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

Segment #5: Policy and Research Comments, William Gale

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MR. GALE: All right. Thank you very much. It’s always hard to follow Peter Tufano because he’s such a great speaker and has such interesting ideas. It’s particularly hard this morning because he swiped some of my ideas. But I will - I take that as a sign that sort of brilliant minds think alike, they just can’t communicate with each other.

Anyway, this is an extraordinarily good book. A lot of people put out conference volumes and a lot of people care about the poor and a lot of people care about saving. I put out some of those conference volumes on saving, and so I can say I think with appropriate authority, this is an excellent book, the editors make great choices in terms of the authors and the topics, the authors really put together some first rate paper, some first rate thinking, and it’s really kind of the state-of-the-art where the profession is on this issue right now.

I am going to comment not so much on the book, but on the whole diastole of the literature, and the way I want to do that is by focusing on five issues, starting with the simplest one, moving to the most complicated one. And all of these issues are touched on in the book. I’m not going to create all the links for you, but it’s all in there. So the first question, focusing on Becky’s emphasis on the short term
consumption issues, is how important is it to have a bank account for someone to move up the economic ladder?

Clearly, for someone who is upper middle class or is running a big business or whatever, a bank account is a regular functioning – regular part of functioning. But if someone is low income and sort of marginal to the system, how much do we gain by getting them into the financial system, into the formal financial system? I think that’s a first order question.

Of course, the counter hypothesis that when people are ready to move in, they move into the formal financial system. But there’s a lot of emphasis in the policy discussion on getting people in who wouldn’t otherwise be, and there’s a question of how valuable that is, I think that’s one of the big, open questions here.

And, of course, it depends, in part, on what the bank account looks like. You can imagine high fee, kind of your father’s bank account, which is not going to be very helpful, you can imagine some of these innovative, new bank accounts that could potentially be very helpful, but we don’t know essentially how much it helps people who would not otherwise be in the formal financial system, to move into the formal financial system, that’s point one.

Question two is, what are the economic benefits of home ownership? This was almost a religious questions for many
years in that you couldn’t even have a conversation in Washington about, hey, maybe it wasn’t such a great idea to push people into homes that they were not either mentally or financially ready to sustain and maintain.

The experience in the last 18 months has sort of reopened this discussion. We’ve seen a lot of people who, if the good times had kept rolling, it would have been fine for them to be in homes, but when home prices fall all of a sudden, they do not have the financial wherewithal to continue.

So we need to understand better what the benefits of home ownership are, in particular, what the benefits of moving people into home ownership before they would otherwise move into home ownership are. Peter mentioned the IDA results that - in Michael Sharadin’s chapter. Michael and I and two other people, Mikal Weiss and Bill Rowe at North Carolina, have just finished being in the field for a ten year follow-up survey on those households. We can look at stuff like long term effects of IDA’s on home ownership, and wealth accumulation, and in particular, how the IDA group did relative to the control group over the last five years during all the turbulence in housing markets, and hopefully I’ll report back on that in a couple months.

Okay, the third issue, moving to slightly more complicated and somewhat away from the focus of the book, per
se, but important in the saving literature is, are people saving enough for retirement, and this is a very strange literature. In the ‘90’s, basically every paper said we’re all going to hell in a hand basket. At the end of ’99, I wrote a paper that said, well, it looks to me like about one-third of households are doing fairly well, one-third are doing pretty badly, and one-third are in this nebulous middle where you can’t really figure it out, and that was regarded as like a revolutionary outcome at that point.

Since then, though, almost all the literature has found even stronger effects. Michael Heard, Carl Schultz, Eric Hurst have all found that 80 to 100 percent of Americans are doing just fine. Now, two comments on that, one is, all of that is before the recent downturn; the other comment is, it doesn’t square with what we think of when we think of people on, you know, if you go to a party and ask, people, are you saving enough for retirement, you not only get, you know, no’s, you get, you know, laugh, that doesn’t pass the laugh test, of course, I’m not saving enough for retirement.

So there’s a distinction – there’s a tension between what the data say and what people seem to think. And, you know, if 20 percent of the population can’t calculate change on a restaurant check or whatever those statistics are, you know, it’s hard to believe that 80 percent is saving enough for
retirement. So there’s this tension there and we don’t know what the right answer was, and we certainly don’t know what the right answer is now that the stock market and housing market have both fallen.

Okay, fourth issue, how different are low income households? Yes, they have less money than us, but does that make them different? Is it their constraints that are different, is it their behavior that are different? I think this notion that I believe either Peter or Becky touched on that the same, you know, absolute dollar change, $1,000, can be a devastating impact on a low income household because they lose their car, they lose their job, they start a downward spiral, that wouldn’t happen with the same shock to a middle or an upper income household.

Understanding the sources of differences between the behavior, the constraints, the goals, the needs of high income and low income households is a growing area. But I think there’s been a growing recognition of the difference, but I don’t think there’s a full answer in terms of, oh yeah, they’re just like everybody else, they just have more constraints, or they have different goals or needs or different time horizons.

All right. The last point then is, what do we do about all of these issues. Peter mentioned I think six different tools. The way I’ve thought about this generally is
in four categories; one is the mandate, you can impose Social
Security taxes; the second is incentives, this is, of course, the classic economic solution in terms of tax incentives for saving, you know, IRA’s, 401K’s, IDA’s. I’m less sanguine than Peter was about the benefits of tax incentives for saving, but it is a second option. A third option is to change the defaults, to change the choice architecture to automatic enrollment or automatic investment in 401K’s or IRA’s; and the fourth option is to educate people, to give information. And these options are not exclusive, are not mutually exclusive. You can think of them, in fact, you can think about whether they’re substitutes or compliments. If you default someone into an account, into a 401K, and they start accumulating a balance, does that mean you need to do less education because you’ve already gotten them into the account, or does that mean you need to do more education because you just gave them an account that they have no idea what to do with.

So they’re not mutually exclusive categories. Peter had a couple of other categories that I thought were very good. The communal aspect I think is important. And we need to think about what combination of policies work. But then the deeper question is, work to do what. And this is the thing that I’m currently stuck on, is, do we want to change outcomes, do we want to change the environment in which people operate through
either default or incentives, hoping that that changes the outcomes, or do we want to change people, do we want to change their behavior, their knowledge, their attitude, their aptitude, et cetera, and maybe we want to do all of those things, but some of those are likely to be more effective than others. And just let me give you an example that we were talking about this morning, which is not financial, just get away from the finance side for a second.

Suppose there were a way to put anti-oxidants into cigarettes, all right, would that be a good thing? Well, you know, people who are smoking anyway would then get more anti-oxidants and they would be healthier. On the other hand, you know, you’ve got to be real careful suggesting that cigarettes are a healthy thing to be doing.

Now, that’s a loaded example, because cigarettes, you know, if you use them as prescribed, you will die, but let’s change it to chocolate bars. Suppose the government — suppose somebody figures out a way to get you your full compliment of vitamins and anti-oxidants and put them in chocolate bars, or I think Diet Coke had calcium or something like that, which my wife thought was the greatest thing in the world, and I thought, well, you know, there’s an issue here, which we did not talk about, but there are issues if you, you know, do you want to encourage people to eat chocolate bars as a way to get their
vitamins, their anti-oxidants? And if all you care about is getting the vitamins into their system, the answer is yes; if you care about developing healthy eating habits, then the answer is probably no. And the same thing is true, it seems to me to be true in the saving field. If all you want to do is get people into these accounts or get them to accumulate balances, you follow one or two sets of approaches. If what you want to do is sort of inculcate saving behavior, you know, have people learn about the benefits of savings, you know, change attitudes and aptitude about it, then you might follow a different approach.

And I want to be clear, I don’t have the answer, this is not a criticism of any particular approach, I just think it – the more I think about this issue, the more – once you get out of the strict confines of economics, which tells you if you change the incentive, people will optimize in a perfectly rationale and have full information, once you get into the world of sociology and behavioral economics and psychology, you face these sort of issues, not quite morale issues, but they are – they do present interesting ways to think about policy.

So that’s currently what I’m thinking about in the saving arena. And I found the articles in this book to be very helpful to me in thinking about what the costs and benefits of each of those options are. Thank you.