Profitwise
News and Views

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Savings Account Usage by Low- and Moderate-Income People in the Chicago Metropolitan Area

FEDERAL RESERVE BANK OF CHICAGO

In Brief

Chicago Community Ventures Launches Community Development GIS Website

Chicago Community Ventures (CCV) has launched a new Geographic Information Systems (GIS) Website, Chicago Prospector.

Chicago Prospector is a market analysis tool and commercial real estate selection service that uses GIS technology. It provides in-depth demographic reports and business analyses for Chicago's Empowerment Zones, Enterprise Communities, Renewal Communities (EZ/EC/RC), and surrounding low-income areas.

Chicago Prospector is a free research tool for economic and community development organizations, real estate professionals, and business owners. Information is readily available on Chicago's EZ/EC/RC and low-income areas including population, ethnicity, household income, consumer expenditures, work force statistics, education attainment, plus much more—all at one comprehensive Website.

The Website also displays information on the incentives that are available for businesses located in the EZ/EC/RC as well as in Tax Increment Financing Zones.

Chicago Prospector was designed to be user-friendly displaying information on an interactive map. Users are able to select a specific neighborhood or choose a radius around a specific address to easily access the data in which they are most interested. CCV is providing this new service as another method to promote and support economic and community development in Chicago's low-income areas.

For more information, please call 773-822-0318. The Website can be accessed at www.chicagoprospector.org.

Profitwise
News and Views

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Around the District

Illinois

Illinois Approves Statewide Community Reinvestment Policy

Illinois Governor Rod Blagojevich signed the State Funds Reinvestment Act into law in July 2003, allowing Illinois State Treasurer to consider a bank's Community Reinvestment Act rating and other factors in order for banks to receive state deposits. The Act "serves the interest of Illinois taxpayers," said Marva Williams, Senior Vice President of the Woodstock Institute. "I believe [Illinois tax-payers] would agree that only those financial institutions that adequately meet the credit needs of the communities they serve, including low- and moderate-income areas, should receive state funds."

For information, visit http://www.woodstockinst.org/document/ilcrabill.html, or view the state legislation at www.legis.state.il.us/legislation/BillStatus.asp?DocNum=277&GAID=3&DocTypeID=HB&LegId=602&SessionID=3.

Indiana

Former Checking Account Customers Get Second Chance in Indiana

Five financial institutions in central Indiana will participate in Get Checking, a six-hour financial education course that gives a second chance to those who cannot obtain checking accounts due to account-related problems. In central Indiana, approximately 20 to 30 percent of those attempting to open checking accounts run into trouble, estimates Rebecca Haynes-Bordas, an educator at Purdue University's Marion County Extension Service and coordinator of Get Checking.

For information call the Purdue University Marion County Extension Service at 317-275-9305 or see the Summer 2000 edition of Profitwise at www.chicagofed.org/ publications/profitwise/2000/pwjune00.pdf.

Iowa

Iowa Values Fund Invests in Major Wells Fargo Expansion

The Iowa Values Fund Board (IVFB) recently approved a $10 million investment to aid expansion in the Des Moines area of the Wells Fargo Home and Consumer Finance Group. Project plans call for the preservation or creation of over 5,000 jobs. Capital investments in the project include an estimated $175 million in facilities and infrastructure investments over four years.

The $503 million IVFB was recently created to "expand and stimulate the Iowa economy, increase the wealth of Iowans, and increase the population of the state. Financial aid is structured to assist business start-ups, expansions, modernization, new company recruiting, and business retention. Projects must meet high-wage, high-skill and education requirements. Priority is given to businesses in the life sciences, advanced manufacturing, and information solutions. Retail business projects are not eligible."

For information visit www.iowasmartidea.com

Michigan

Compuware, EDS Bring Jobs to Downtown Detroit

Compuware and EDS Corporation recently announced plans to move nearly 6,000 jobs to Downtown Detroit from outlying suburbs. The city continues to push plans to create a downtown "neighborhood" of 2,000 new residential units and 50 new small businesses and retail anchors by 2006.

For information see Economic Revitalization in Detroit Enters New Phase at www.chicagofed.org/publications/profitwise/2003/pwwinter03.pdf.

Wisconsin

Southeast Wisconsin Developments Win Charles L. Edson Awards

Milwaukee's Hawley Ridge Apartments and Grafton's "The Berkshire" development were honored recently by the Affordable Housing Tax Credit Coalition, a national tax credit advocacy group of developers, lenders, nonprofit groups, public agencies and others involved in affordable housing tax credits. The awards are to be used to bring additional services, facilities, or amenities into the project to benefit tenants.

For information visit: www.taxcreditcoalition.org/awards/awards2003/winners.asp. For more information on these and other Low-Income Housing Tax Credit developments in Wisconsin, visit the Wisconsin Housing and Economic Development Authority Website at http://www.wheda.com.

Introduction

Holding a savings vehicle with mainstream financial institutions carries several benefits including asset building opportunities, secure storage of income, a cushion against unforeseen financial events, and the ability to establish or maintain a positive credit history. To better understand the demand for savings products among low- and moderate-income (LMI) people, the Federal Reserve Bank of Chicago sponsored a series of savings behavior questions in the 2001-2002 Metro Chicago Information Center's annual household survey[1]. Our findings offer evidence that lower-resource consumers accumulate savings, identify specific savings goals, and add to their savings on a regular basis. As such, they demonstrate demand for savings products. We also observe that relative to moderate-income respondents, the lowest-income respondents are less likely to hold savings accounts and to identify a savings goal.

By Robin Newberger

Savings Account Usage by Low- and Moderate-Income People in the Chicago Metropolitan Area

Table 1: Savings Goals

	LMI		NON-LMI	
	N	Percent	N	Percent
Any savings motivation	541	63.6	1817	83.1
No savings motivation	309	36.4	369	16.9
Set money aside in the past year for:				
Education	144	16.9	692	31.7
Furniture or household appliances	189	22.2	657	30.1
Buy/improve home	121	14.2	629	28.8
Buy a car	116	13.6	437	20.0
Start or expand business	27	3.2	120	5.5
Retirement	183	21.5	1201	54.9
Unexpected expenses	271	31.9	1063	48.6
To feel more financially secure	296	34.8	1305	59.7
Observations	**850**		**2186**	

	Low-Income		Moderate-Income	
	N	Percent	N	Percent
Any savings motivation	215	54.7	326	71.3
No savings motivation	178	45.3	131	28.7
Observations	**393**		**457**	

Note: Multiple responses possible for all queries

Table 2: Money Held in Savings

	Whole		LMI		Non-LMI	
	N	Percent	N	Percent	N	Percent
Bank/ Savings and Loan						
Save less than $1000	355	22.9	134	36.1	221	18.8
Save $1000 to less than $5000	372	24.0	93	25.1	279	23.7
Save $5000 to $10,000	349	22.5	66	17.8	283	24.0
Save over $10,000	473	30.5	78	21.0	395	33.5
Total	**1549**		**371**		**1178**	
Credit union						
Save less than $1000	213	45.5	64	62.1	149	40.8
Save $1000 to less than $5000	123	26.3	22	21.4	101	27.7
Save $5000 to $10,000	74	15.8	2	11.7	62	17.0
Save over $10,000	58	12.4	5	4.9	53	14.5
Total	**468**		**103**		**365**	
Bank/Savings and Loan or Credit Union						
Save less than $1000	568	28.2	198	41.8	370	24.0
Save $1000 to less than $5000	495	24.5	115	24.3	380	24.6
Save $5000 to $10,000	423	21.0	78	16.5	345	22.4
Save over $10,000	531	26.3	83	17.5	448	29.0
Total who reported on saving amt	2017	66.4	474		1543	
Total sample	3036		850	34.0	2186	51.4
People who reported a savings vehicle	2636	76.5	644	73.6	1992	77.5

Savings Account Ownership

Perhaps the most important finding from the survey is that three-quarters of low- and moderate-income respondents kept their savings in either a formal or informal savings vehicle. By comparison, 90 percent of middle- and upper-income respondents, "non-LMI" individuals, reported the use of a savings vehicle. Consistent with other studies, we find that people of modest means do save.[2]

The most common savings vehicle for both the LMI and non-LMI respondents comes from the formal sector in the form of savings or money market accounts.[3] About 60 percent of the LMI sample held a savings or money market account. Almost 30 percent of the LMI respondents had a 401(k) or other investments, and close to 22 percent possessed an IRA account. Fourteen percent of LMI respondents saved in an informal instrument, a category comprised of extra-institutional and "other person-held" instruments.[4] The preponderance of respondents who saved through informal mechanisms did so in combination with formal vehicles.

Relationships with financial institutions tended to start at an early age. Almost half of the LMI respondents and over 70 percent of the non-LMI respondents opened their savings accounts before they were 18 years old. Moderate-income respondents were more likely than low-income respondents to open accounts before they were 18. Few respondents from any income group opened their savings accounts after age 45. For respondents who did not open their checking and savings accounts at the same time (but had both), we find that savings accounts were most likely to be opened first. In contrast, the largest proportion of respondents who owned a checking but not savings account opened their checking accounts after the age of 18. This suggests that obtaining a savings account may be an important first step for individuals interested in establishing a relationship with mainstream financial institutions.

Table 3: Money Held in Savings by Age Group

	Age 61+ N	Age 61+ Percent	Age 45-60 N	Age 45-60 Percent	Age 30-44 N	Age 30-44 Percent	Age below 3 N	Age below 3 Percent
Save less than $1000	51	16.3	157	25.9	208	29.0	152	39.9
Save $1000 to less than $5000	66	21.2	145	23.9	183	25.5	101	26.5
Save $5000 to $10,000	73	23.4	119	19.6	160	22.3	71	18.6
Save over $10,000	122	39.1	185	30.5	167	23.3	57	15.0
Total	**312**		**606**		**718**		**381**	
LMI								
Bank and Credit Union								
Save less than $1000	34	22.1	60	53.1	49	47.6	58	54.2
Save $1000 to less than $5000	37	24.0	22	19.5	29	28.2	27	25.2
Save $5000 to $10,000	29	18.8	14	12.4	19	18.4	16	15.0
Save over $10,000	54	35.1	17	15.0	6	5.8	6	5.6
Total	**154**		**113**		**103**		**107**	
Non-LMI								
Bank and Credit Union								
Save less than $1000	17	10.8	97	19.7	162	26.2	60	49.6
Save $1000 to less than $5000	29	18.4	123	24.9	154	24.9	30	24.8
Save $5000 to $10,000	44	27.8	105	21.3	141	22.8	21	17.4
Save over $10,000	68	43.0	168	34.1	161	26.1	10	8.3
Total	**158**		**493**		**618**		**121**	

Identification of Savings Goals

Another indicator of savings activity among LMI respondents is their identification of diverse savings goals. As reported in Table 1, nearly 64 percent of LMI respondents and 83 percent of non-LMI respondents reported putting money aside in the past year for a particular motivation or goal. The most common savings goal reported for both groups (respondents were not asked to rank their goals) was to feel more financially secure. The second most popular motive for the LMI sample was saving for unexpected expenses. Retirement and saving for appliances/ furniture were tied for third. Among the non-LMI sample, the second most popular goal was saving for retirement and the third was unexpected expenses. Forty-five percent of the lowest- income respondents within the LMI group listed no motive, compared to 30 percent of moderate-income respondents.

Money Held in Savings

The survey also attempted to gather information about the amount of money held in savings accounts. Seventy-seven percent of the respondents who reported having a savings vehicle provided information about the amount in their savings accounts. (The survey did not ask about dollar amounts held in other savings vehicles). Table 2 shows the amounts held by the LMI and non-LMI groups. As expected, a greater proportion of the non-LMI sample reported higher levels of savings. About 34 percent of the LMI sample held over $5,000 in a savings account compared to 51 percent of the non-LMI sample. Importantly, however, respondents in the LMI sample reported having accumulated savings. Nearly 60 percent of the LMI sample held $1,000 or more in their savings accounts at banks[5] or credit unions. Thirty-four percent held over $5,000 in savings and 17 percent held over $10,000 in savings. Savings levels at banks tended to be higher than those at credit unions for both LMI and non-LMI respondents.

Observing the amount saved by age category, we see that half of low- and moderate-income respondents with household savings over $5,000 were more than 60 years old (Table 3). Almost two-thirds of the LMI respondents with household savings above $10,000 were also more than 60

Table 4: What is the Most Important Factor in Deciding Where to Open a Savings Account

	Whole		LMI		Non-LMI	
	N	Percent	N	Percent	N	Percent
Safety and Security	310	14.1	77	15.7	233	13.6
Earning Interest	270	12.3	55	11.2	215	12.6
Easy Access to Withdraw Money	196	8.9	35	7.1	161	9.4
To Encourage Savings	141	6.4	40	8.1	101	5.9
Low Fees/Minimum Balance	130	5.9	24	4.9	106	6.2
Convenience	893	40.6	188	38.2	705	41.3
All of the above	9	0.4	3	0.6	6	0.4
History with Institution	105	4.8	23	4.7	82	4.8
Credit union member	6	0.3	4	0.8	2	0.1
Customer service	38	1.7	7	1.4	31	1.8
Selection of services available	15	0.7	4	0.8	11	0.6
Observations who respond	2113	96.0	460	1653		
Observations who report savings	2201	492	93.5	1709	96.7	

years old. Among the lowest income respondents, more than 80 percent with household savings above $10,000 were more than 60 years old. At the other extreme, nearly 30 percent of LMI respondents with household savings of $1,000 or lower were under 30 years old. We also see a relatively high percentage of 45 to 60 year-old LMI respondents with household savings at $1,000 or lower—similar to the under age 30 cohort. In addition, we find a marked drop-off in the proportion of household savings above $10,000 for those 60+ years of age and the 45 to 60 age group.

Frequency of Saving

The majority of LMI respondents with savings accounts saved regularly, at least once a month, either in their savings accounts or in another savings instrument. Nearly half of the lowest-income respondents also saved at least once a month. Thirteen percent of LMI respondents with savings accounts reported they had not saved at all in the past twelve months. Of those LMI respondents who had not saved at all, 42 percent were over 60 years old, about 30 percent were between 45 and 60 years old, 21 percent were 30 to 44, and 7 percent were under 30 years old.

Preferred Features of Savings Accounts

To get a better understanding of what consumers want from a savings account, the survey asked: (1) what is the most important factor in deciding where to open a savings account, and (2) what an institution could do to provide a better way to keep money in a savings account. The first question was asked only of respondents who already had savings accounts. As shown in Table 4, the LMI and non-LMI respondents gave very similar answers. About 40 percent of both groups cited convenience as the most important factor. Next in importance was safety and security, followed by earning interest. The only significantly different response between the two groups was "to encourage savings," which was more frequently cited by the LMI group as the most important factor. Both low- and moderate-income respondents demonstrated little sensitivity to the costs associated with having a savings account and were even less likely to choose this factor than their non-LMI counterparts.

The second question, "What an institution could do to provide a better way to keep money in a savings account" was asked of the entire sample. Respondents were allowed to give multiple responses to this question. The most common recommendation given by LMI respondents was to do "nothing" (Table 5). The second most frequent answer was to improve the rate of interest offered, followed by the recommendation to lower the costs of the account. In comparing the LMI to the non-LMI respondents, we find that a significantly greater proportion of non-LMI respondents would like financial institutions to pay higher interest, while

Table 5: What Could an Institution Do to Provide a Better Way to Keep Money in Savings Account?

	Whole Sample		LMI		Non-LMI	
	N	Percent	N	Percent	N	Percent
Nothing	854	28.1	283	33.3	571	26.1
Easier to deposit money	41	1.4	15	1.8	26	1.2
Accept lower dollar value deposits	28	0.9	11	1.3	17	0.8
Easier withdrawals	37	1.2	11	1.3	26	1.2
Raise number free withdrawals	23	0.8	9	1.1	14	0.6
Lower minimum balance/fees	193	6.4	65	7.6	128	5.9
Better hours	89	2.9	22	2.6	67	3.1
Operate in other language	6	0.2	2	0.2	4	0.2
Interest paid	959	31.6	192	22.6	767	35.1
Improve accessibility	38	1.3	13	1.5	25	1.1
Financial counseling	23	0.8	10	1.2	13	0.6
Improve service	82	2.7	26	3.1	56	2.6
	2373		659		1714	
Observations	**3036**		**850**		**2186**	

a significantly higher proportion of LMI respondents desired institutions to lower minimum balance requirements and fees. Not surprisingly, the non-LMI sample focused more on the return for their money, whereas the LMI sample were more concerned about fees and other charges. Comparing the popularity of answers within the LMI group, however, we see that a much higher number of LMI respondents cared about interest rates rather than fees. The same was true for the lowest-income respondents.

Responses to other questions in the survey relating to personal financial management skills show that few people had trouble managing their savings accounts. Ten percent of the LMI group and 5 percent of non-LMI respondents with savings accounts reported difficulty in managing this type of account (Table 6). For the few who reported a difficulty, the overwhelming response among the LMI group was "maintaining a minimum balance"—a difficulty that is likely driven by liquidity constraints and a sensitivity to fees and other charges.

Respondents Without a Savings Account

Thirty-eight percent of the LMI sample and 16 percent of the non-LMI sample did not have a savings account. Nearly a quarter of LMI respondents and 9 percent of non-LMI respondents reported no savings vehicle whatsoever, formal or informal. Of the LMI respondents without a savings account, about half did not own a checking account either. LMI respondents without a savings account tended to be younger, have fewer years of education, a higher rate of employment, lower incomes, and be members of a minority group compared to their LMI counterparts with a savings account. LMI respondents who were under 60 years old and did not have a savings account also tended to have fewer years of education, lower incomes and were more likely members of a minority group, but they were less likely to be employed.

When LMI respondents without savings accounts were asked to answer why they did not have a savings account, sensitivity to the issue of fees and charges became more apparent. The majority of LMI respondents cited costs as their main reason for not having a savings account (Table 7). More than four times the number of LMI respondents answered "costs" than the next most-cited reason, "did not need or want one." The lowest-income respondents were more likely to give costs as a reason relative to moderate-income respondents. Compared to the non-LMI respondents, a significantly higher proportion of the LMI sample also gave costs as a reason for not having an account. A significantly lower proportion of the LMI sample explained their decision not to hold a savings account in terms of their money being placed into other investments or that the interest rate on savings accounts was not competitive.

Access to Financial Services

Thirteen percent of the LMI sample gave “failing” or “needs to improve” ratings to the question of access to financial services (Table 8). Of these, 65 percent did not have a savings account, 45 percent did not have any savings instrument, and 36 percent were unbanked. Additional investigation into the underpinnings for these responses could further our understanding of consumers’ perceptions about access to financial services.

Conclusion

The ages of low- and moderate-income respondents ranged from teenagers to nonagenarians, and our findings about how much and how often LMI people save, as well as their opinions about savings accounts, clearly have different implications across this wide age spectrum. We might expect that many of the under-30-year-olds will cross over to the “non-LMI” category as they advance to the next life cycle stage. In the meantime, their relatively high educational attainment (they were more likely to have a college degree relative to LMI respondents over 30 years old) and the relative frequency at which they added to savings suggest many financial marketing opportunities over this cohort’s life-cycle. In contrast, LMI respondents between the ages of 45 and 60 were less likely than any other LMI age cohort to report a savings motivation. They also reported particularly low levels of saving in their savings accounts and they were not more likely than their younger counterparts to hold other instruments besides savings accounts. These respondents would most likely benefit from a targeted financial education outreach program.

Age considerations notwithstanding, having comparatively fewer resources seemed to matter most for the lowest-income respondents in the LMI group. The lowest-income respondents were less likely to hold a savings account or to report a savings goal relative to moderate-income respondents. Almost half of this segment was between 30 and 60 years old. For the lowest-income respondents without savings accounts, they were more likely than moderate-income respondents to report costs as a factor in why they did not own one. Our findings suggest that the majority of low- and moderate-income people in the Chicago area actively save through financial institutions, and they are satisfied with the services provided with their savings accounts. Other LMI consumers, particularly the most financially vulnerable, might have an interest in lower-cost savings products, financial education that helps consumers identify savings goals, and outreach that begins at an earlier age.

Table 6: Personal Financial Management

If have savings account, have had any difficulty managing savings account?

	LMI		Non-LMI	
	N	Percent	N	Percent
	50	10.2	92	5.4
Observations	**492**		**1709**	
If Yes, what one aspect do you find most difficult?				
None	4	8.0	4	4.3
Knowing the rules of the account	2	4.0	2	2.2
Understanding account statements	0	0.0	3	3.3
Maintaining a minimum balance	40	80.0	68	73.9
Converting my savings to cash when needed	4	8.0	9	9.8
Keeping track of cash withdrawals, general management	0	0.0	2	2.2
Finding savings account with high interest rates	0	0.0	2	2.2
	50		90	
Observations	**50**		**92**	

Table 7: Reasons for Not Holding a Savings Account

	LMI		Non-LMI	
	N	Percent	N	Percent
Credit history bad	4	1.2	3	0.8
Banks turned me down	4	1.2	7	1.8
Costs	194	59.5	134	35.4
Lack of trust/confidentiality	8	2.5	14	3.7
Inconvenient hours or location	2	0.6	2	0.5
Staff does not speak my language	1	0.3	0	0.0
Don't know how	11	3.4	9	2.4
Money in investments	24	7.4	78	20.6
Prefer checking account	17	5.2	29	7.7
Low return	13	4.0	47	12.4
Don't need or want one	43	13.2	55	14.5
Legal reasons	3	0.9	1	0.3
In process of getting one	2	0.6	0	0.0
	326		379	
Observations	**326**		**379**	

	Low Income		Moderate Income	
	N	Percent	N	Percent
Credit history bad	2	1.0	2	1.5
Banks turned me down	2	1.0	2	1.5
Costs	126	65.3	68	51.1
Lack of trust/confidentiality	5	2.6	3	2.3
Inconvenient hours or location	2	1.0	0	0.0
Staff does not speak my language	1	0.5	0	0.0
Don't know how	5	2.6	6	4.5
Money in investments	8	4.1	16	12.0
Prefer checking account	8	4.1	9	6.8
Low return	6	3.1	7	5.3
Don't need or want one	25	13.0	18	13.5
Legal reasons	2	1.0	1	0.8
In process of getting one	1	0.5	1	0.8
	193		133	
Observations	**193**		**133**	

Table 8: Access to Financial Services

	LMI		Non-LMI	
	N	Percent	N	Percent
Good Access	524	61.6	1686	77.1
OK Access	174	20.5	324	14.8
Bad Access	112	13.2	114	5.2
Don't know	40	4.7	62	2.8
	850		2186	
Observations	**850**		**2186**	

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These views are those of the author and do not necessarily reflect the opinions of the Federal Reserve Bank of Chicago or the Federal Reserve System.

Notes

1 Metro Chicago Information Center is a nonprofit research organization located in Chicago, IL (www.mcic.org). The majority of the survey data was collected in a telephone survey of households selected through a random-digit-dialing sampling technique. Face-to-face surveys also were conducted to include information in the sample from households without telephones. Interviews were given in Spanish to accommodate Spanish-speaking respondents.

2 See Dunham, Constance R., "The Role of Banks and Nonbanks in Serving Low- and Moderate-Income Communities," Changing Financial Markets and Community Development: A Federal Reserve System Research Conference held in Washington, DC, April 5-6, 2001; Kennickell, Arthur B., Martha Starr-McCluer, and Brian J. Surette," Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances," Federal Reserve Bulletin, January 2000, pp. 1-29; and Hogarth, Jeanne and Jinkook Lee, "Use of Financial Services and the Poor, Working Paper 00-13, Center for Social Development, Washington University in St. Louis, 2000.

3 Our definition of formal vehicles covers savings or money market accounts (hereafter referred to as a savings account), CDs, IRAs, savings bonds, and 401(k)s/other investment instruments. The survey treated 401(k)/stocks/bonds as a single category.

4 This category includes cash/jewelry/gold, uncashed checks, another person's bank account, savings circles, gifts/loans to other people, and other valuables.

5 "Banks" includes savings and loan companies.

A Discussion and Display of Innovations: The Second Annual Illinois Asset-Building Conference

By Harry Pestine

The Second Annual Illinois Asset-Building Conference sponsored by the Federal Reserve Bank of Chicago and the Sargent Shriver National Center on Poverty Law (NCPL) was held on September 25 and 26, 2003.

Approximately 100 individuals from various financial institutions, non-profit organizations, community groups, local and state policymakers, and institutions of higher learning attended the conference. Dory Rand, supervising attorney for community investment at Chicago-based NCPL, and coordinator of the statewide Financial Links for Low-Income People coalition, moderated the conference.

Panel Presentations and Brainstorming Sessions

The conference included four panel discussions and twelve brainstorming sessions. The overarching topics that guided the conference were:

- How do low-income people save, build assets, and benefit from financial education?
- Should we incorporate financial education into public school curricula?
- Are there State of Illinois asset policy initiatives that should be pursued?
- What are some of the private sector asset-building innovations that are working?

The panel presentations provided an opportunity for experts and professionals to share information about on-going research, asset-building strategies for low-income individuals, and successful asset-building/financial education programs. The presentations also provided ideas for the brainstorming sessions that followed. The panelists presented data on: "the assets and savings of lower-income people:" success of adult financial education programs and Individual Development Account (IDA) programs and available K-12 curricula. Data also included the needs and strategies for incorporating financial education into school curriculums successful policy initiatives and initiatives worth pursuing and model programs in Cleveland, Milwaukee, and Chicago.

Panelists and attendees used this information in the brainstorming sessions and produced the following "top" policy/program recommendations:

- Provide greater access to asset-building programs for low-income people through inclusion of more agencies, more populations, higher asset limits, and more funding.
- Mandate financial education for adults who are on any form of public assistance and for K-12 students.
- Involve financial institutions in schools as providers and sponsors of financial education programs.
- Strengthen and enforce state and federal regulations of traditional and "fringe" (e.g., payday lenders) financial institutions.
- Provide tax incentives for corporations, banks, and employers to build, market services, and provide jobs in underserved areas (urban and rural) and low-income areas.
- Create a more equitable tax code.
- Complete longitudinal studies (with control groups) on the effects of IDA and financial education programs on low-income individuals.
- Perform comprehensive research on the financial habits, practices, and needs of a variety of cultural groups and physically challenged groups.
- Study mandatory financial institutions in schools and its impact, if any, on students.
- Create a formal communication and service network among agencies that serve low-income individuals.

SEED Initiative

Carl Rist, program director for the Corporation for Enterprise Development (CFED), gave a presentation on CFED's new initiative, the Savings for Education, Entrepreneurship and Downpayment (SEED) Policy and Practice Initiative. This initiative was designed to assist young children in saving for their future and as means to address child poverty. The question guiding SEED is, "What difference would it make if every child in America grew up knowing that she/he had a nest egg to use to go to college, start a business, or buy a home?"

Rist advocated that it would make a significant difference. This is why CFED has partnered with 10 organizations around the United States to set up SEED accounts. SEED accounts are long-term savings and investment accounts for children ages 0-18 to be used at a future date to attend college, start a business, or buy a home. CFED and other cooperating financial institutions provide the funds for these accounts. Each partner organization has a specific age group and has established the guidelines for their SEED participants.

In Chicago, NCPL has been chosen as one of the 10 CFED partner organizations. NCPL, in coordination with Bronzeville's Mayo Elementary and Bank One, has begun the process of establishing SEED accounts for 50 children in grades K-4 at Mayo Elementary. For more information about the SEED program go to www.cfed.org or www.povertylaw.org.

Chicago Fed Research on the Assets and Savings of Low-Income People

Robin Newberger, a research analyst with the Consumer Issues Research unit at the Federal Reserve Bank of Chicago, discussed research on the financial practices and asset accumulation of low-income people as compared to those with moderate incomes. Newberger's three main findings were: 1) the majority of low- and moderate-income people have positive levels of wealth, 2) asset ownership differs substantially between low-income and moderate-income respondents, and 3) there is considerable variability among low-income respondents in terms of asset ownership and dollars of assets held. See Newberger page 2.

Model Programs: Cleveland, Milwaukee, and Chicago

The final presenters of the conference included George Barany, executive director at WECO Fund, Inc. and director of financial education of Consumer Federation of America (CFA), James Maloney, chairman of Mitchell Bank (Milwaukee, Wisconsin), and Allen Rodriguez, vice president and director of community development, Illinois division, of Charter One Bank. Each presented a viable model program.

Barany shared information about Cleveland Saves/America Saves, a nationwide social marketing campaign that utilizes a broad coalition of nonprofit, corporate, and government groups to encourage individuals to save. The WECO Fund, Inc. and CFA provide materials and/or facilitators to members of the coalition as well as any other interested parties to do motivational presentations on how to save. In addition, Cleveland Saves/America Saves has special events to encourage people to save. Currently, efforts are under way in Illinois to implement this program. If you would like more information about Cleveland Saves/America Saves, please go to www.americasaves.org. To learn more about Illinois Saves, please contact Steve Wrone at stevewrone@povertylaw.org.

Maloney provided evidence that financial institutions should seek to serve their local Hispanic population. First and foremost, the Hispanic population is quickly becoming the "greatest potential source of new customers." Banks that serve Hispanics effectively grow a loyal customer base with little additional effort. Mitchell Bank opened Cardinal Bank, a full service branch at the local high school where 70% of the student body is Hispanic, in part to address negative perceptions of banks recent immigrants sometimes hold. The school provides a familiar environment to encourage families to enter the bank and take advantage of its services. This bank has not only provided services to the parents of students, but it has also provided many opportunities for the students to learn and take on new responsibilities. For more information about Cardinal Bank at Milwaukee's South Division High School go to www.mitchellbank.com/c_cardinal.htm.

Rodriguez described Charter One's services, and specifically how the bank's free checking can help low-income customers. What Charter One Bank provides free is key to helping those who are currently unbanked to get banked. For more information regarding the services offered by Charter One Bank go to www.charterone.com.

The recommendations collected at the conference will be used to create a 2004 agenda for the Financial Links for Low-Income People coalition as well as to guide ongoing asset-building policy activities. For a full report on conference proceedings and recommendations, please contact Heidi Weber at heidiweber@povertylaw.org.

Harry Pestine *is the community affairs program director for the State of Illinois, in the Consumer and Community Affairs division of the Federal Reserve Bank of Chicago. Mr. Pestine is a specialist on economic development issues, including bank compliance and the Community Reinvestment Act. He is also the economic development editor for Profitwise News and Views. Prior to joining the Federal Reserve Bank, Mr. Pestine was with the Governor's office of economic development in Illinois for 12 years. He has coordinated financial and technical assistance programs for small businesses throughout the State of Illinois, as well as managed or comanaged small and major retention, expansion, reindustrialization and recommercialization projects. Mr. Pestine has been an instructor at the Neighborhood Reinvestment Institute and the National Small Stores Institute. He was also an alternate-voting member on the board of the Illinois Development Finance Authority.*

Beyond Financial Education: Changing Financial Behavior

A Portfolio of Applied Research Projects

By Michelle Coussens

This article is one in a series of PNV articles regarding a portfolio of applied research projects pertaining to financial training. The ultimate goal of these projects is to develop an approach to financial education that will better inform consumers and lead to measurable changes in personal and household financial management. The research portfolio's focus is on designing new approaches that move beyond traditional financial literacy training, drawing on the fields of cognitive psychology, anthropology and behavioral economics. This article provides background on the financial literacy field, along with a discussion of the role of expanded knowledge in changing behavior.

Study Overview

The Federal Reserve Bank of Chicago has an interest in educating consumers in the area of financial literacy as part of its overall commitment to the nation's economic welfare: "Recognizing the importance of educated and informed consumers to the operation of efficient markets, the Federal Reserve has been an active provider of economic literacy materials to help students and the public better understand the U.S. economy and the role of the Federal Reserve. Each of the twelve Federal Reserve Banks supports this objective through a wide variety of education partnerships, publications, learning tools, and student challenge contests."[1]

While historical and current financial literacy programs predominantly emphasize informing consumers, this article introduces the reader to a study underway to develop and demonstrate a successful, cost-effective financial education program to influence financial behavior.

Background: Why is Improving Household Financial Behavior Important?

Improving household financial behavior benefits both the consumer and the financial system at large. The consumer benefits in many ways. The most significant benefits are: reduced likelihood of falling victim to predatory lending or credit-related fraud; a better understanding and awareness of options in the marketplace for financial services; decrease in credit risk and/or unintended investment risk; lower vulnerability to economic shocks such as unexpected job loss; and improved planning and balance between current expenditures and future financial needs.

Financial institutions and the financial system at large also benefit. Desired effects include: improved efficiency of market operations and competitive forces; decrease in bankruptcies, defaults, and their effects; and increase in investments for future economic development.

Financial Trends in American Households

A 2000 report by the Woodstock Institute states, "financial knowledge has become not just a convenience but an essential survival tool."[2] Recent trends impacting the financial decision-making of American households have been a mixed blessing. While we have greater opportunity to influence our current and future financial status, we also have incurred significantly more direct responsibility for our financial well-being in an increasingly complex world. Some of the trends significantly influencing financial attitudes and decisions include:

- **Financial product innovation and marketing:** Increased marketing and use of both new and existing products has allowed financial institutions to better address individual customer needs, but it has also allowed for increased manipulation of consumers. Credit card options have proliferated and even households previously lacking access to credit (including college students) receive frequent credit card offers.

- **Technological advances:** The Internet and other advances have allowed information, marketing, and tools to increase in speed, sophistication, and availability. Consumers reap the benefits of increased awareness, access, and efficiency, but can also suffer from information overload and the lack of effective tools to discern competitive offers from others.
- **Consolidation and restructuring of the financial services industry:** Financial entities continue to consolidate both within their own organizations and via mergers and acquisitions with other financial organizations. Lines between banks and non-banks have blurred, as insurers, securities firms, and other new entrants have begun to compete for customers and to create new and hybrid financial products.
- **Changes in retirement and, pension plans:** Clark and d'Ambrosio's 2002 paper, "Financial Education and Retirement Savings" points out, "In the twenty-first century, American workers will be required to assume greater responsibility for determining their retirement income. Many workers will have to decide whether to participate in a company pension plan, how much to contribute, and how to invest these funds."[3] Potential changes in Social Security retirement benefits will also impact consumers.
- **Shifts in consumer attitudes:** Society has become less concerned with saving for the future and more concerned with immediate satisfaction. The "live for today" mentality is increasingly permeating society. In an *Employee Benefits News* article, Kathy McNally, vice president for financial literacy at the National Foundation for Credit Counseling suggests that, "We truly are an instant gratification nation, where people have stopped differentiating between wants and needs."[4] Goods and services traditionally considered to be luxuries have become necessities. Living within our means is being redefined away from use of liquid assets to use of all available sources of assets and credit.

Why Current Approaches to Financial Education May Be Inadequate

The trends in Figure 1 indicate that current approaches to financial literacy training may be inadequate. Federal Reserve Board Vice Chairman Ferguson has remarked, "We certainly expect that economic and financial literacy can keep people from making uninformed decisions. But, it cannot keep them from making bad decisions. Additionally, education will not always overcome circumstances… Also, education will not overcome human nature. Procrastination, for example, can heavily affect financial outcomes, and education may not overcome the tendency to put off financial changes… For example: in a study of defined contribution plans by James Choi and others, one-third of self-reported undersavers said they intended to increase their savings rate in the next few months, but almost none actually made a change in their 401(k) savings rate. This finding amply demonstrates the value of bringing a variety of disciplines to bear in creating effective programs."[6]

Figure 1: Reasons for Potential Concern: Some Telling Statistics[5]

- In 2001, the percentage of income used for household debt payments rose to the highest level in more than a decade and remained at 14 percent in 2002.
- Consumer bankruptcies in 2001 increased 19 percent over those in the previous year, exceeding the previous high reached in 1998.
- Personal savings as a percentage of Gross Domestic Product decreased from 7.5 percent in the early 1980s to 2.4 percent in 2002.
- Home foreclosures in 2002 reached the highest rate in 30 years.
- 45 percent of college students have credit card debt, with the average debt of $3,066.

This portfolio of applied research projects targets an unusual population in the realm of financial education initiatives. It focuses on moderate- to high-income individuals, who are well-educated (perhaps overall, but certainly in regards to household financial management), who are not financially disadvantaged/victimized, and who, through their own behavior, not only fail to take advantage of that knowledge for their present and future financial well-being, but risk financial disaster. Such behavior includes "burning"[7] money by using revolving credit card balances; using payday loans; and regularly using ATMs that require fees. This behavior also includes passive financial mismanagement, such as inadequate saving for retirement and the failure to shop carefully for significant loans or other financial products.

Project Portfolio

Drs. Suzanne Fogel and Nina Diamond of DePaul University, along with Federal Reserve Bank of Chicago staff members have begun a portfolio of projects that individually and collectively seek to improve long-term consumer financial behavior, particularly for those who have financial information and resources, but are not currently using them effectively.

Project Descriptions

Qualitative Research

1 Review of Representative Financial Literacy Programs: The goal of this project, which is in progress, is to inventory representative financial training programs, summarize and contrast program characteristics, and to identify the theoretical assumptions underlying their design. In addition, it will highlight input received from program leaders regarding program effectiveness based on both perception and measurement (when available).

2 Behavioral Economics and Cultural Analysis: The goal of this project is to examine household financial management practices and the culturally agreed upon meanings that guide those practices and relate these practices to current economic and psychological theory to derive implications for design and development of effective financial literacy programs.

Field Study

3 Individual/organization interviews, focus groups, written surveys and ethnographic research will be employed to understand how people actually go about making their daily financial decisions.

Creation and Execution of Pilot Training Program

4 Based on the lessons learned in the projects above, the researchers hope to design and pilot a financial education program. Such a program would focus on consumers with adequate financial means and educational attainment to allow them to operate effectively in the financial sphere, but who are having problems doing so. The pilot program would be rigorously evaluated to determine whether it was more effective than traditional financial literacy programs in changing behavior.

What's At Stake

Statistics quantifying the impact of counterproductive financial decisions are not readily available, nor are they easily derived. One could estimate the relative magnitude of such impact by considering Year 2000 Census household projections and debt and payment indications from the 2001 Survey of Consumer Finances, and then calculate estimates of dollars wasted ("burned") per household.[8] Conservative assumptions show that financially educated households may still be collectively wasting at least $1 billion per year. Other estimates suggest that the amount could be as high as $12 billion. Such waste would certainly contribute to inefficiency in our financial system, adversely impacting our economy. Financial literacy initiatives must continue and improve. While financial education informs, it does not necessarily ensure changed behavior. It may be an insufficient means to achieving the end result desired. This portfolio of projects aims to draw on research in cognitive psychology/anthropology and economics, as well as the best practices in the financial literacy and self-help fields to identify practical, cost-effective ways to improve making financial decisions that will benefit both the individual consumer and the overall economy.

Year 2003 Projections

Maximum	Minimum	Maximum
Projected # U.S. Households	108,539,122	108,539,122
% Population Constrained*	1.3%	15.5%
Corresponding # Constrained	1,411,009	16,823,564
Average Dollars "Burned" per Hhold**	$753	$753
Total Dollars "Burned"	$1,062,489,465	12,668,143,624

*As defined by the year 2000 potential size of target population (see side table on the potential target size), projected to 2003.

**Extracted from Glaeser, Edward L. and Anna L. Paulson. A reconsideration of the (in) sensitivity of tests of the intertemporal allocation of consumption to near rational alteratives. Journal of Economic Dynamics and Control 21 (1997) 1173-1180. $100/quarter in 1983 dollars estimated in year 2003 dollars.

Appendix A: Some Estimates of the Potential Target Size[9]

Yr 2000 Households	% Households	
14,525,637	14%	Those making at least $40,000, between ages 25 and 34, with at least a high school education, who hold credit card balances.
2,075,091	2%	Those making at least $40,000, between ages 25 and 34, with at least a high school education, with debt payment to family income ratios greater than 40%.
1,482,208	1%	Those making at least $40,000, between ages 25 and 34, with at least a high school education, with any payment past due 60 days or more.

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Ferguson, Roger W., Jr. Reflections on Financial Literacy, National Mortgage News, 6/10/02, p.4

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108th Congress, 1st Session. Senate Resolution 48, designating April 2003 as "Financial Literacy for Youth Month," 02/05/03

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U.S. Census (2000), www.census.gov

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Unless otherwise referenced, the views presented in this paper are those of the author alone, and they do not necessarily reflect the views of the Federal Reserve Bank of Chicago, the Federal Reserve System, or its staff. The author wishes to thank Anna Paulson and Ed Green at the Chicago Fed for their advisement, and Susan Parren for her research assistance. The author also thanks a number of academics and practitioners for their comments on the project outline associated with this article: James Choi, Joan Henderson, Jeanne Hogarth, Virginia Hopley, Gerri Kozlowski, Dave Leeney, John Pattison, Rae Rosen, Bobbie Salgado, Guy Summers, Julia Talbot, Christopher Tan, Garth Taylor, Jennifer Tescher, and James Thomas. Their comments do not necessarily imply endorsement. Any errors in this paper are the responsibility of the author alone.

Notes

1 Braunstein, Sandra and Carolyn Welch. Financial Literacy: An Overview of Practice, Research, and Policy, Federal Reserve Bulletin, November 2002.

2 Jacob, Katy, Sharyl Hudson, and Malcom Bush. Tools for Survival: An Analysis of Financial Literacy Programs for Lower-Income Families, Woodstock Institute, January 2000, p.3.

3 Clark, Robert L. and Madeleine B. d'Ambrosio. Financial education and Retirement Savings. Presented at *Retirement Implications of Demographic and Family Change* Symposium, San Francisco, June, 2002.

4 Elswick, Jill. Workers' Deficit Spending Requires More Education, Employee Benefit News, 6/15/02, Vol. 16, Issue 8.

5 108th Congress, 1st Session. Senate Resolution 48, designating April 2003 as "Financial Literacy for Youth Month," 02/05/03.

6 Ferguson Jr, Roger W. Reflections on Financial Literacy. National Mortgage News, 6/10/02, p.4.

7 "Burn" represents the cost of counterproductive financial decisions such as, (based on borrowers risk profile), paying above market interest and/or fees.

8 Based on Glaeser and Paulson (1997). Calculate the dollars lost when consumers follow a rule of thumb in managing savings versus consumption decisions relative to optimally choosing how much to save each period.

9 Household income, age and education from the 2000 Census; credit card, debt payment, and payment past due data from the 2001 Survey of Consumer Finances.

An Informed Discussion of the Earned Income Tax Credit–Milwaukee

By Steven Kuehl

"On the one hand, there could be as much as $10 billion in EITC noncompliance, and this could suggest that the IRS proposal [to increase the burden of proof on eligible recipients] is quite important. On the other side is a sense of fairness; why on earth would you subject low-skilled, low-income taxpayers to greater scrutiny than any other taxpayers in the tax system?" John Karl Scholz

The Earned Income Tax Credit (EITC) continues to be a controversial public benefit tool. The EITC was last highlighted in the Profitwise Winter 2003 edition, available at: www.chicagofed.org/community-development/profitwise.cfm.

On May 5, 2003, the Consumer and Community Affairs division of the Federal Reserve Bank of Chicago went to Milwaukee to host another conference entitled, "An Informed Discussion of the Earned Income Tax Credit." The event included a keynote address by Professor John Karl Scholz, and was followed by panel discussions of key issues and opportunities associated with the credit. This article summarizes the new insights provided by the forum's discussion.

Keynote Address

JOHN KARL SCHOLZ, is a Professor of Economics and Director of the Institute for Research on Poverty at the University of Wisconsin–Madison. Professor Scholz has written extensively on the Earned Income Tax Credit and low-wage labor markets, and also on public policy and household saving, charitable contributions, and bankruptcy laws. Professor Scholz is a research associate at the National Bureau of Economic Research.

Professor Scholz discussed a current flashpoint issue on EITC policy: the new IRS proposal to increase the burden of proof on those claiming the credit. He cited a study by the Internal Revenue Service (IRS) concluding during the 2000 filing season, which found that $8.5 billion to $9.9 billion of the $31.3 billion (27.0 to 31.7 percent) of EITC claims were erroneous (made by ineligible taxpayers). Most of the inaccuracies were "qualifying child" errors. Typically the child who was claimed for the purposes of the EITC either did not live in the household or did not have a qualifying relationship to the person who was claiming the child.

In response to the high error rates found by the study, the IRS has introduced a new proposal to obtain greater proof of eligibility for people claiming the credit. Scholz agreed with critics of the unprecedented demand of the more than four million working poor who now claim the credit.

"The proposal targets single fathers, and adults other than single mothers and married couples," explained Scholz; "it will target aunts, uncles, grandparents, foster parents, and the like who claim the EITC." If this happens, it will require taxpayers to show evidence of the claimant's relationship to the child, and evidence that the child lived with the claimant for at least six months.

"Now, among a lot of people, there is concern that this documentation will be very difficult," stated Scholz. "For instance, how many of us could find our marriage certificates?" Scholz asked. He cited a current New York Times article on the new IRS proposal stating that the backlog in California to obtain a copy of a marriage license could be as long as two or three years.[1] He also stated that the requirement to produce school records may also create hardships; the tax filing calendar year spans two school years.

Scholz summed up his remarks by stating that there are two sides to every story. "On the one hand, there could be as much as $10 billion in EITC noncompliance, and this could suggest that the IRS proposal is quite important. On the other side is a sense of fairness, why on earth would you subject low-skilled, low-income taxpayers to greater scrutiny than any other taxpayers in the tax system?"

Panel Discussions
Key Issues Associated With the EITC

Speakers

Steven Kuehl
Moderator

Steve Holt
Holt & Associates

Arlene Kay
Executive Director for Systemic Advocacy, Internal Revenue Service

Jon Peacock
Director of the Wisconsin Budget Project with the Wisconsin Council on Children and Families

Robert Weinberger
Vice President for Government Relations at H&R Block, Inc.

STEVE HOLT noted that the huge administration costs involved with the EITC; however, they do not appear in the form we traditionally recognize. They are not the cost of welfare offices or caseworkers. Holt observed that the average computer-literate person who wanted to file their tax return online, would naturally just go to www.irs.gov and log in. "Well you can't, at least not directly," explained Holt, "because the software developers who were involved in preparing tax preparation software didn't want the IRS developing their own software business. So, to file your taxes [electronically], you have to use a private software product." Holt argues that the IRS has essentially privatized the costs of administering the EITC and put those costs onto the individual taxpayer who must figure out how to finance it. "This is an issue of how to get benefits to recipients in a cost-effective manner," stated Holt.

ARLENE KAY followed up on the study of the 2000 filing season cited by Scholz. According to Kay, since the study, "the IRS has put into place some internal safeguards that have reduced the number of potential fraudulent or inadequate returns by about a third. This should help us to whittle away some of the problems that have been noted."

JON PEACOCK focused on the Wisconsin EITC and stated that outreach for the credit was particularly important. "The private sector, for better or worse, is the main vehicle by which people get the credit, and that's not necessarily bad. It's great that the private sector is there to let people know," stated Peacock. He added, "I think we need to do a better job of having alternatives, though. What are the negatives [to private sector distribution]?" Peacock then referenced a recent Brookings Institution study that indicated half of EITC recipients in Milwaukee are using both private sector preparers and obtaining refund anticipation loans (RALs). He stated that obtaining the credit via RALs was better than not getting the credit at all; however given the fees and interest associated with RALs, it is a very costly way of implementing the EITC. Peacock urged interested parties to work creatively to discover hard-to-find attractive alternatives.

ROBERT WEINBERGER discussed the role of the paid preparers. He suggested that there is a spectrum of possible alternatives to having the EITC tax return completed. The spectrum ranges from, on one extreme, a completely self-administered program, where recipients complete their own return, and to the other extreme, of having a government employee complete the return.

Somewhere in the middle are several alternatives. The first is called "preparer due diligence," where the preparer informs the taxpayer of the taxpayer's record keeping and substantiation requirements, but does not audit the return. "This is where we have been [and are] right now," stated Weinberger.

The next step up the line would be "certified preparers," where the paid preparer would utilize enhanced diligence and conduct a sort of quasi-audit verification. "They would determine whether school records or documentation need to be improved," explained Weinberger; "it would be the equivalent of what the department of motor vehicles does in many states where they outsource to service stations emissions testing, instead of doing it themselves."

The next step is "pre-qualification." "This is what the IRS is now proposing," stated Weinberger. Here, the IRS itself takes in the returns rather than having the preparers do the screening, and the IRS determines who are the high-risk applicants. The IRS will then ask high-risk applicants to send in documents that verify their claims.

Weinberger concluded by advocating for the "certified preparer" enhanced due diligence model where professional preparers are utilized in some form of quasi-government function. Weinberger believes this model will be both the most efficient and cost-effective.

Key Opportunities Associated With the EITC

Speakers

John Karl Scholz
Moderator

Deborah Blanks
Executive Director, Social Development Commission

Margaret Henningsen
Founder and Vice President of Legacy Bank

Stephen Percy
Director, Center for Urban Initiatives and Research and Deputy Chancellor for the Milwaukee Idea at the University of Wisconsin–Milwaukee

Robert Weinberger

DEBORAH BLANKS discussed her work with the Milwaukee Asset Building Coalition (MABC). MABC is a coordinated effort of Milwaukee area service providers to integrate wealth- building and other initiatives among Milwaukee County's low-income residents. This coordinated effort has included increasing the number of individuals who file for the EITC, obtain a bank account, complete financial literacy courses, or start an individual development account (IDA). Blanks discussed the EITC as a major tool that increases the number of people who can accumulate assets and explained the importance of this feature. She related her personal experience of when her grandfather was able to provide her with a car when she was in college.

"It wasn't the kind of car a young girl in college wanted to drive to make her look cool," explained Blanks, "but it was an asset."

As a college student, the car made a big difference for Blanks. She explained how the ability to accumulate assets enables people to begin to interact and operate more productively in society. It also enables one generation to help the next, allowing parents and grandparents to pass assets to their children, and thus enables them to become more independent and engaged in society quicker than if they had to accumulate enough assets on their own.

Blanks also cautioned against equating poverty with personal failure. She believes some of the welfare reforms enacted in 1996 reflect the English Poor Laws of old, which essentially reasoned that the poverty of the poor was a result of their own mistakes and incompetence, and that poor parents were bad parents. She closed by saying that the EITC helps people to move out of poverty and to make the dream of America a dream for all its citizens.

MARGARET HENNINGSEN stated that too much emphasis is placed on EITC recipients as being poor, and not enough focus is placed on the fact that EITC recipients work for a living and earn money. She discussed the idea that the business community sees EITC recipients as a marketing opportunity to sell their products. These businesses recognize the profit potential in communities where people receive the Earned Income Tax Credit. Her financial institution, Legacy Bank, prides itself on helping traditionally underserved communities and has developed an outreach campaign to EITC recipients. Legacy has chosen to fulfill its mission by getting involved with key community groups such as the MABC. By getting involved with the EITC, Legacy has been able to grow its business by developing products that serve the needs of EITC recipients, such as specialized accounts. Legacy also became a Volunteer Income Tax Assistance (VITA) site to assist people with filing their returns and receiving the credit. To Henningsen, the goal is to help people obtain the credit as a jump start to accumulating and growing wealth.

STEPHEN PERCY discussed findings of recent research studies conducted on the EITC in Milwaukee. The research found a need to increase awareness of the EITC, as 56 percent of individuals surveyed from an EITC eligible neighborhood were not aware of the credit. Further, 75 percent were not aware of the free income tax assistance available through the VITA program sites. When asked who completed their taxes, 82 percent responded that a commercial preparer had assisted them. When asked what they did with the refund, the most frequent responses included purchasing food, clothes, paying debts, and buying furniture. Only 30 percent said that they opened or added money to a deposit account. A remarkable 85 percent of those who used a VITA site had not been there the year before. Respondents indicated that a referral from a friend or neighbors led them to the VITA site.

Percy commented on the implications of the research findings. He stated that VITA sites will most likely serve more people next year, as this year's EITC recipients will inform their friends and neighbors. Also, publicity and marketing efforts for the VITA sites would help, including efforts to inform people of the documentation they need to bring and beginning the marketing effort by January 1, 2004. Finally, Percy emphasized the importance of leveraging the EITC to magnify its impact, such as through Individual Development Accounts, where the funds could be used for education or starting a new business.

ROBERT WEINBERGER identified several opportunities attached to the EITC:

First, there could be more IRS information sharing with tax preparers, particularly regarding the IRS dependent database, which is largely based on child custody awards. Weinberger explained that a custody arrangement may be somewhat "fluid" over time, with shifting responsibilities for the welfare of a particular child. Despite the reality that child custody may be changing over time, the IRS dependent database reflects only the legal status recorded through the courts. Consequently, an EITC filer who claims the child may be "bounced" (disallowed as a dependent) if the information provided is not consistent with the IRS dependent database. This problem could be corrected at the preparer level if tax preparers had access to the relevant information.

Second, to augment the number of returns filed through "free help" alternatives such as IRS walk-in services, VITA, and Tax Counseling for the Elderly sites, Weinberger suggests utilizing the network of commercial tax preparers by providing vouchers for approved paid preparers. In addition, the IRS could change its current policy of not competing against the private sector, and instead, provide software or online filing.

Third, promotion of the EITC and outreach efforts could be expanded. Currently, about 4.3 million families or about 25 percent of those eligible, don't file. This represents $2.7 billion in missed benefits, where 38 percent would be going to households with three or more children. Those most likely not to file are workers with very low incomes, women moving from welfare to work, and immigrant families. The problem of non-filing will grow, because 2.5 million current welfare recipients are projected to move off welfare into the workforce by 2007. Based on experiences in Chicago, New York, Indiana and Washington, data indicates that EITC promotional campaigns are effective.

Finally, tax season is the one time of the year that people collect together all their financial information and are open to advice. This is an opportunity to connect taxpayers to deposit accounts and other bank products, plus other government benefits.

Conclusion

This forum explored key issues and opportunities associated with the EITC in Milwaukee. There was much concern regarding the IRS proposal to increase the burden of proving eligibility. Most speakers found that the need to address the non-compliance issues was real, and expressed concern that increased scrutiny of EITC recipients might, on a net basis, do more harm than good.

Consensus emerged that the cost of administering the EITC has been placed on those claiming the credit. Commercial tax preparers were recognized as the main vehicle by which the majority of recipients obtain the credit, and this has inherent costs and benefits. Various recommendations were made as to ways to optimize access to the EITC at reasonable cost, direct or indirect, to recipients.

As an extension of the Federal Reserve's overall goal to promote a stable economy and sustainable growth, the Consumer and Community Affairs division of the Federal Reserve Bank of Chicago is concerned with critical topics such as the EITC, and its ramifications for local economies and disadvantaged individuals and communities. We will continue to explore topics relevant to our mission in future forums and publications.

Steven Kuehl *is the consumer regulations director for the Consumer and Community Affairs division, Federal Reserve Bank of Chicago. Mr. Kuehl conducts seminars and workshops, and frequently writes on matters dealing with consumer banking regulations. Mr. Kuehl served as senior examiner for consumer regulations compliance and CRA (Community Reinvestment Act) with the Federal Reserve Bank of Chicago, and later managed a technical advisory service program targeted to banks in the Seventh Federal District. Prior to joining the Fed, he was an examiner for the Office of Thrift Supervision. Mr. Kuehl holds a B.S. in finance and economics from Carroll College and a Juris Doctor from the Chicago Kent College of Law.*

Notes

1 See Mary Williams Walsh, "IRS to Ask Working Poor for Proof on Tax Credits," New York Times, April 25, 2003.

Calendar of Events

MCIC Community Development, Government, and Banking Forum

Chicago, IL
February 10, 2004

Metro Chicago Information Center (MCIC) will hold its annual Community Development, Government, and Banking Forum at the Federal Reserve Bank of Chicago from 8:00 a.m. to 11:30 a.m. This is a "don't miss" event for community lenders, community development practitioners, policy makers, and government program representatives. The forum is free, but space is limited.

For more information please contact Mari Gallagher at mari@mcic.org, or visit www.mcic.org

15th Annual Rural Community Economic Development Conference

Peoria, IL
March 10-11, 2004

This year's conference will feature presentations on a variety of topics involving community and economic development in rural communities. The conference is sponsored by the Illinois Institute for Rural Affairs at Western Illinois University, in conjunction with Rural Partners and the Governor's Rural Affairs Council. Additional support is provided by the Federal Reserve Bank of Chicago.

For more information please contact Carol Harper at (800) 526-9943, (309) 298-2637, or at CS-Harper@wiu.edu.

Financial Access for Immigrants

Springfield, IL
March 12, 2004

Sponsored by the Federal Reserve Bank of Chicago, this event will address issues and opportunities surrounding financial access for immigrants. Topics will include: demographic background and interpretation of Illinois' immigrant population; workforce development and matters facing employers of immigrants; bankers' perspective on emerging immigrant markets; views of the Mexican government regarding Mexican nationals, remittances and the Consular Identification Card; and issues stemming from efforts to increase homeownership and entrepreneurship among immigrants. Also, a panel of government representatives will discuss documentation and identification issues confronting immigrants, including the USA PATRIOT Act.

The event is free, but seating is limited.
For more information, contact (312) 322-8232.

Community Reinvestment Conference

Los Angeles, CA
March 29-31, 2004

Sponsored by the Federal Reserve Bank of San Francisco, Office of Thrift Supervision, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, American Bankers Association, National Association of Affordable Housing Lenders, and National Community Capital Association.

For information please contact Scott Turner at (415) 974-2722, or at scott.turner@sf.frb.org.