6%
90%-100%	60.6%	48.8%	29.7%	88.3%	99.2%	41.8%
<b>All Families</b>	<b>21.3%</b>	<b>17.1%</b>	<b>16.7%</b>	<b>52.2%</b>	<b>90.9%</b>	<b>28.0%</b>

The percentage of families holding assets is strongly correlated with their incomes. Compared to those households in the top 10% of income, households in the bottom forty percent of income were less likely to own stock (11% to 61%), retirement accounts (33% to 88%), and transaction accounts (89% to 99%). The differences in retirement asset holdings are especially revealing. The number of families owning a retirement plan drops to less than 15 percent for families making \$15,000 or less, while 75 percent of those making more than \$50,000 have a retirement savings account. For defined contribution plans, over 54% of families with incomes over \$50,000 have such plans, while only 18.9% of families with incomes under \$30,000 have them.

Taken together, financial assets made up 42% of total household assets.<sup>7</sup> Beyond differences in what households own, there are also differences in how much they own. The mean net worth is over \$380,000, but 17.6% of households have zero or negative net worth. Over 30% of households have a net worth of less than \$10,000. Further, the distribution of wealth by wealth class is highly unequal. The top 20% of households own 84.5% of the nation's wealth, while the bottom 60 percent own less than 5% of the nation's wealth. Another dimension with which to examine wealth holdings is race. In general, minority households own less than ten cents for every dollar of wealth owned by a typical non-Hispanic White family.<sup>8</sup> Even though their income is roughly two-thirds of that of White families, their wealth is only 10% as much.

<b>Family Net Worth</b>	
Median	<b>\$73,500</b>
Mean	\$380,100
Percent with net worth	
a. Zero or Negative	17.6%
b. Less than \$5,000	26.6%
c. Less than \$10,000	<b>30.1%</b>
Source: Wolff (2004). Changes in Household Wealth in the 1980s and 1990s in the U.S.	

<sup>4</sup> Aizcorbe, Kennickell, and Moore (2003). Includes only all employment-based defined contribution plans plus IRAs and Keogh plans, but not defined benefit plans.

<sup>5</sup> Includes all types of defined contribution plans owned through a current employer or former employer.

<sup>6</sup> Aizcorbe, Kennickell, and Moore (2003). Figure for 2001.

<sup>7</sup> Di (2003).

<sup>8</sup> Wolff (2004); Kochar (2004).

### Mean Net Worth by Wealth Class

*In thousands*

	Top 20%	60-80%	40-60%	Bottom 40%
	\$1,604.7	\$215.3	\$75.0	\$2.9
Percent of Wealth Owned	<b>84.5%</b>	<b>8.8%</b>	<b>3.9%</b>	<b>0.2%</b>

Source: Wolff (2004). Changes in Household Wealth in the 1980s and 1990s in the U.S.

The promise of an ownership society will dissipate if it is used only to further concentrate the wealth of those already financially secure. In order to promote a true ownership society, we must first significantly broaden access to asset ownership by those who own little or nothing. The current proposals in the Administration's 2006 Budget that focus on Social Security, health savings, and retirement accounts fail to get us all the way there.<sup>9</sup> Following are a set of proposals that would.

## POLICY OPTIONS

This menu of policy options is presented with federal policymakers in mind. It reflects our latest and best thinking, and draws heavily on the work of many experts focusing on various facets of savings and asset-building policy. The menu includes calls for new structures and policies as well as small changes to existing financial products and government programs. As there are many policy routes to broadening savings and asset ownership, there is necessarily some overlap among the ideas presented below. The proposals are at varying stages of development, but each contributes to the overarching goals of promoting savings, encouraging asset building, and constructing an inclusive ownership society.<sup>10</sup>

### 1. Create a System of Children's Savings Accounts at Birth

One of the most novel and promising ways to achieve a universal, progressive asset building system over time would be to provide each generation of children a restricted, start-in-life asset account at birth, an idea first proposed by Michael Sherraden and, separately, by former IRS Commissioner Fred Goldberg.<sup>11</sup> These accounts would establish a universal platform and infrastructure to facilitate future savings and lifelong asset accumulation. While every child would have an account, it would especially benefit the 26 percent of white children, 52 percent of black children, and 54 percent of Hispanic children who start life in households without any resources whatsoever for investment. Different versions of children's savings accounts have been proposed by Members of Congress; most, however, are not progressive and are focused on building only retirement assets (most notably former Senator Bob Kerrey's "KidSave" proposal, which recently has received renewed attention). A great model for the U.S. is the newly established Child Trust Fund in the U.K. Also, the recently launched, privately-funded SEED Initiative (sponsored by CFED; see <http://seed.cfed.org>) is already providing valuable insights on policy design.

- **Enact the America Saving for Personal Investment, Retirement, and Education Act (ASPIRE Act).** Sponsored by a strong bi-partisan coalition of legislators in both the House and the Senate, the ASPIRE Act was introduced in July 2004 and is scheduled for reintroduction early in the 109<sup>th</sup> Congress. The ASPIRE Act would provide every child with an account at birth—called a KIDS Account—that would be endowed with \$500 and supported with progressive, targeted savings incentives until age 18, at which point it could be used for going to college, buying a home, or building up a nest-egg for retirement. (For more information, see [www.AspireAct.org](http://www.AspireAct.org).) Specifically, children from households earning below the national median income receive a one-time, supplemental deposit up to \$500 and would be eligible to receive an additional \$500 match for voluntary savings deposited each year. Voluntary contributions to the account will be tax-free and cannot exceed \$1,000 per year. Access to account funds will be restricted until the accountholder reaches the age of 18, and parents or legal guardians would control investment decisions until that time. The bill will establish a national fund within the U.S. Treasury, similar in

<sup>9</sup> For an analysis of the President's 2006 budget proposals, see "Federal Assets Policy Report and Outlook 2005," available at [AssetBuilding.org](http://AssetBuilding.org).

<sup>10</sup> For a discussion of principles and policy design considerations for building assets, see "Federal Policy and Asset Building" (Issue Brief No. 1, by Ray Boshara, available at [www.newamerica.net](http://www.newamerica.net)). For additional, comprehensive information on asset building assets, including research, program initiatives, existing and proposed policies, news stories, etc., see [www.AssetBuilding.org](http://www.AssetBuilding.org).

<sup>11</sup> See Cramer (2004) for details.

structure to the Thrift Savings Plan, which would provide a life-long savings platform and would be responsible for administering the accounts, holding all deposits, and managing investments.

## 2. Encourage Retirement Savings

Numerous studies of retirement savings confirm that participation rates, contribution rates, and levels of retirement savings for those near retirement are all significantly lower for lower-income workers. For example, data from the 2001 Survey of Consumer Finances, as summarized by Peter Orszag and Robert Greenstein, show that for the bottom 40% of workers, the median value of defined contribution and IRA assets for those with a retirement account is about \$10,000, while the median value of those without an account is, perhaps not surprisingly, zero. Also, current tax incentives, which are based on marginal tax rates, offer virtually no incentives to those who need them most: 1999 data show that about only 10 percent of tax benefits for retirement savings reach households earning \$50,000 or less per year.

To encourage greater retirement savings for low-income persons, these ideas should be considered:

- **Improve the “Savers Credit.”** The 2001 tax bill created a new voluntary individual tax credit—the Savers Credit—to encourage low-income workers to contribute to existing retirement products (IRAs, 401(k)s, etc). However, the credit is flawed in several important ways. It is not refundable, and it offers only a modest matching contribution. Consequently, it benefits only a small proportion of those technically eligible. For example, Peter Orszag and Matthew Hall show that only about 20% of filers get any benefit, while only one in one-thousand persons gets the full benefit. Mark Iwry of the Brookings Institution, who helped design the Savers Credit, suggests four ways to improve the credit: (a) make it refundable; (b) expand eligibility—instead of a 50% credit that phases down to 20% for joint filers with AGI over \$30,000, the 50% savers credit should be expanded to cover joint filers with significantly higher incomes within the middle-income range, for example, up to \$60,000, phasing out at about \$70,000 to \$75,000; (c) smooth the phase-down of the credit to resemble IRA income eligibility, instead of the “cliffs” now in effect; and (d) make it a permanent feature of the tax code rather than a mechanism scheduled for sunset in 2006, as the Administration proposes to do in its FY 2006 budget. These fixes will increase its price tag by about \$5 billion a year, but would offer a meaningful retirement incentive for families currently left out.
- **Encourage firms to adopt inclusive policies for defined contribution plans, such as “opt-out” instead of “opt-in” enrollment, automatic allocation, and automatic escalation.** Only about one-half of employers offer their employees 401(k) retirement plans. Roughly three-quarters of employees choose to participate, but participation tends to be linked with income. The problem is that currently workers are required to actively choose to participate in a company 401(k), or “opt-in.” Many workers, especially low-income workers, choose not to do so. However, compelling research data has shown that participation in retirement savings plans increases if workers are automatically enrolled rather than compelled to sign up. In one study by Madrian and Shea, this “opt-out” approach was found to increased participation from 36 percent to 86 percent when employed at a Fortune 500 company, and the increase was higher for lower-income workers.

Automatic allocation would ensure that all employee contributions would be automatically placed in a balanced, diversified set of low-cost funds. Many plans offer too many investment choices. Too large a variety of options can lead to paralysis, especially for novice investors. One outcome that should be avoided is the tendency for these investors to choose low-yielding funds rather than a more diversified portfolio in line with their life cycle needs.

Richard Thaler, economics professor at the University of Chicago Business School, also proposes implementing automatic escalation that would raise an employee’s contributions to their retirement accounts as their pay rises. This would overcome the debilitating effects of inertia on investment performance. Very few employees make the maximum contribution to their retirement plans and, even when their pay increases, employees often do not readjust their contribution amounts. Automatic escalation would ensure higher contributions as a workers’ income rises.

- **Offer employers a tax credit for matching the deposits of low-income workers who save in a 401(k) or equivalent.** An alternative to making the Savers Credit refundable is to offer employers a tax credit for contributing matching funds to low-income workers who save in defined-contribution retirement plans. One disadvantage to this approach is that it would encourage contributions only to workplace-based retirement products—contributions by low-income workers to IRAs, for example, would not qualify for matching funds.
- **Create a system of “Universal 401(k)s.”** Michael Calabrese of the New America Foundation and Gene Sperling of the Center for American Progress have each called for a nationwide system of fully portable retirement savings or “career” accounts that are both tax-subsidized and automatically deducted from one’s payroll. Such accounts would function like a government-facilitated 401(k)—just as employers match contributions by eligible employees, the government would match voluntary saving by individuals with a refundable tax credit deposited directly in workers’

portable accounts. This proposal is not unlike President Clinton's 1999 Universal Savings Account (USA) proposal, which did not receive (for political reasons) serious policy consideration. In the context of current policy debates focused on Social Security, a system of universal 401(k)s could serve as the complementary account-based savings platform constructed to bolster retirement security.

- **Modify the Administration's Retirement Savings Account (RSA) proposal.** The Administration's 2006 Budget proposes creating a new set of tax-preferred retirement savings accounts, called Retirement Savings Accounts (RSAs) and Employer Retirement Savings Account (ERSAs). In their current form, they would offer higher-income households tax sheltering opportunities, while offering little saving incentive to lower-income households. These proposals could be improved by imposing an income limit on eligibility and providing matching deposits for lower-income families, delivered through existing refundable tax credits or tax credits to financial institutions that offer RSAs.

### 3. Use Tax Returns to Connect Tax Refunds to Savings Products

The tax system can be a gateway to the financial system and to building savings and assets. Last tax season the IRS sent refund checks averaging \$2,300 to 130 million tax filers. These cash infusions are often the best chance people have to save some money in any given year. This is particularly true for lower-income families. Over 20 million lower-income families—one in six taxpayers—received an average \$1,700 boost to their refund from the Earned Income Tax Credit (EITC), a refundable tax credit designed to reward work. The Child Credit is another vital source of tax refunds. Also, for the millions of Americans who do not have bank accounts, tax time is an opportunity to help them open accounts to receive their refunds electronically, to take their first step to enter the financial mainstream, and begin to save. People may spend rather than save their refunds because they do not have an easy way to convert a portion of their refunds into savings vehicles. Recent research finds that many Americans—including lower income ones—can and will save their refunds if offered appropriate incentives and a clear way to do so. The challenge for policymakers is to facilitate and incentivize the savings of tax refunds into existing—and possibly new—savings products.

- **Encourage the IRS to allow tax refunds to be split among multiple accounts.** Under this proposal, people could deposit their refund into IRAs, 529 college savings plans or a variety of other savings accounts. Right now, taxpayers have only one choice; refunds are issued in a lump sum. If it is easier for people to save right on their tax forms, to split their refunds into “money to save” and “money to spend,” people will save more, perhaps much more. Research has indicated that even low-income tax filers would use this “splitting” option to save. The Administration has signaled their intention to implement this change to the tax filing process by the 2007 tax year; they should be encouraged to keep to this implementation schedule.
- **Provide a matching deposit, up to \$500 per year, if a low-income taxpayer saves part of their tax refund in a targeted savings account (such as a 529 college savings plan or a Roth IRA).** If a low-income taxpayer is willing to set aside up to \$500 of their tax refund in an after-tax savings product, they would be eligible for a 1 to 1 match, up to \$500 per year, to be deposited directly by the government into that account. This matched IRA could be justified as providing EITC recipients with similar opportunities for tax-favored savings enjoyed by higher-income workers. While legislation would be necessary to provide the matching deposit, no new refundable tax credits, and no new financial products would be required. Ideally, at some point the IRS could consider listing these savings products directly on tax forms, so that with a check-of-the-box a portion of a tax refund could be saved.
- **Set goals and performance measures for the IRS to promote savings by tax filers.** The Treasury and IRS should develop performance measures and track progress toward goals to: (a) increase tax returns that are sent by direct deposit to tax filers' bank accounts; and (b) increase the percentage of tax filers that deposit into IRAs as part of the tax filing process. Through their Annual Performance Plan, the IRS has a set of performance goals to help gauge their success in providing taxpayers assistance and education. They have a goal to have 44% of returns filed electronically in FY2004, but they don't have one regarding electronic payments. They should adopt one, and then set a performance target.

The first performance measure would be driven by a goal that a certain percentage, for example, 80 percent, of all filers will receive their refunds by direct deposit. Sending refunds electronically would not only decrease costs for the IRS but would spur more filers to open bank accounts, which are needed to receive refunds sent by direct deposit. However, this recommendation is subject to an important clarification—only refunds sent by direct deposits to specified accounts should count toward this goal. Refunds sent to the temporary accounts set up for Refund Anticipation Loans would not count. The second performance measure would be driven by a goal that a certain percentage, for example 30 percent, of tax filers open or deposit a portion of their refunds to IRAs in connection with the tax filing process. Finally, the IRS should also set a deadline that it will achieve these goals by some future date, for example, by 2009, to enable the agency to work with financial institutions.

- **Expand the Earned Income Tax Credit (EITC).** An expansion of the EITC, in addition to enabling more low-income Americans to save, would provide tax relief to lower-income working families. Previous expansions of the EITC have proven to be effective at providing work incentives and lifting families out of poverty. A well-crafted expansion would increase the maximum credit for working families with three or more children, expand the credit for married, two-earner couples, and expand the credit for families with two or more children. An expanded EITC program will create larger tax refunds, which in turn can be linked to savings products.
- **Allow tax filers to purchase savings bonds with part of their tax refunds.** People do not need accounts to buy savings bonds. The process to buy savings bonds is relatively simple, but could be made even easier for savers if the process was linked to the tax filing process. Peter Tufano, a professor at the Harvard Business School and a founder of the Doorways to Dreams Fund, recommends that the rules governing savings bonds be changed to make them more useful for asset building by low-income families. For example, the bond holding periods could be shortened for smaller denominations, people could be allowed to exit the bonds in case of emergency, and the interest rate could increase the longer they are held. Furthermore, this proposal could allow low-income individuals to accumulate the savings to meet the minimum balance requirements in IRAs.

#### **4. Make Section 529 College Savings Plans More Inclusive and Attractive to Low-Income Families**

The federal government has created a set of rules which create special savings account systems designed to help families set aside money for a college degree. Implemented in 1996 and expanded greatly in 2001, these 529 accounts are established and maintained by states. Each state's plan allows savings to grow and eventually be withdrawn on a tax-free basis when used to pay for qualified higher education expenses; the majority of states also offer state tax deductions for contributions into 529 accounts. These plans have the benefit of centralized accounting systems, pooling of invested funds, and a popular financial product. Because these plans offer incentives primarily through the tax code, however, the benefits of saving in these accounts flow primarily to middle- and upper-income families. A series of reforms could help low-income families learn about, evaluate, and be encouraged to save in 529 Savings Plans.

- **Make it easier to compare costs and benefits of state 529 plans.** It is currently difficult to directly compare the overall price of the various plans. Uniform disclosure of fees and other costs are required to facilitate good consumer choices. In response to criticism from consumers and the federal government, state 529 administrators have drafted disclosure principles.<sup>12</sup> With 21 states already beginning to implement these principles, this first step will hopefully lead to clear data points that consumers can use to evaluate multiple plans on an “apples to apples” basis. These changes will not only lead to better consumer choice, but also may help states to evaluate whether their partnership with a selected financial institution providing the 529 plans for their residents is fair or if renegotiation is needed.
- **Expand inclusiveness of 529 plans.** Currently, the largest incentives to save in 529 accounts accrue to families who need the least amount of help—those with the highest incomes and, therefore, the highest tax liability. Lower-income families, who may have to make painful sacrifices to save into these accounts, do not benefit from existing incentives. Fortunately, states have the ability to introduce their own policy innovations and can experiment with different ways to encourage low-income families to save for college. Measures have been adopted in several states to encourage low-income families to participate in these savings plans, including low minimum deposit requirements, low maintenance fees, low or waived application fees, and matches on contributions.<sup>13</sup> Five states—Louisiana, Maine, Michigan, Minnesota, and Rhode Island—already offer a savings match to low- and moderate-income families who are state residents.

Another reform that could increase the inclusiveness of 529s is to ensure that savings in these accounts are excluded when determining eligibility for public assistance programs. Although most low-income savers are not adversely impacted by a reduction in financial aid due to savings in education accounts, they may have their TANF, food stamp, and other assistance eligibility threatened. Since financial aid is already excluded from eligibility, this could set a precedent for college savings to be excluded as well.

- **Use 529s as a basis for universal Children's Savings Accounts.** Since 529 accounts are already designed to help children and their families save for a significant asset, a post-secondary education, this account structure could form

<sup>12</sup> These disclosure principles, adopted in December 2004, are available via the College Savings Plan Network, which is comprised of officials and senior staff in the executive, legislative and administrative branches of state government with responsibilities in the college savings area. See <http://www.collegesavings.org/activities/Disclosure.Principles.12.2.04.pdf>.

<sup>13</sup> For a more detailed discussion on some inclusive measures adopted by several states, see The Potential for Inclusion in College Savings Plans: Report on a Survey of States by Margaret Clancy and Michael Sherraden. Available at: <http://gwbweb.wustl.edu/csd/Publications/2003/ResearchReport-529savingsplanssurvey.pdf>

a basis for both a universal Children's Savings Account program, as well as be revised to allow for other asset building purposes. 529 plan features such as the ability to subsidize the cost of small accounts with larger ones, centralized accounting, a menu of investment options, and the state's role in providing outreach and incentives for participation, could serve as the "plumbing" behind a system which provides an account a birth for every child. The state of Kentucky is exploring just such a possibility. State Treasurer Jonathan Miller and Secretary of State Trey Greyson have proposed a Cradle to College initiative which would provide a college savings account for every child born in Kentucky. Currently, a Commission is refining this idea and identifying long-term financing options.

## **5. Expand the Number of Individual Development Accounts (IDAs)**

Individual Development Accounts are matched savings accounts typically restricted to buying a first home, pursuing post-secondary education and training, and starting a small business. According to CFED, at least 20,000 people in the U.S. are saving in an IDA, but this number represents well below one percent of the eligible population. Moreover, recent experimental research has demonstrated that low-income persons can successfully save in IDAs, and that IDAs are effective in building assets. Accordingly, Congress should expand the number of IDAs available for low-income, working persons.

- **Enact an Individual Development Account Tax Credit.** Congress should authorize the IDA Tax Credit included S. 6, the Family and Community Protection Act (a House version of a forthcoming related bill—the CARE Act—however, will not include the IDA tax credit, but instead the reauthorization of AFIA, per below). This proposal—which in the past has been stand-alone bi-partisan legislation entitled the *Savings for Working Families Act*—would authorize tax credits to financial institutions that set-up and match (up to \$500 per person per year) the IDAs of 300,000 persons over a seven-year period; note that the Bush Administration has included in this and every previous budget funding for 900,000 accounts. However, in order for the IDA tax credit to work effectively, Congress should strongly consider three changes to the IDA title in S. 6: (a) the cap on the number of accounts eligible for the tax credit should be removed; (b) the reporting and performance requirements should be eased and simplified; and (c) the prohibition on financial institutions against charging accountholders fees on IDAs should be removed. See [www.cfed.org](http://www.cfed.org) for further details about the legislation and its prospects.
- **Support the reauthorization of the federal Assets for Independence Demonstration Program.** In 1998 Congress authorized this 5-year, \$125 million IDA demonstration program, which awards grants on a competitive basis to community-based organization to run IDA programs. The program, which now provides the vast majority of funding for IDAs throughout the U.S., should be reauthorized by Congress. While reauthorization was slated for last year, it was delayed but should proceed this year, although the legislative vehicle remains unclear. In the reauthorization process, Congress should relax the requirement that the federal funds must be spent in exactly the same ways as the non-federal funds required to be raised (on a dollar-for-dollar basis) by grantees in order to secure a federal grant. See [www.cfed.org](http://www.cfed.org) for details and other AFIA recommendations supported by the IDA field.

## **6. Modify the President's Lifetime Savings Account Proposal.**

Also in the 2006 Budget (and in previous budgets) is the President's proposal for Lifetime Savings Accounts, or LSAs, which are designed to encourage savings for any purpose—medical expenses, consumption, an automobile, new washer and dryer, down payments, etc. Contributions to LSAs, which would be after-tax, would be capped at \$5,000 per year but earnings and withdrawals would be tax free. LSAs would be open to everyone regardless of income or age. Like RSAs and ERSAs, LSAs as proposed would likely provide tax-sheltering or "asset shifting" opportunities for better-off Americans while doing little to encourage low-income Americans to save. The concept of subsidizing saving for any purpose, however, should be embraced because recent insights from the IDA field strongly suggest that the poor—like all Americans—need and want to save for a variety of purposes, not just long-term asset accumulation; in fact, facilitating saving for uses other than long-term assets could reduce the pressure and expectations on IDAs, Roth IRAs, and 529s to meet the savings needs of the poor as well as everyone else.<sup>14</sup>

- **LSAs should be revised to encourage more low-income Americans to save.** In addition to adding an income limit on persons eligible to save in LSAs to reduce the likelihood of asset shifting, LSAs can be made more inclusive by offering a matching deposit, on a 1-1 basis, for low-income persons who save in LSAs. The matching deposit could be delivered through a tax credit to financial institutions that offer LSAs, through existing refundable tax credits, or through the creation of new refundable tax credit.

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<sup>14</sup> For an extended discussion of this idea, see *IDAs and Savings Policy for the Poor*, by Ray Boshara, forthcoming from the Brookings Institution.

## 7. Foster Access to Mainstream Financial Services (“Bank the Unbanked”)

Somewhere between 10 and 20 million American families are “unbanked,” meaning they lack a basic checking or savings account. Many others are “under-banked;” they have a bank account but are not fully integrated into the financial mainstream. These families pay more for basic financial services, and the higher fees can trap users into an ever-increasing cycle of debt. Anne Stuhldreher, a Senior Research Fellow at the New America Foundation, and Jennifer Tescher, Director of the Center for Financial Services Innovation, have made the following recommendations to increase access by lower-income families to the provision of financial services.

- **Expand the reach of the Electronic Transfer Account and improve its functionality.** Currently, the ETA is available only to those Americans who receive a recurring federal payment, like Social Security. To date only 2 percent of federal benefits recipients have opened an ETA. Yet it is estimated that at least 4.5 million federal benefit recipients still do not have bank accounts.<sup>15</sup> Thus, the ETA continues to represent a potentially useful infrastructure for providing access to financial services – particularly if account eligibility guidelines are expanded and banks are given greater flexibility to better tailor the product to meet consumers’ needs. The ETA should be made available to a broader segment of unbanked consumers, especially those who receive tax refunds, and banks should be given greater flexibility in how the ETA can be structured. As it stands, the account doesn’t meet the needs of either consumers or banks very well. For consumers, the account lacks functionality. For banks, there is an insufficient volume of small accounts. The Treasury Department should enable banks to offer customers a range of options with different fee structures, as long as the bank continues to offer at least one low-cost option that is available to any federal benefit recipient regardless of past banking history.
- **Allow tax filers to open accounts directly from their tax forms.** With a check of a box, tax filers should be able to open a checking, savings, or IRA account directly on their tax forms. The IRS could achieve this goal in several ways. For instance, the IRS could solicit proposals for private financial institutions to provide low-cost quality accounts nationwide. Or, the IRS could create and maintain a web-based directory of financial institutions that open low- or no-cost accounts online for tax filers. The directory’s URL address would be printed on all tax forms and it would be searchable by zip code.
- **Strengthen the Community Reinvestment Act (CRA), and expand the service test to encourage more retail banking activities aimed at lower-income, under-banked consumers.** The CRA is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods. In the last year, some of the bank regulatory agencies have proposed reducing the number of banks subject to a full CRA exam. A limited exam would allow banks to choose among community development lending, services, and investments to apply to their CRA exam. This means that banks could play to their current strengths, ignoring opportunities to provide basic financial services or build bank branches in lower-income areas. The CRA has had an enormous impact in broadening access to credit for low- and moderate-income consumers. The exam and the service test need to be expanded, not curtailed.
- **Encourage state governments to link benefit cards to bank services.** All fifty states now administer food stamp benefits through Electronic Benefits Transfer (EBT) instead of the traditional paper coupons. Benefit recipients use plastic cards with personal identification number (PINs) to purchase eligible foods at authorized stores. States are also delivering other benefits—such as TANF—via EBT. The conversion to EBT has largely been deemed successful. It has saved the federal government money, reduced fraud, and decreased the program’s error rate. This success should be built upon by linking these cards to individually-owned bank accounts.

The federal government should set a performance measure that a certain percentage of each state’s benefit recipients receive their benefits by direct deposit into individually owned bank accounts by a certain date. States that meet certain benchmarks on accounts opened could receive “TANF bonus awards,” which currently reward states for various successes in their TANF programs.

- **Require the inclusion of financial literacy education in Kindergarten through Twelfth grade curricula.** All Americans need the knowledge and skills to navigate the changing financial services industry in order to make good choices for themselves and their families. The Treasury Department recently formed a Financial Literacy and Education Commission to determine how best to build the financial literacy skills of all Americans. Adult financial education usually reaches people already in financial crisis. To reach the most people most efficiently, comprehensive financial literacy education should be integrated into the K-12 curriculum.

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<sup>15</sup> “Understanding the Dependence on Paper Checks: A Study of Federal Benefit Check Recipients and the Barriers to Boosting Direct Deposit,” sponsored by the U.S. Treasury’s Financial Management Service and conducted by the Federal Reserve Bank of St. Louis, 2004.



- **Capitalize an Innovation Fund for financial institutions to facilitate R&D focused on under-banked consumers.** The Treasury Department should create an Innovation Fund to spur systemic change throughout the financial services industry by providing seed funding for financial services companies to develop products and services for un- and under-banked consumers. These R&D funds would encourage banks—and other financial services firms—to engage in the kind of intensive research and planning that they perform to develop products and services for higher income consumers. The Fund would seek to increase the reach of mainstream financial institutions into the under-banked market by encouraging innovation both in how products are structured and in how they are marketed and delivered. Ideally, products would bundle multiple functions, include a savings feature where feasible, use incentives creatively and be competitively and responsibly priced.

## 8. Expand Access to College and Post-Secondary Education

A post-secondary education is increasingly a necessity to secure a well-paying job, but also is often the first step to achieving security, acquiring assets, and building wealth. While educational attainment rates continue to rise across all race and income groups, persistent gaps remain between races and people of difference socio-economic backgrounds. Today, financial barriers prevent almost half of academically qualified low-income students from attending a four year college and almost a quarter from attending any college at all within a few years of high school graduation. In addition, there is less of a focus on need-based aid in the form of grants and a greater emphasis on loans, merit awards, and tax credits.

- **Revise and expand Pell Grants.** An increase in the maximum Pell Grant award that a student can receive every year would be the most beneficial way to increase access to college.<sup>16</sup> But the current Pell Grant program should be restructured so that aid is concentrated in the first two years of college. This “front-loaded” grant would cover a larger percentage of expenses and greatly reduce the need for a loan in the first two years. While students would then have to finance their remaining years of school with a federal loan, they would be less averse to taking out a loan after having gained confidence in their abilities to complete their education.

With increasing numbers of Pell Grant-eligible students going to college, costs for this grant are rising rapidly even with the award level remaining the same. One idea that holds promise is to re-direct the federal funding that currently goes towards providing banks subsidies to operate the Federal Family Education Loan (FFEL) program into increased funding for Pell Grants.<sup>17</sup>

- **Expand pre-college programs.** One of the most important parts of making college more accessible is ensuring that every child receives a quality K-12 education so that they are prepared to succeed in college. They must also begin their school career with the expectation that college is within their reach. To this end, it is important to increase awareness and financial support of pre-college programs which have shown that they are successful. The TRIO and GEAR UP programs should be dramatically expanded so that far more than the current 10 percent of eligible students are able to take advantage of these programs. This expansion could be implemented through a variety of funding mechanisms which could be shared by federal, state, local, and nonprofit community groups. Innovative new ideas, such as the Early College High School Initiative demonstration conducted by Jobs for the Future and its partners, should also be explored as other possible parts of a comprehensive pre-college strategy. This initiative, which will be implemented in 19 high schools this year, will allow students to take college courses for credit during their junior and senior years. They can earn up to two years of college credit this way without paying any college tuition, while being in a more intimate high school environment.<sup>18</sup>
- **Provide help for nontraditional students.** All grants, loans, and other assistance programs must be adapted to the new and growing majority of students who are currently classified as “nontraditional.” Policies should not categorically exclude the large number of students who attend college part-time or less, while working or carrying out parental responsibilities, and neither should these policies exclude students who choose from new innovations in education such as web-based classes. These students may face additional costs such as child care or a salary over the very low threshold which disqualifies them for needed aid, or they may need to take breaks from their schooling. All programs should be designed with enough flexibility to adapt quickly to students’ changing circumstances and needs.

<sup>16</sup> In the FY 2006 Budget, the Bush Administration calls for increasing the maximum Pell Grant award from \$4050 to \$4550 over the next five years.

<sup>17</sup> This idea is highlighted in HR 4370, the Direct Loan Reward Act, introduced by Rep. Petri in 2004.

<sup>18</sup> The FY 2006 Budget rolls existing college readiness programs, including TRIO and GEAR UP, into a consolidated High School Intervention Initiative. In addition, \$125 million has been allocated for community college initiatives which allow students to obtain college credits while in high school.

## 9. Expand Homeownership Opportunities for Lower-Income Families

Homeownership is at the core of the American Dream. Supported by a steady stream of public policy interventions that have facilitated the purchase and continued ownership of homes, the rise in the national homeownership rate has been impressive. Yet lower-income families face significant hurdles in becoming homeowners and do not benefit from most of the current policy incentives designed to promote homeownership. This can be addressed through a series of new policies, program, and reforms.

- **Make the homeowner's mortgage deduction refundable for lower-income households.** This tax break provides \$70 billion a year in tax relief. Since the mortgage deduction is not refundable, benefits go to higher income families. 54 percent of the homeowner's deduction goes to households earning more than \$100,000 a year, and nearly 90 percent of this benefit goes to households with adjusted gross incomes over \$50,000. Making the deduction refundable for households earning under \$50,000 will open up this subsidy to families on the cusp of achieving the American Dream.
- **Enact a refundable First-Time Homebuyers' Tax Credit.** The largest obstacle for most first-time homebuyers to overcome is saving for the down payment. This problem has only increased as home prices have risen. First-time homebuyers earning under \$50,000 a year should be eligible for a dollar-for-dollar tax credit for money used as a down payment, up to a \$10,000 amount. This tax credit should be made refundable to benefit families without high tax liabilities.
- **Increase use of the Family Self-Sufficiency program.** The FSS program allows public housing authorities to create escrow accounts where earnings increases are stored rather than being used to pay for rent. While public housing authorities have the ability to open escrow accounts, they are required to identify designated case managers. HUD should either increase its dedicated funding to hire case managers or more effectively seek partnership with agencies already in the case management business. This is one of the central objectives of the FSS Partnerships, a national initiative of the Local Initiatives Support Corporation directed by Jeff Lubell. Lubell is committed to expanding awareness of the potential of the FSS model, and then fostering the local partnerships between organizations with complimentary skill sets. Developing and publicizing FSS partnership arrangements will provide support for FSS practitioners by sharing best practices and entrepreneurial approaches to program growth.
- **Preserve rental housing subsidies that support affordable housing.** For many low-income families, affordable rental housing is often the first step towards homeownership, so programs aimed at expanding the supply of subsidized rental units need to be preserved.

## 10. Support Microenterprise Development

Microenterprises—businesses with five or fewer employees that can benefit from a loan of \$35,000 or less—are an important source of household income for many families. These businesses access training and financial services from microenterprise development organizations, of which there are currently more than 600 in this country. Yet public support for these programs, and the businesses they serve, has been fragmented and uneven. To more effectively support microentrepreneurship, Lisa Servon, a Senior Research Fellow at the New America Foundation, recommends that the following ideas should be considered:

- **Create a New Entrepreneur Tax Credit and Self-Employment Literacy Campaign.** Schedule C is perhaps the single most important “formalizing” event in a new business’s start-up process. It could be an appropriate vehicle for targeting different kinds of asset-building deductions and credits for micro businesses and other self-employed businesses. A New Entrepreneur Tax Credit could be offered to first-time Schedule C filers that have at least \$10,000 in net business income. The credit could be taken over a multiple-year period for new entrepreneur start-ups. Further, a Business and Tax Literacy Campaign would inform sole proprietors about the benefits of Schedule C filing and the new tax credit.
- **Restructure the SBA Microloan Program.** Since 1992, the Small Business Administration has provided grants and loans to nonprofit intermediary lenders engaged in microenterprise development. This program could be more effective if the following changes were made: (a) create a credit enhancement pool of \$500 million; (b) expand the target market; (c) establish standards for borrower, loan performance, and technical assistance.
- **Amend the tax code to allow for penalty-free withdrawals from IRAs for “business start-up expenses.”** This proposal would require only the addition of “business start-up expenses” to the section of the code that lays out the exceptions to the 10% penalty tax on early distributions from IRAs. Lawmakers have already introduced several bills over the years that would have done exactly this. An alternative is to allow microentrepreneurs to capitalize

their businesses with loans made against IRA assets. Structuring funding as loans rather than as straight distributions would mitigate against the concern that low-income savers might dissipate their hard-earned assets on ill-conceived or risky ventures and thereby lose funds they could have used for education, a home, or retirement. This strategy would have the advantage of effectively requiring the return of the borrowed funds to the IRA account and thereby helping to guard against dissipation. If loans against IRA plans rather than distributions from the plans themselves were used to fund small business start-ups, then private lenders or the SBA could underwrite the loans and evaluate the merits of the proposed business plans, helping to prevent ill-conceived plans from going forward.

## **11. Revise Asset Limits in Public Assistance Programs**

The application of low asset limits to determine eligibility for federal public assistance benefits is a huge disincentive for saving. One of the great policy achievements of the 1990s was that nearly all states raised their assets limits as part of their TANF plans. In addition, the majority of states have raised their asset limits on Medicaid above the federal minimum and 44 states have waived asset limits for providing Medicaid for children. While states continue to innovate where they have the flexibility to do so, an opportunity also exists to reform these limits at the federal level. Some reforms include the following:

- **Exclude restricted savings from resource tests.** Currently, only retirement savings in pension plans are universally excluded from consideration in assistance eligibility, while 401(k)s are excluded in only some programs, and IRAs are generally counted. Therefore, families needing to go on temporary public assistance may need to spend down critical retirement resources even though they will face a tax penalty in doing so. In addition to restricted retirement savings accounts, all other restricted accounts should be excluded from eligibility consideration. For example, investing in a higher education is one of the best ways to move a family towards self-sufficiency and ensure that the next generation has better economic opportunities. Several states have recognized this by excluding all savings in education savings accounts from state financial aid calculations and offering matches to low-income people who save. The next step is to exclude these accounts across the board so that these savers are not rewarded in some programs and penalized elsewhere.
- **Raise limits to make them more in line with contemporary standards, or eliminate them entirely.** While many assistance programs index income limits for eligibility, asset limits have failed to keep pace with rising costs. For example, the asset limit for the Supplemental Security Income program has remained frozen at \$2,000 (\$3,000 for couples) since 1989. While some states have liberalized their asset limits over the past decade where they have the flexibility to do so, indexing these limits for inflation would help to gradually raise the amount that families can save without need for additional legislative or other action.

## **12. Strengthen Laws to Protect Assets**

While financial education efforts are critical to ensure that those low-income people who have assets don't lose them, and that low-income consumers make good financial choices, the market for providers of unscrupulous loans and financial services is vast, profitable, and poorly regulated. Predatory lending is responsible for the stripping of billions of dollars of assets from low-income families and communities each year. The Center for Responsible Lending estimates these annual losses amount to \$9.1 billion as a result of predatory mortgages, \$3.4 billion from payday loans; and \$3.5 billion in other lending abuses, such as tax refund anticipation loans, overdraft loans, and excessive credit card debt.

Some experts note that we have “dual” and unequal regulatory systems—one well-regulated for the mainstream, “high-road” providers, and the other weakly regulated for the alternative “low-road” providers. Policing this asset-stripping regime has been recently complicated by some of the high-roads acquiring some of the low-roads. Proposals to strengthen asset protection laws and curb predatory lending through tighter regulations on financial products ranging from mortgages to payday loans could include the following.

- **Increase the oversight of the home-buying and refinancing processes, especially in the sub-prime market.** The existing protections for high-cost home loans must be improved. This would include prohibiting equity stripping practices, such as excessive prepayment penalties and fees for payoff information, modification, or late payment; requiring a borrower receive counseling before entering into a high-cost loan; and prohibiting mandatory arbitration clauses on high-cost loans.
- **Provide federal oversight and coordination of now state-regulated alternative financial services providers.** Provisions could include limiting the number of loans to an individual each year, creating a minimum loan term for each loan of at least 60 days, establishing a borrower's right to repay the loan in installments. In addition, states with stricter laws could be empowered to effectively enforce their laws within their boundaries.

- **Reduce the cost of tax preparation and restrict the marketing of Refund Anticipation Loans.** The IRS should continue to expand the provision of free electronic filing. Further, it should ensure that (1) the free services are easier for eligible tax filers to access and navigate; 2) the marketing of Refund Anticipation Loans is limited; and 3) options to open IRAs online are included.
- **Protect consumers from abusive credit card practices.** This can be done by: (1) restoring the 14-day payment grace period before late fees are imposed; (2) notifying customers at least 15 days prior to unilaterally raising rates; (3) charging no late fees larger than the outstanding balance; (4) restricting bait and switch practices when customers are pre-approved at one rate but then offered a card with a higher rate; (5) requiring full disclosure and honest advertising; and (6) protecting youth from receiving cards without cosigners.

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