

SUMMARY



HIDDEN IN PLAIN SIGHT

A LOOK AT THE \$335 BILLION FEDERAL ASSET-BUILDING BUDGET



Corporation
For Enterprise
Development

The full study, which contains the complete data sources and methodology used in this analysis, is available for free download at www.cfed.org.

The Corporation for Enterprise Development thanks the Ford Foundation for its generous support.

The Corporation for Enterprise Development (CFED) fosters widely shared and sustainable economic well-being by promoting asset-building and economic opportunity strategies—primarily in low-income and distressed communities—that bring together community practice, public policy, and private markets in new and effective ways.

CFED is a nonprofit organization that creates economic opportunity by helping the poor save and invest, succeed as entrepreneurs, and participate as contributors to and beneficiaries of the economy. By helping individuals and communities harness latent potential, CFED builds long-term models to help people move from poverty to prosperity while strengthening the overall economy. CFED identifies and researches promising ideas, collaborates with the private and public sectors to test them, and helps drive the application and adoption of proven concepts.

Established in 1979, the Corporation for Enterprise Development works nationally and internationally through its offices in Washington, DC, Durham, NC, San Francisco, CA, and St. Louis, MO.



For years, lawmakers have enacted policies that encourage individuals to accumulate assets. Throughout generations, these policies have helped millions of Americans plan for the future, buy homes, prepare for retirement, send their children to college, and weather unexpected financial storms. Today—through a diverse array of initiatives—the federal government spends billions of dollars to foster asset building. Yet, for all the analyses of the federal budget, there has never been a comprehensive look at these policies in total.

Now, for the first time, the Corporation for Enterprise Development has analyzed spending and tax policy to determine how much American asset-building initiatives cost, where the money goes, and who benefits.

The study, summarized here, reveals that, in Fiscal Year 2003:

- **Federal asset policies cost \$335 billion (conservatively measured).**
- **Federal policies disproportionately benefit those who already have assets. Analysis of the largest spending categories shows that over a third of the benefits go to the wealthiest 1% of Americans—those who typically earn over \$1 million per year. In contrast, less than 5% of the benefits go to the bottom 60% of taxpayers.**
- **Federal spending to stimulate asset building results from many uncoordinated policies. There is no coherent strategy, no explicit asset budget, and little public scrutiny.**
- **Federal asset policies include both direct outlays and tax expenditures that reward specific types of behavior. For every dollar spent on asset-building outlays, the government gives up \$642 in revenue through tax expenditures that reward asset-building behavior.**
- **Many benefits of federal asset policies can only be realized by people with certain types of assets or levels of tax liability.**

The federal government spends billions to foster asset building, but there has never been a comprehensive look at these policies in total.

Even by the standards of the federal government, \$335 billion is a lot of money.

How big is this asset-building budget? Even by the standards of the federal government, \$335 billion is a lot of money. It is nine times more than it spends on building roads, bridges, and mass transportation systems (\$37 billion). It is almost 10 times more than Washington spends on housing assistance programs (\$35 billion). It is 15 times more than the government invests in higher education (\$23 billion). And, to put it in perspective,

\$335 billion compares to a national defense budget of \$405 billion.

Where does the money go? More than 98% of it goes to support homeownership, reward retirement savings, and subsidize other kinds of savings and investments.

Who benefits? Many of the programs are theoretically universal, and there are some specifically aimed at the middle class and the poor. In practice, however, the data show that the major beneficiaries are those who already have the most assets.

It is critical to decide intentionally who should benefit from America's asset-building policies.

Assets provide families with stability and protection against the unexpected. Yet in the event of the sudden loss of a job, for example, one in four American families lacks sufficient net assets to survive even at the poverty line for more than three months. The critical importance of assets in stabilizing American families, and the vast amount spent to help them accumulate assets, call for a more rational and transparent approach to this federal

investment. Robust public debate and an explicit asset-development budget is needed to inform policymaking and to frame national decisions about how scarce dollars are spent.

Given the scope of federal spending on asset building, it is surprising that no attempt has been made to examine these programs in a coordinated way and consider what they mean together. No comprehensive analysis, for instance, has been done on the relative effectiveness of different kinds of asset-building policies or on the returns (to the economy or to society) that they represent. Since there is no unified vision of just what the government intends as its asset-building goals, it is difficult to measure whether or not they are the most effective tools to use.

In particular, it is critical to decide *intentionally* who should benefit from these policies: the wealthy, who pay the most in taxes (yet still benefit disproportionately from asset-building policies) or the middle class and the poor, who have fewer assets to begin with and are less able to take advantage of many of the existing policies.

This study provides a clearer picture of what impact these federal policies are already having. This is a starting point for a more coherent understanding of—and intentional decision-making about—asset building at the federal level.

WHAT IT COSTS

Federal policies promote a variety of ways for Americans to accumulate assets, or marketable goods. For most American households, principal sources of assets include owned homes and real estate, cash and savings, stocks and bonds, retirement and life insurance plans, and any business ownership. For most purposes, these are usually offset (as “net assets”) by associated debt, so that, for instance, the market value of a home is generally reduced by the balance of any mortgages on it.

Although federal asset policies represent a collection of intentional decisions by policymakers, such decisions are almost never analyzed as a comprehensive set of strategies. Because the federal government does not have an explicit asset-building budget, the overall level of spending could only be determined by scrutinizing and segmenting the entire federal budget.

Two types of spending are included in this study.

- **Budgetary outlays** are direct spending by the government that can be found as line items in a budget.
- **Tax expenditures** are preferences in the tax code that reward taxpayers who engage in specific types of behavior. (Tax expenditures have been called “spending programs in disguise” because they have the effect of direct outlays but are less visible.)

Federal asset-building policies are almost never analyzed as a comprehensive set of strategies.

Outlays and tax expenditures included in this study meet three criteria:

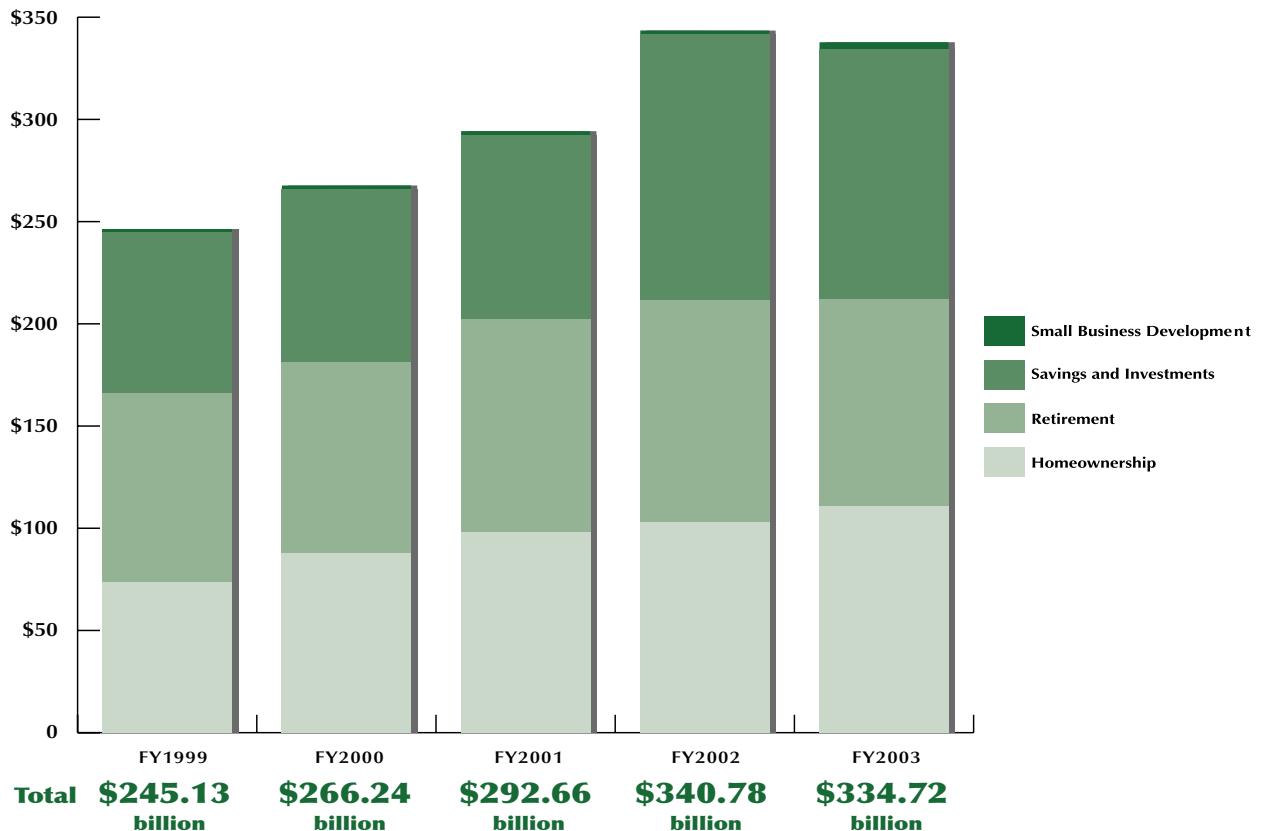
1. They are related to specific, explicit federal policies that reward asset building. Policies aimed at asset protection are not included.
2. They are directed at individuals or households. Policies that promote asset building among corporations, for instance, are not included.
3. They are available to most of the general public, but also are the result of some personal action, rather than benefiting broad segments of the population more or less equally. Policies aimed at unique subgroups, such as veterans, that have access to exclusive programs are not included.

Further, this analysis focuses on four main categories of assets:

- homeownership
- retirement accounts
- savings and investment
- small business development

COST OF AMERICAN ASSET-BUILDING POLICIES: FY1999-FY2003

In Billions of Current Dollars



These are conservative selections, as strong cases can be made to include other categories. (Some discussion is included about other items that are omitted from the calculations for this study.)

This sort of analysis is inherently—and fairly—open to debate about what to include, where to draw appropriate demarcations, and, in those cases in which data are not available or exact, how to count the costs. By and large, this study errs on the side of caution, excluding spending that could be potentially controversial. This analysis, therefore, is a conservative estimate of the value of such programs, and should be treated as a baseline figure.

HOMEOWNERSHIP

The family home is the chief asset of many American households. Part of the American dream, ownership provides families with both physical and financial security. Because mortgage payments can be substituted for rent, even households with modest incomes can nonetheless, over time, build assets through homeownership.

COST OF AMERICAN HOMEOWNERSHIP POLICIES	
In Millions	FY2003
Deduction for mortgage interest	\$69,900
Deduction for property taxes	\$22,100
Exclusion of capital gains on sales of principal residences	\$17,800
Exclusion of interest on state and local bonds for owner-occupied housing	\$700
<hr/>	
Home Investment Partnership Program (HOME)	\$75
Community Development Block Grants	\$41
FHLB Affordable Housing Program	\$91
USDA Section 502	\$236
IDAs	\$25
TOTAL	\$110,968

Tax Expenditure
 Direct Outlay

Washington’s active involvement, especially from the 1930s onward, has been largely responsible for driving homeownership rates to an all-time high. The federal government offers a number of programs that promote the purchase and financing of homes.

The most significant incentives are provided through tax expenditures. Over the years, lawmakers have enacted policies that shift the tax burden away from homeowners, providing valuable benefits to those who can and do purchase homes.

Four principal tax expenditures actively promote the building of assets through homeownership. First, the deduction of the interest paid on mortgages, the single largest housing subsidy in the country, totals \$69.9 billion. Second, the deduction for property taxes paid on owner-occupied homes is worth \$22.1 billion. Third, an exclusion on capital gains earned on principal residences costs \$17.8 billion. Finally, earnings from certain state- and municipal-issued bonds used for homeownership initiatives are exempt from federal taxes, totaling another \$700 million. Combined, these four tax expenditures total \$110.5 billion.

In addition to these tax expenditures, a smaller volume of support is provided through direct outlays that actively promote homeownership. Some of this comes through specific provisions of the U.S. Department of Housing and Urban Development's (HUD's) HOME program (\$74.5 million) and Community Development Block Grant program (\$40.8 million). The Federal Home Loan Bank (FHLB) system also allocates a portion of its Affordable Housing Program funds to homeownership activities (\$91 million), and the U.S. Department of Agriculture provides mortgage financing in rural areas through its Section 502 program (\$236 million).

The federal government also supports homeownership and other asset building activities through Individual Development Accounts (IDAs). These are matched savings accounts that provide structure and incentive for low-income families to save for investments that build assets. (IDAs can be used for other activities such as small business development and for education, both discussed later, but more funds go toward housing than any other category.) A five-year demonstration program currently funds IDAs at \$25 million per year.

Flexible mortgage financing is widely available through the Federal Housing Administration, particularly through its 203(b) loan program. Although the volume on these loans is high, collected premiums from borrowers cover the costs of the program, so that there is currently no outlay required by the federal government.

A small portion of other federal programs—such as HUD's Section 8 program—can be used for homeownership, but the numbers are so negligible that they are inconsequential in the context of this study. HUD also allocates funds for homeownership counseling, but in the interest of being conservative, programs like this that strictly provide technical assistance are excluded from this tally.

It is worth noting that tax expenditures on homeownership are 236 times greater than similar direct outlays spent by Washington that are generally targeted to low- and moderate-income households.

RETIREMENT ACCOUNTS

Most Americans need assets to retire. Social Security provides some income once paychecks have stopped, but people must supplement this stream. Toward this end, the federal government has created various tax incentives to encourage individuals and employers to save for retirement.

COST OF AMERICAN RETIREMENT ACCOUNT POLICIES	
In Millions	FY2003
Employer-sponsored plans	\$83,500
Individual-based plans	\$10,400
Keogh plans	\$5,700
Tax credit for certain elective deferrals and IRA contributions	\$1,600
TOTAL	\$101,200

■ Tax Expenditure

There are two principal groups of retirement policies subsidized by tax expenditures.

The first group of policies includes employer-sponsored pensions. This includes traditional "defined benefit plans" that guarantee retired workers a regular income but are not transferable if the employee changes jobs. Also included are "defined contribution plans"—such as 401(k) and 403(b) plans—in which the cost and responsibility for saving are shifted to employees. The net cost of employers' and employees' tax-deferred contributions under these various plans, after being offset by taxed withdrawals from the plans, is \$83.5 billion.

The second group of policies provides other rewards to individuals who save for retirement outside an employer-employee relationship. This includes traditional Individual Retirement Accounts (IRAs) and Keogh plans that allow part or all savings to be deductible depending on the depositor's income, participation in another retirement plan, and filing status. Roth IRAs, in which taxes are excluded on earnings rather than contributions, are part of this group as well. Deposits are made with after-tax dollars but earnings on the deposits are tax-free. Together, the net tax expenditures represented by these plans total \$16.1 billion.

These tax credits, together with a small amount of more specialized credits that reward deferrals and IRA contributions, total \$101.2 billion.

This is a conservative estimate of the cost of such federal policies, as other ones—such as the exemption of the cash value of certain types of life insurance policies—could arguably be included as well. Nonetheless, even this baseline amount demonstrates the significant price the federal government pays to reward savings for retirement among individuals and their employers.

SAVINGS AND INVESTMENT

The federal government encourages certain behavior once wealth has been accumulated. Specifically, three sections of the tax code play significant roles in asset building: capital gains, estates, and the treatment of certain types of insurance and annuities.

Capital gains and estate transfers are similar to interest income, in that they represent income earned through means other than wage or salary. While most interest income is taxed at the same rates as earned income, however, capital gains and estate transfers are not.

COST OF AMERICAN SAVINGS AND INVESTMENT POLICIES	
In Millions	FY2003
Reduced rates of tax on long-term capital gains	\$55,300
Exclusion of capital gains at death	\$38,100
Carryover basis of capital gains on gifts	\$4,500
Exclusion of investment income on life insurance and annuity contracts	\$24,000
TOTAL	\$121,900

■ Tax Expenditure

The reduction in capital gains tax rates creates a significant difference in the treatment of this income versus other types, especially among those in the top tax brackets. This makes it more attractive for individuals and households to invest. It also creates incentives for some households to shelter their money in assets that are likely to see more capital growth than wage/salary earnings. Since most households’ capital appreciation comes in the form of homes or businesses, lowered capital gains tax rates are, in one sense, subsidies for business development and homeownership.

The estate tax captures a portion of inherited income from the very largest estates—currently those over \$1.5 million. The appropriate role of the estate tax, including possible permanent elimination, is the subject of much debate in Washington.

One other large tax expenditure falls into this category. With certain forms of life insurance and annuity contracts, owners can make contributions over the amount of the premium. These additional dollars can be targeted toward a variety of investment options, the earnings of which are not subject to federal tax.

SMALL BUSINESS DEVELOPMENT

Small business development is a major asset-building avenue for entrepreneurs. As a significant driver of the U.S. economy, small businesses receive the support of lawmakers, and their development is encouraged by the federal government.

While businesses in general enjoy many benefits through U.S. tax policy, this study only includes those small enough—still owned by one person or set of partners and not yet incorporated—that the wealth-building is likely to accrue at the individual level.

COST OF AMERICAN SMALL BUSINESS DEVELOPMENT POLICIES	
In Millions	FY2003
SBA 7(a) Program	\$19
USDA Business and Industry Program	\$8
SBA MicroLoan Program	\$4
Amortization of business startup costs	\$600
TOTAL	\$631

Tax Expenditure
 Direct Outlay

The federal government encourages entrepreneurs to start and expand businesses through a number of policies, the most significant of which are funded through the Small Business Administration (SBA). The largest of these are loan guaranty programs provided to banks to encourage commercial lending. The most widely used is the SBA's 7(a) program. Businesses apply

for 7(a) loans through a participating lender, and the SBA provides a significant level of guaranty, reducing the risk to the lender. The cost of the guaranty (which leverages \$8.1 billion in lending) is \$85 million; of this, \$18.9 million is directed at unincorporated small businesses. Another large SBA loan guaranty, the 504 program, provides businesses with financing for major fixed assets, such as land and buildings. The 504 program is essentially self-sustaining through program revenue and does not represent a significant net cost to taxpayers.

Similar to the 7(a) program, the U.S. Department of Agriculture's Business and Industry program encourages lending to businesses in rural areas. The cost of this guaranty is \$35.8 million (supporting \$901 million in loans). Assuming a similar distribution across business type as its 7(a) cousin, the cost of these loans to sole proprietors and partnerships is \$7.9 million.

The SBA also funds programs that are explicitly aimed at microenterprises, or "mom and pop" businesses, with no or very few employees. These funds are not large—they cost \$3.8 million—but they do provide important support to some entrepreneurs. The SBA also funds a range of other programs that focus on technical assistance, rather than financing, and so are not included in this study.

The only tax expenditure directly tied to small business capitalization is the amortization of business startup costs. At a relatively modest \$600 million, it is nonetheless 20 times the value of the other programs combined.

POLICIES NOT COUNTED IN THIS TALLY

Together, these federal policies total \$335 billion. This is a conservative calculation, as strong cases can be made to include a number of other types of policies. For instance:

- This study explicitly focuses on asset building among individuals and households. Although it includes "mom and pop" businesses whose assets accrue to the individual owners, it stops short of looking at asset-building incentives for corporations (such as, for instance, the accelerated depreciation of machinery and equipment).
- This study focuses on ordinary taxpayers, and so excludes certain distinct employment and other groups that have access to exclusive programs. Most notably in this regard is spending on veterans. This excludes, for instance, the cost of the Veterans Administration's popular mortgage program or the SBA's Veterans Business Development program.

- This study focuses on specific federal policies but excludes the wide array of institutions that enable asset building in America. Many asset-building systems are institutionally supported by the federal government. The estimated cost to the federal government, for instance, of Freddie Mac, Fannie Mae, and the Federal Home Loan Banks—which make the modern mortgage industry possible—totals another \$14 billion per year.
- Investment in education and human capital is not included in this study. Education directly increases individuals' opportunity and earning power, improving their ability to build assets. If just that portion of federal spending on post-secondary education aimed at individuals were included, the total would rise by another \$28.4 billion. This represents \$16.9 billion in direct expenditures (grants and loans) and \$11.5 billion in tax expenditures (education tax credits and deductions).

\$335 billion should be treated as a baseline figure. The total could be much higher, depending on where the line is drawn.

Thus, \$335 billion should be treated as a baseline estimate for federal asset-building policies, with the total possibly much higher depending on where the line is drawn.

UNEQUAL DISTRIBUTION

That the government spends (or forgoes) \$335 billion each year to promote individual asset building is, in itself, value neutral. Assets play a critical role in the economy and in the lives of families. Robust debate, however, should critically evaluate *who* should benefit most from this collection of federal policies.

Data regarding the beneficiaries of these policies should inform the debate. Firm data, unfortunately, are not available for many of the programs cited in this report, but some inferences can be made based on broad issue categories. Research shows, for instance, that people who participate in employer-sponsored pension plans are better educated and paid more, and are more likely to be older, white, and male, than those who do not participate in such plans. While inferences can be drawn from such data, and while similar information exists for some of the other categories, it is still too fragmented to tell a robust story.

Instead, this study took a different approach. Borrowing a highly refined model developed by the Institute on Taxation and Economic Policy, simulations were directed on those programs for which there were reliable data. The model calculates how much tax revenue is foregone, and who benefits, by income group. It relies on one of the largest tax databases in existence, and is very similar to calculations produced by the U.S. Department of Treasury and the Congressional Budget Office.

Using this model, results were generated for several of the largest programs in the study: capital gains and dividend rates, the mortgage interest deduction, and the home property tax deduction. Although these represent a small number of the policies evaluated in this study, they comprise 57% of the spending.

For these policies, the distribution of benefits highly favors upper-income citizens. The top 20%—those with incomes over \$81,000—receive the lion's share of benefits. More striking still, 34% of the tax savings go to the top 1% of taxpayers—those with incomes averaging over \$1 million.

In contrast, the bottom 60% of taxpayers received less than 5% of the tax savings. While the poorest 20% of taxpayers receive an average benefit of \$4.24, the wealthiest 1% net a benefit that is 8,988 times as much (\$38,107).

The richest 1% who benefit can buy a Mercedes. The poorest 20% can get a cup of coffee.

The preferential tax rates on capital gains and dividends present the most lopsided picture. The richest 1% receive 69% of the benefits from this expenditure. On average, they enjoy a \$31,219 benefit—about enough to buy, for instance, a 2004 Mercedes-Benz C240 sedan. The poorest 20% of the population receive an average benefit of just \$1.53—about enough for a cup of coffee at Starbucks (though not enough for a cappuccino).

The distribution of tax expenditures for homeownership is nearly as skewed. For the mortgage interest and property tax deductions combined, the richest 5% enjoy 35% of the benefits, while the bottom 80% split 21% of the benefits.

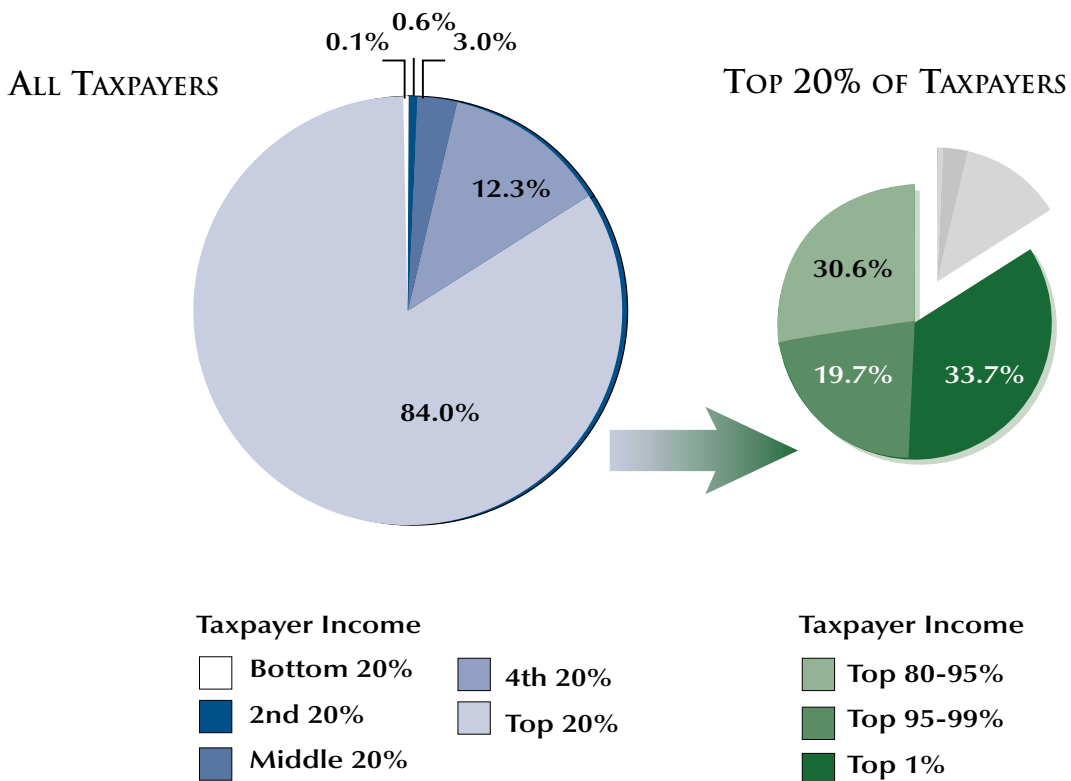
AMERICAN ASSET-BUILDING POLICIES: DISTRIBUTION OF BENEFITS

Mortgage interest, property tax deductions, and preferential rates on capital gains and dividends.

BY AVERAGE DOLLAR AMOUNT

If a taxpayer's income is in the...	then their average benefit is...
Bottom 20%	\$4.24
2nd 20%	\$34.26
Middle 20%	\$173.45
4th 20%	\$705.64
Next 10%	\$1,959.68
Next 5%	\$3,060.69
Next 4%	\$5,528.64
Top 1%	\$38,107.10

BY PERCENT OF TOTAL



While these results are striking, are they representative of the broader set of policies outlined in this study? Absent more complete data, it cannot be known with certainty. Some of the other policies, particularly some of the mortgage programs that have specific income limitations, are likely to be less regressive than these, which may temper the overall findings somewhat.

This said, it is highly likely that those with the most assets do, as the simulation numbers strongly suggest, benefit disproportionately from asset-building programs. This is true for four reasons.

The bulk of federal asset-building programs are structured as tax incentives, the majority of which are deductions or nonrefundable tax credits. By contrast, only a handful use refundable credits through which qualified households can get the credit even if they owe no net taxes. Because most tax policies are not structured this way, they do not help many lower-income families who may otherwise qualify but have relatively low tax burdens. (The mortgage interest deduction, for example, only helps a family if they already have a net tax liability.) For this reason, most of the tax expenditures cited in this analysis exclude the bottom tier of earners, by design skewing the distribution of benefits.

Many asset-building policies require that the beneficiary already hold assets or have substantial income to begin with. Middle-class and poor people are less likely, for instance, to have capital gains to be taxed at lower rates, and are less likely to be able to reach the limits on retirement plan savings.

Many asset-building policies have no, or very high, upper limits. This means that, even if many families qualify for the benefits specified under any specific policies, upper income taxpayers will enjoy a greater share in aggregate dollars. The capital gains exclusion on the sale of a primary residence, for example, may benefit a middle-class family who sells its house and realizes a modest gain. Only the wealthy, however, are likely to approach the half-million dollar cap. Further, the mortgage interest deduction claimed for second homes does little to benefit the average family working to pay the mortgage on their first (and only) home.

Only a modest number of dollars support policies that specifically target middle-class and poor people. The SBA funds programs that help microbusinesses, for instance, many of which are started by entrepreneurs of modest means. Individual Development Accounts are targeted to low- and moderate-income families to help them save for the future. Most of these programs, however, are direct outlays in the millions, which are dwarfed by tax expenditures that favor the wealthy in the billions.

While parts of the picture remain to be filled in, this analysis does provide a good idea of who benefits from federal asset programs. The general message is clear—the federal government’s \$335 billion in asset policies most heavily favors those who already have the most assets. Whether that is desirable or not has never, in a comprehensive way, been debated.

WHERE TO GO FROM HERE?

Three conclusions can clearly be drawn from this analysis:

- 1. The federal government already provides spending and incentives to encourage individuals and households to build assets. While the precise number is open to debate, a conservative baseline is that this activity totals at least \$335 billion.**
- 2. Federal policies disproportionately reward those who already enjoy the highest incomes and the most assets. In fact, the largest programs are among the most skewed toward the wealthy.**
- 3. A clear articulation of the country’s asset-building goals, more study, better data, and better-informed decisions are needed.**

Asset-building policies are not accidental. Each is the result of intentional decisions by lawmakers and civil servants, with the input and influence of citizens and interest groups. Yet, as a whole, these efforts are haphazard. While budgetary outlays and tax expenditures to foster asset building add up to a staggering sum, they do not result from a deliberate vision. There is no federal assets budget. There is no federal assets policy. There is only a hodgepodge of policies that happens to have the effect of encouraging asset building on a massive scale. The benefits are tilted—intentionally or not—heavily to those who need that help the least.

In the meantime, important policy changes are being actively debated, and likely will be for some time. Proposals for changing the treatment of capital gains and dividends, for instance, are commonly put forward. The creation of new tax-advantaged savings plans and changes to retirement planning come up with regularity. But these vital (and expensive) debates are taking place in relative isolation, without regard to the big picture of how the collection of American policies can most effectively promote asset building to enhance the economy and stabilize families.

The Corporation for Enterprise Development conducted this analysis because this broader story had not yet been told. This is but the first chapter.

To begin to ensure that federal asset-building policies are effective and the sizable investments made are well used, there should be vigorous public debate about what our national priorities should be. Policymakers, activists, academics, and others must ensure that this includes both line-item outlays and less visible tax expenditures. If the current volume and distribution of programs continues as is, it should be the result of measured deliberation rather than benign neglect and lack of information.

If the current volume and distribution of investment is to continue, it should be the result of measured deliberation, not benign neglect and lack of information.

The federal government should also publish an annual budget of all the federal government's asset-building policies. As this information gets more uniform and more reliable, more can be learned about this immense, but poorly understood, collection of federal policies.

Assets matter. People need them for security, and they need them to plan for and invest in the future.

Federal policies that promote asset building, done well, can provide opportunities for families to realize the American Dream. Federal policies that promote asset building, done poorly, can have effects that few Americans would knowingly support at this level.

Today, the federal government devotes at least \$335 billion in intentional strategies to promote asset building. Yet, there is no coherent asset strategy. There is no explicit asset-building budget. There is little public scrutiny of this spending.

It's about time to shed daylight on this vast investment and ensure that it supports the dreams of all Americans.

The full study, which contains the complete data sources and methodology used in this analysis, is available for free download at www.cfed.org.



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