INSUFFICIENT FUNDS: SAVINGS, ASSETS, CREDIT
AND BANKING AMONG LOW INCOME HOUSEHOLDS

Segment #2: Overview, Rebecca Blank

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PARTICIPANTS:

Welcome:

RON HASKINGS
The Brookings Institution

Overview:

REBECCA BLANK
The Brookings Institution

Panelists:

JANE DOKKO
Federal Reserve Board

PETER TUFANO
Harvard Business School

WILLIAM GALE
The Brookings Institution

BELLE SAWHILL
The Brookings Institution

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Overview

MS. BLANK: Thanks, Ron. Thank you all for coming today on a rainy Monday morning. Working on this book was one of the more fascinating things that I’ve done over the last couple of years. And I also want to thank the National Poverty Center, which really was the organization, and the Ford Foundation, that put this whole project together.

We all started about three years ago on this in terms of lining up authors, and it was long before the current economic collapse. And I was saying, just as – we were talking earlier, that we had a pre-conference in the, I guess it was in January or February of 2007, and we were talking about this whole set of policies and saying, gosh, it would be really nice if at some point people became interested in some of these.

And, you know, sort of the bad news is, the economy has evolved in such a way that it’s led to the good news, which is, we’re really talking about a whole series of policies on new regulations on credit cards, new regulations on mortgage and mortgage behavior, and about the need to expand financial services and to improve financial services for low income, as well as moderate income families, so I guess that’s both good news and bad news. I should note that one of the people who was in the room on that very first pre-conference who was going to
be one of the key contributors in the book was Ned Gramlich, who died in the process of this book, and hopefully not because of the book, but he did pass on, and the book is dedicated to him. And many of you here know that Ned was deeply involved in these issues as a member of the Federal Reserve Board and throughout his life as a researcher. And I think the dedication of the book to Ned is just right. I mean he is a person who, you know, really has symbolized the importance of these issues for a long, long time.

So I want to spend just a little bit of time here summarizing what are the main themes that come through this book, because it’s, you know, got all these separate chapters written by different people, and so talking about the big themes I think is important to give a sense of the whole message of the book.

And, you know, overall, when you look at the book, there is both good news and bad news. There is a wonderful chapter here looking at long term trends on financial assets and wealth holdings. It turns out that the bottom quintile of the income distribution in 1962, about 60 percent of the bottom quintile held some form of financial assets. That’s, you know, credit cards, savings accounts, stocks, bonds, pension plans. By 2004, that 60 percent of the bottom quintile had increased to 80 percent of the bottom quintile. So there has been an
expansion among low income families in their access to financial assets, and there has been, at least through the data that we have, and I must say, we don’t have data for 2008 and 2009, there was a long term growth in the level of financial assets.

Now, that might be the good news; the bad news is, there’s still not a lot of financial assets down there. On average in the bottom quintile, we were talking in the mid 2000’s of about $1,400 on average in financial assets. That compares to the top quintile, whose financial assets are just under 200,000, so, you know, huge differences here in wealth holdings. As I suspect you all know, wealth holdings are much more unequally distributed than income holdings.

If you look at low income families, those below 20,000, you find that between 20 to 25 percent of them are unbanked, they do not have checking accounts, they do not have a formal relationship with a bank. If you look at moderate income families, between 20 to 40,000, 13 percent of them are unbanked. So there’s still a substantial need here to expand and improve formal financial services. What are the four messages of the book that I most want to highlight? Message number one, low income households are financial decision-makers who need a range of financial services. They need a place to receive and store income, to invest and create wealth, to pay bills and to receive credit. And, in fact, one might argue that low income families,
in some ways, need at least short term financial services far more than many middle or upper income families. Why is that? Because of the high degree of variability in the income that low income families face.

Unemployment is much more concentrated among people of lower educational levels and in low wage jobs. So right now, if you look at unemployment rates among the college educated, they’re around four percent. Among those who are high school dropouts, they’re around 13 or 14 percent.

That spread, while it’s going up, is not unusual. And even in times of low unemployment, you have a huge spread in, you know, the bulk of unemployment is born by low wage and low education workers. They are also disproportionately involuntary part-time workers, therefore, they move in and out of jobs much more, they’re much more likely to have variable incomes because their jobs come and go. In addition to that fact, it’s also true that household composition in low income families turns over more and changes more. It’s more common for earners and adults to move in and out of the household. You know, partnership arrangements change at a little bit higher rate, so that you’ve not only got variability in individual income, you’ve also got greater variability in the composition of who are the adults in the household. And you put those two forms of variability on top of each other, and incomes simply are much
more volatile among lower income families than among higher income families.

What does that mean? That means their need to smooth consumption is much greater than among higher income families on a short term basis. They need either short term savings or flexible credit in order to handle exactly those sorts of income fluctuation problems. So message number one is that low income families, you know, need involvement with financial sector.

Message number two is that – which falls directly out of this, is that short term income - short term consumption smoothing may be even more important than long term savings. And I don’t in any way want to imply that long term savings, you know, for education, for retirement, for home ownership, for people for whom that makes sense, is not a good thing to do. But given the variability that you see in incomes, the first need for low income family savings is to smooth short term consumption, so that even $200 -- $300 can make a difference. If you hit a point where your utility - you get in trouble with the local utility and your utility gets shut off, or, you know, you get into an accident with your car and your car needs work, to be able to deal with that immediately can make a real difference, and particularly if you are a lower income household, of course, and you can’t deal with those things
immediately, stuff can, you know, can start cascading on top of each other.

So your car breaks down, you don’t have the $200 to fix it, you don’t get to work on time for a couple of days, you get fired from your job, and, you know, you have those sorts of cascading risk issues which happen again and again when you look at what gets low income families in trouble.

So this need for short term consumption smoothing, you know, is one of the emphases of this book, and I think it’s quite important, in part, because the discussion in the policy realm, and certainly in the research realm, over the last five to ten years has all been about big long term savings, it’s been about things like individual development accounts designed to get people to save for retirement, to save for education, to save for home ownership. Again, I don’t want to say that’s not unimportant; if we can establish that type of savings, that would be wonderful. But for many low income families, the first need is to provide the short term consumption smoothing so you get, you know, you provide stability on a day-to-day basis and a month-to-month basis in terms of your financial affairs.

And, you know, first of all, getting people to have the short term cushion is the first order of priority, and that can either be savings or it can be some form of flexible credit that doesn’t have exorbitant interest rates with it, or, you
know – and then, of course, you also want to talk about long
term savings, as well, and Peter Tufano I think is going to talk
about some of those issues.

So lesson number, you know, comment number two is
search and consumption smoothing, and the implications for that,
the value of small savings, the value for credit is important.
Lesson number three, low income households use both formal and
informal means to manage their financial lives. So you see a
lot of low income households that have checking accounts,
participate in credit unions, savings plans, credit cards,
standard loan, and mortgage vehicles. On the other hand, you
also see a disproportionately high use of informal financial
sector services, things like pay day lenders, check cashers, and
sort of, you know, the money and credit people whose signs hang
out there in low income neighborhoods, refund anticipation
loans.

And the interesting comment here is that this isn’t an
either or, it’s not that people are either banked or they use
pay day loans, but for many people it’s actually a both and.
And when you go in and look at the data on what people on their
day-to-day lives are doing, you see quite a large number of low
income families that both participate in the informal financial
sector and participate in some ways in the formal financial
sector.
So they may have a bank account, but they take out pay day loans every so often.

And what this suggests is that the formal financial sector is not meeting the full needs of, as these people define them, for their, you know, financial services, that they turn to the informal financial sector at times when they need, you know, various additional things. And particularly short term credit is often something that people have a great deal of difficulty finding, which leads them to turn to pay day lenders and all of the problems that those involve. You often see people who claim that the costs of formal financial services are very high.

And it turns out, of course, that banks, over the last ten to 15 years, for a whole variety of reasons, have gotten very, very good at segmenting the market, so that they can make it very hard for people who want to hold very small bank accounts and who might have variability in income and may occasionally bounce checks, it can make it very, very expensive for those people to be formally banked. So that often times you will see people who respond to surveys saying that it’s actually cheaper to go to a pay day lender than to go to my local bank, or that the pay day lender or the money market check cashier provides services I can’t get from my local bank.

And thinking about exactly what are the policies that bring people more fully into the formal sector, provide the
services that they need, and keep them out of the problems that
often they get involved with when they go into the informal
sector is one of the big policy issues in this area, okay.
Finally, the fourth lesson that I think comes out of this book
is that these wealth differences, as we know, are significant
between high and low income families. I mean it’s nobodies
surprise to know there’s huge wealth differences.

But there are a couple of groups for whom these wealth
differences are not explained simply by low incomes. And the
two most common groups that this book talks about are African
American – the African American families and immigrant families,
that simply taking account of peoples’ long term income streams
and what their savings potential might be is not enough to
explain the very low wealth holdings among immigrants and
African Americans relative to other groups, and that you have to
understand more than just what peoples’ income looks like, you
also have to understand something about the behavior and the
institutional opportunities that those particular populations
observe or perceive or think they observe.

So, for instance, the chapter on immigrants notes that
immigrants who come from countries that have bad financial
sectors that are either corrupt, that lack transparency, that go
through regular bank failures, that people who come from those
countries are very reluctant to engage in formal financial
institutions in this country. Perhaps that’s not surprising, but, of course, that then puts them at a real disadvantage in this country when they’re in need of credit or they’re in need of interacting with something that the formal financial sector can provide, and they’re more likely to get that in another way and potentially get themselves into trouble.

So thinking, as well, about not just income and how that leads to wealth differences, but behavioral differences and institutional opportunities and how those three interact is what you really need to do to understand long term wealth holdings and differences in wealth holdings across populations.

So having said those – those are the four main lessons that I think are most interesting that come to this book. Let me just talk very briefly about some of the policies.

And I’m going to – there are a few private sector policies, a few public sector policies. I’m just going to touch these, name them, and encourage you to go back and read some of the sections that talk about these in greater depth. So from the point of view of the private sector, increases in banking services aimed at low income families are very important. And this is something that – I’d say there’s really good news here of the growing interest in communities to expand banking services to low income populations. And the poster child for this is the bank on San Francisco Project that’s being copied in
a lot of other cities, where the city and the private banking sector have really joined together to try to expand the services and provide debit card banking, low overhead accounts, you know, small accounts that you don’t have to pay a lot because you have a small account at the bank, to make banking available at retail stores that low income families will frequent.

So, increasingly, as you all know, if you go to Target or Walmart or those sorts of stores, there are now banking outlets in a growing number of those stores. It’s a way to provide services in a much more convenient way.

And what the employers do in the private sector is equally important. So, you know, there’s been a large discussion and a change in the law that allow employers to provide, you know, a different set of opt and criterion for savings plans, so people who are automatically into pension or savings plans would have to opt themselves out. And those sorts of things can make a real difference. So there are a variety of issues here on the private sector. The public sector is, obviously, a partner in much of this. So let me just name a few public sector programs that are mentioned in the book; tax incentives to banks to help them serve lower income populations, to make it worth their while, because many banks worry that they cannot financially afford to serve expanded numbers of lower income families.
Secondly, IRS refunds, so that when your refund comes through, if you are an unbanked individual, you have the option of having the IRS create a bank account for you by creating a debit card with that refund which you can actually use as a regular bank account. And it’s a way to try to avoid some of the refund anticipation loan problems.

A third option here, we have large numbers of public assistance programs that use electronic benefits. They tend to operate with an electronics benefit card that’s entirely separated from the financial system, it’s run by a separate contractor.

What we should be doing is putting these electronic benefit cards in as bank debit cards that attach you to one of the local banks and give you an actual bank account. So if you’re a food stamp holder, your food stamps are coming through a bank account; if you’re a public assistance recipient, you’re getting your electronic benefits through a bank account, and you can use that bank account for further purposes, as well.

A fourth issue, savings incentives schemes, and Peter is going to talk about this, he’s got a great chapter talking about that particular issue. I don’t have to tell you about the regulation of the mortgage and the credit card industry, we’re in the midst of those conversations right now on the Hill and in the Administration.
And then lastly, I want to note that traditional redistribution programs for low income families are not irrelevant when you’re talking about financial services. First of all, the problems of health and inadequate health care coverage are one of the main reasons that a lot of moderate income families end up in bankruptcy and end up facing a lot of credit related problems, so that simply solving the uninsurance and the underinsurance problems will do a lot to solve some of the really severe financial problems in certain sectors of low income and moderate income families.

In addition to that, many of our redistributional programs really are savings programs for lower income families that may not, by themselves, be able to save enough. So you can imagine savings programs that encourage people to save for retirement, that encourage them to save for education, but that are supplemented by Social Security, that are supplemented by Pell Grants. And particularly, if you’re a low income family, saving enough to get to college, saving enough to create a secure retirement may simply not be possible on very, very low incomes.

But with the knowledge that there is some safety net out there and that what you’re doing is saving to provide additional benefits on top of that may make going to college, or thinking about a secure retirement, or, again, under the right
circumstances, thinking about home ownership, you know, the right thing to do.

So if you take nothing else away this morning, the main message I want you to take away is the need for consumption smoothing, and for short term savings, and for short term and flexible credit within low income families, and the need for financial mechanisms that help stabilize and support good economic decision-making. And with that, I’m going to stop and let a couple of our people who have been involved with this book talk specifically about the topics on which they were writing. Thank you. And I’m going to invite the panel to all come up here to the stage and we’ll just go down the line.