perspectives

Federal Reserve Bank of Dallas

BANKING & COMMUNITY PERSPECTIVES

2006, ISSUE 3

Asset Building *and the* Wealth Gap

"ENSURING THAT EVERY AMERICAN HAS THE CHANCE TO IMPROVE HIS OR HER ECONOMIC CIRCUMSTANCES THROUGH HARD WORK, SAVING, ENTREPRENEURSHIP, AND OTHER PRODUCTIVE ACTIVITIES IS ESSENTIAL FOR BUILDING HEALTHY COMMUNITIES AND ACHIEVING SUSTAINABLE ECONOMIC GROWTH."

—Ben Bernanke
Federal Reserve Board Chairman
November 1, 2006

perspectives
2006, Issue 3

www.dallasfed.org

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December 2006

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In 2005, the national savings rate dipped below zero for the first time since the Depression. To many, this was a wake-up call to the reality that a large and growing number of households are financially insecure. Reaching the middle class has become more difficult, and staying in it has become increasingly tenuous. As a result, an expanding number of families are asking how to make ends meet and save for the future.

The asset-building movement is a response to this growing sense of financial insecurity. The effort is gaining traction, as seen by an increase in legislation, research, public forums, savings and investment tools, and other vehicles designed to increase families' ability to build and preserve wealth.

This issue of Banking and Community Perspectives *identifies trends in American households' wealth, shows its disparities among demographic groups, and spotlights the challenges Texas, Louisiana and New Mexico households face in building and sustaining their assets. We hope this publication provokes thought and discussion on how asset-building policies can enable all households to grow and secure their financial well-being.*

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Asset Building and the Wealth Gap

Building and maintaining financial security is increasingly difficult for a growing portion of American households. Wealth is less prevalent in middle-class households and increasing among the already well-to-do. At the same time, poverty is growing and concentrating disproportionately among the nonwhite population. As the cost of living outpaces income and wealth accumulation, a majority of U.S. households are ill-prepared for financial emergencies or retirement.

How and why this is happening can be explained in part by trends in income, housing and health care costs, educational attainment, homeownership and other vehicles of asset accumulation.

Shrinking Pocketbooks

From 1979 to 2005, the maximum family income for the bottom quintile of U.S. households increased, after adjusting for inflation, by 4 percent. The second quintile, whose maximum family income in 2005 was $45,021, saw income rise by 11 percent. At the same time, the maximum family income for the next highest quintiles rose 19 percent and 31 percent, respectively. The 95th percentile of the population, whose income was $184,500, enjoyed a 46 percent increase in income.[1] This trend shows that over the past quarter century, income increased disproportionately to the benefit of the highest-income households.

Meanwhile, the pace of housing costs outstripped that of income. In 2004, the number of U.S. households that spent over 50 percent of their income on housing increased to an all-time high of 15.8 million, and the number of households that paid over 30 percent increased to 35 million. This serious cost burden is not limited to low-income households; from 2001 to 2004, the number of households earning $22,540 to $75,700 and committing over 50 percent of their income to housing increased from 2.4 million to 3.1 million.[2]

As housing affordability decreases, households have less to spend on food, health care, transportation and other necessities. The increasingly burdensome cost of health care and declining health care coverage compound the problem.[3]

According to the Kaiser Commission on Medicaid and the Uninsured, 46.1 million Americans under age 65 (18 percent of this population) were not covered by health insurance in 2005, an increase of 1.3 million since 2004 and over 7 million since 2000.[4] Approximately 80 percent of the uninsured are from working families, and two-thirds of them are low income. Those whose employers offer health care benefits may not be eligible for insurance, says the commission, because they work part-time or are recent hires. Others may not sign up because they cannot afford to pay their required share of the premium.

Of the individuals who seek out private, non-group insurance plans, many report that affordable coverage is often unattainable. In the 2005 Commonwealth Fund Biennial Health Insurance Survey, 89 percent of respondents who sought out these plans said that they did not buy a plan because they were denied coverage or had difficulty identifying one that was affordable. The respondents who did obtain private insurance spent a greater share of their income on health care expenses than their employer-insured peers.[5]

Lack of Retirement Readiness

Because a large and growing number of U.S. households have shrinking pocketbooks, fewer and fewer have enough financial resources for retirement. As seen in Table 1, 2004 median household income in the United States was $43,200, ranging from $11,100 per year for the lowest 20 percent of households to $184,800 for the top 10 percent. Only 10 percent of households in the

Table 1
Income and Tax-Deferred Retirement Accounts Among U.S. Households, 2004

Income Percentile	Income Range	Median Income	Retirement Account Holders	Median Value of Account
< 20	≤ $18,900	$11,100	10%	$5,000
20–39.9	$18,901–$33,900	$25,700	30%	$10,000
40–59.9	$33,901–$53,600	$43,200	53%	$17,200
60–79.9	$53,601–$89,300	$68,100	70%	$32,000
80–89.9	$89,301–$129,400	$104,700	82%	$70,000
90–100	>$129,400	$184,800	89%	$182,700
All households		$43,200	50%	$35,200

NOTES: Tax-deferred retirement accounts consist of IRAs, Keogh accounts and employer-sponsored accounts such as 401(k), 403(b) and thrift saving accounts. Data are based on a sample size of 4,522.

SOURCE: Federal Reserve Board.

Mean vs. Median: A Story Unfolds

Looking at the difference between the median and mean values of family net worth reveals that the wealthiest families are becoming wealthier while the middle class is becoming relatively poorer. The *mean* is the average wealth, and the *median* the number in the middle—half the families fall below it and half above. The median draws a more accurate picture because it is not skewed by the wealthiest households.

In 1995, the median family net worth in the United States was $70,800, while the mean was 3.7 times higher, at $260,800. By 2004, the median was $93,100 and the mean $448,200, nearly five times higher.*

The wealth gap will widen if the status quo continues because disparities in wealth are significantly larger than disparities in income and have been increasing. Between 1989 and 2004, the mean net worth of the top 10 percent of households grew 67 percent, adjusted for inflation, while the mean net worth of the bottom 50 percent increased by 38 percent. The bottom 25 percent had a negative net worth of –$800 (in 2004 dollars) in 1989; this had worsened to –$1,300 by 2004.†

*See note 6.

†"Changes in Household Wealth in the 1980s and 1990s in the U.S.," by Edward N. Wolff, in *International Perspectives on Household Wealth*, ed. Edward N. Wolff, Edward Elgar Publishing Ltd., 2006, pp. 107–50.

lowest quintile had tax-deferred retirement accounts, with a median value in 2004 of $5,000. In contrast, over 80 percent of households in the top quintile held retirement accounts, and the values of these accounts were dramatically higher.[6]

These data lead to two significant findings: (1) The majority of U.S. households lack a secure and robust financial cushion, and (2) there is a glaring disparity in the proportion of retirement account holders, and the size of their accounts, between the bottom and top income earners.

This disparity is evident among households headed by 51- to 61-year-olds, a group that is particularly vulnerable to financial shocks because it is approaching the peak of its asset-building years. For 60 percent of these households, the average value of Medicare and Social Security accounts for over half their wealth. In comparison, the top 10 percent of households have an average of $2.6 million in assets, and only 15 percent ($389,000) of that wealth is from Medicare and Social Security. These data clearly indicate that a majority of households headed by 51- to 61-year-olds do not have enough savings and investment for a secure retirement.[7]

The Wealth Gap: Unequal Representation

Across the board, research shows continuing disparity in financial security between non-Hispanic white and minority households in the United States. Two of the most important assets are homeownership and retirement accounts, and in both cases, minorities' holdings lag far behind.

According to the 2004 Survey of Consumer Finances, 33 percent of minorities and 56 percent of non-Hispanic whites had tax-deferred retirement accounts. The median value of minorities' accounts was $16,000, while that of non-Hispanic whites was $41,000. In the same year, 51 percent of minorities and 76 percent of non-Hispanic whites were homeowners. The median value of minorities' primary residence was $130,000, while that of non-Hispanic whites was $165,000.[8]

What accounts for this wealth gap? Since the founding of the United States, the federal and state governments have created and supported policies and institutions that foster wealth primarily for the majority population. Although many of these policies and institutions have ceased to exist or are no longer legal or enforced, they have left a legacy of wealth inequality.

This situation persists because approximately 80 percent of household assets comes from the previous generation. When wealth passes from one generation to the next, it brings access to resources and opportunities like quality education, housing and health care; emergency and retirement funds; and upwardly mobile social networks. Poverty shuts out access to these engines of economic mobility.

Today, the asset poverty rate is twice the income poverty rate. According to the Washington, D.C.-based nonprofit CFED (Corporation for Enterprise Development), the highest 20 percent of wage earners take in 43 percent of earned income and control 86 percent of net financial assets. Moreover, in times of emergency, one quarter of American families would not have enough assets to sustain their living standard at or above the poverty line for more than three months.[9]

In *The Color of Wealth: The Story Behind the U.S. Racial Wealth Divide*, United for a Fair Economy outlines the asset-building histories of African–Americans, Asian–Americans, Latinos, Native

> **"Income feeds your stomach, but assets change your head. That is, you really do act differently when you have a cushion of assets so that you can strategize. . .about the future, create and take advantage of opportunity. Otherwise you stay in the present."**
>
> **—Melvin Oliver, coauthor of *Black Wealth, White Wealth***

Americans and European Americans.[10] It chronicles how government policies and institutions boosted, blocked, included or excluded specific groups from building and keeping their assets. The GI Bill and Federal Housing Administration (FHA) are two of the largest and most impactful of these devices in recent history.

In 1944, Congress passed the Servicemen's Readjustment Act, commonly known as the GI Bill, to help war veterans readjust to civilian life by providing them with asset-building opportunities. The bill helped them find jobs, gave them unemployment compensation for up to 12 months and paid for up to four years of education or job training. More than 7 million veterans benefited from this legislation; an estimated 1 to 2 percent of them were African–Americans.

Minority war veterans came home to a different environment than their peers. At the end of World War II, there were a multitude of state laws, city ordinances and constitutional amendments that segregated schools, public facilities, transportation and neighborhoods; outlawed interracial marriage; and further discriminated against minorities. One result was that most African–Americans could use the GI Bill only at historically black colleges and universities, which were not nearly large enough to accommodate the demand. It is estimated that in 1946, only 20 percent of the 100,000 African–American applicants for educational benefits were registered in college.[11]

Furthermore, when veterans went to U.S. Employment Services centers for job placements and unemployment benefits, the centers steered applicants in different directions. Eighty-six percent of the referrals to skilled jobs went to whites. As a result, 450,000 became engineers, 240,000 became accountants and 238,000 became teachers. More than 90,000 entered the sciences, while others became doctors or dentists. In contrast, most black veterans got referrals to jobs like tailoring and dry cleaning.

The GI Bill also provided low-interest mortgages through the FHA and Department of Veterans Affairs. Most of these loans were for homes in the suburbs, which tended to be less expensive than inner-city housing units and were made possible by government-subsidized roads, utilities and other infrastructure. Minorities were rarely beneficiaries of these subsidies. The FHA's manuals for housing appraisers encouraged financial institutions to provide loans specifically to whites and encouraged restrictive covenants in deeds to prohibit sales to minorities, thereby institutionalizing redlining. As a result, by 1962, minority homebuyers had accounted for less than 2 percent of these loans and could use them only in segregated neighborhoods.

Although the FHA officially eliminated redlining covenants in 1950, the government did not mandate that the real estate industry—agents, appraisers, financial institutions, insurance companies, white homeowners and others—follow its lead. As a result, redlining continued, leaving most minorities with little ability to build wealth through homeownership or use the home mortgage interest deduction to reduce their income taxes.

The mortgage interest deduction is a major benefit for homeowners. In fiscal 2005, it totaled $72.6 billion, making it one of the tax code's biggest expenditures and the largest federal subsidy for homeowners.[12] The property tax deduction and exclusion of capital gains taxes on the sale of a primary residence are two other governmental rewards for homeownership. Not all homeowners benefit equally, however. The highest 10 percent of income earners receive 59 percent of mortgage interest and property tax deductions; the bottom 50 percent get only 3 percent.

Assessing the Wealth Gap

Looking at the nation's large and expanding wealth gap, CFED measured the federal government's contribution toward asset building. Adding up the cost of direct outlays and tax expenditures that support homeownership,

Photographer is Curtis Humphrey. Photograph is listed as unidentified graduation in East Texas circa 1960. Courtesy of The Texas African American Photography Archive.

retirement accounts, savings and investment, and small business development, they estimated the federal asset-building budget to be $362 billion in fiscal year 2005. The poorest 20 percent of households received $3 each, on average, in asset subsidies. In contrast, the wealthiest 1 percent received $57,673 per household, on average.[13]

Compounding this imbalance, according to the CFED study, was an unequal distribution of tax liabilities. Although the top 1 percent of tax filers in 2003 received 45 percent of these asset subsidies, they paid only 23 percent of federal taxes. Clearly, households' ability to take advantage of federal asset-building benefits increases exponentially as they move up the income ladder.

An Asset-Building Scorecard

In 2005, CFED developed the Assets and Opportunity Scorecard to assess how well states support, promote and protect asset building while hindering asset-stripping activities.[14] The scorecard is based on the philosophy that states are not solely responsible for their residents' financial security but are essential to creating an environment that facilitates it.

The scorecard rates states as A through F overall and in five general areas: business development, education, financial security, health care and homeownership. The indicators include such components as residents' access to quality education, homeownership and health insurance; the prevalence of bankruptcies; and the state's support of entrepreneurship and encouragement of mainstream financial service providers to offer products to low- and moderate-income consumers.

States can improve their rankings by facilitating asset building, such as by eliminating asset limits that impede savings for enrollees of Medicaid; Section 8 housing; Special Supplemental Nutrition Program for Women, Infants and Children (commonly known as WIC); and other such programs. The scorecard also gives states points for supporting savings through individual development accounts (IDAs) and protecting their residents from alternative financial service providers whose products may strip assets, such as auto-title lenders, check cashers, payday lenders, rent-to-own stores and pawnshops.

RAISE Texas and Asset Building

Recognizing that a significant number of Texans are not financially secure or able to make ends meet, a number of state and local organizations teamed up to create what is now known as the Texas Asset Building Coalition (TABC).

A project of Houston-based Covenant Community Capital Corp., TABC is a network of financial institutions, local governments, Earned Income Tax Credit/Volunteer Income Tax Assistance (VITA) site tax coalitions, IDA program administrators, financial and homebuyer education practitioners, credit counselors and others dedicated to expanding asset-building opportunities for low-income Texans.

TABC's first campaign is RAISE Texas, which stands for Resources, Assets, Investments, Savings and Education. At the second annual RAISE Texas summit, cohosted at the Dallas Fed in November, practitioners strategized how to expand asset-building opportunities for low-income Texans in 2007. They concluded with a three-part plan: asset preparation, creation and facilitation.

- *Asset preparation* focuses on expanding financial education to elementary and middle school students, encouraging employers to provide financial education in the workplace and developing a comprehensive web site listing IDA programs, VITA sites, financial and homebuyer education classes, and related programs.
- *Asset creation* involves developing regional asset-building centers in urban and rural areas, researching best practices and lessons learned in existing asset-building programs, and creating sheltered savings accounts specifically designed for individuals who receive public benefits with attached asset limits. The accounts would shelter savings by allowing account holders to increase their savings without risking loss of benefits.
- *Asset facilitation* includes researching alternatives to payday and other emergency loans and expanding the coalition's reach by supporting public awareness campaigns that also target low-income communities.

Woody Widrow, TABC project director, says that the asset-building movement will be considered successful if access to financial education and asset-building products and services is expanded to all income levels and public policies are implemented to support this inclusive approach. The greater the number of financially resilient households, the fewer will depend on unsecured debt and public assistance for basic necessities. As more households are able to generate and enjoy intergenerational economic stability, the more likely they will increase their civic participation.

In the long run, the confluence of higher financial security and civic participation can lead to stronger and healthier communities.

How the Eleventh District Measures Up

Texas. In 2005, Texas was one of five states that scored an F overall on the Assets and Opportunity Scorecard because, CFED says, the state's policies on financial security, health care and homeownership are substandard. While Texas ranks first in home value among the 50 states and the District of Columbia, it is 42nd in households with savings accounts; 45th in households with zero net worth, private loans to small business, and homeownership rate; 48th in households' net worth, uninsured low-income parents, and Head Start cover-

age; 49th in employer-provided insurance; and 51st in uninsured low-income children. Despite its low rating, CFED concludes that relative to its peers, Texas' policies are generally favorable, but more are needed to help ensure residents' financial well-being.

Louisiana. Like Texas, Louisiana received a failing grade. While it scores seventh in home value, it is 42nd in household asset equality by gender; 43rd in foreclosure rate and academic degrees by income level; 44th in asset poverty by gender, households with savings accounts, and subprime mortgage loans; 45th in four years of college; 47th in employer-provided insurance, math and reading proficiency, and two years of college; 49th in homeownership by gender; and 50th in academic degrees by gender. Louisiana did, however, rank above average in providing opportunities for all residents trying to create and grow a business. It also performed well in the affordability of housing, which helped it rank ninth in distribution of homeownership across income levels.

New Mexico. New Mexico performed better than Texas and Louisiana but still earned a D on the scorecard. It was 41st in four years of college; 43rd in uninsured low-income children and households with savings accounts; 44th in asset poverty and private loans to small business; 47th in households with checking accounts and academic degrees by race (white vs. nonwhite); 49th in math and reading proficiency; 50th in net worth of households; and 51st in employer-provided insurance. CFED points to the state's funding of Head Start and workforce training as evidence that it has implemented some strong asset-building policies. While its homeownership rate ranks 30th in the country, it takes first place in homeownership by income, second place by race and fourth place by gender.

Addressing the Wealth Gap

In November 2006, San Francisco Fed President and CEO Janet Yellen

spoke about the rising tide of economic inequality and concluded that while "some market-determined income differences are needed to create incentives to work, invest, and take risks. . .there are signs that rising inequality is intensifying resistance to globalization, impairing social cohesion, and could, ultimately, undermine American democracy." Therefore, she said, it is "worthwhile for the U.S. to seriously consider taking the risk of making our economy more rewarding for more of the people."[15]

Her perspective is echoed across the nation, as there is growing discussion about how to reverse the decline in upward mobility. At the heart of this issue is preserving the hallmark of the American compact that hard work and education guarantee financial security.

Congress is considering the America Saving for Personal Investment, Retirement, and Education (ASPIRE) Act as one tool to help all children, and by extension their families, improve their potential for financial well-being. As proposed, the ASPIRE Act would create a Kids Investment and Development Savings (KIDS) account of $500 for every child born in 2007 and thereafter. Children in households that earn less than the national median income would be eligible for an additional contribution of up to $500.

The Senate version of this bill allows for a dollar-for-dollar matching contribution of up to $500; the House version would match up to $1,000. The match rates are indexed to median household income. Individuals' eligibility for public assistance would not be affected by these accounts.

KIDS account holders could make or accept after-tax contributions to their account every year. The Senate's ceiling is $1,000; the House's is $2,000. Every five years the amount of contributions allowed would be adjusted for inflation.

Account holders could not withdraw funds until they are 18. At that time, their accounts would fall under Roth IRA rules, which specify that in preretirement, funds can only be withdrawn without penalty for investments such as postsecondary education and purchase of a first home. When account holders turn 30, they would be required to start paying back the initial $500 contribution to help fund the next generation's KIDS accounts.

Working Toward Economic Inclusiveness

Like the GI Bill, KIDS accounts and IDAs are among the many tools that public and private institutions can tap into to promote asset building and help shore up the American Dream. Their ability to do so depends largely on how effectively the federal and state governments facili-

tate asset preservation, business development, homeownership, and quality education and health care.

The city of New York has just announced a new initiative designed to combat poverty. Its Center for Economic Opportunity will administer a $150 million fund of public and private money to help low-income people become self-sufficient and build assets. The new center will promote or offer tools such as IDAs, personal financial education, child care tax credits and cash incentives for people to get preventive health care or remain in school. This initiative is actively seeking out private investment, trying out tools that are new to the city and dedicating $5 million annually to measure progress.

Mayor Michael Bloomberg says that the city is taking this nontraditional approach because "conventional approaches. . .have kept us in this vicious cycle of too many people not being able to work themselves out of poverty even though they're doing everything that we've asked them to do."[16]

How will the public, private and nonprofit sectors throughout the U.S. allocate their resources now and in the future to address the increasing concentration of wealth, growing number of impoverished people and stubborn pockets of concentrated poverty? The answer to this question will be reflected in the financial security of future generations—from all demographic groups.

Notes

Additional resources on asset building are available from the Center on Budget and Policy Priorities at www.cbpp.org; Center for Responsible Lending, www.responsiblelending.org; www.assetbuilding.org, a project of the New America Foundation; and Urban Institute, www.urban.org. For more information on the Assets and Opportunity Scorecard, visit www.cfed.org.

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