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

Segment #6: Panelist Discussion, moderated by Belle Sawhill

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Welcome:

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Overview:

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Panelists:

JANE DOKKO
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Panelist Discussion

SPEAKER: Okay. Well, we’ll have a few minutes for discussion up here with the panel, and then we’re going to open it up to all of you, so be thinking about what your comments or questions are. And also, let us know where you’re coming from if you decide to make a comment.

I want to go back to this theme that Bill has I think nicely put on the table here, which is sort of two big questions, and then I want to go down the line here, maybe I’ll start with Becky and go down in this direction, because Becky has the broadest overview here, although Bill, of course, does the whole literature, so you both do.

But the big questions I think are, first of all, as Bill suggested, what are the goals here. And, Becky, you suggested in your opening remarks that — I mean obviously multiple goals, but I’m not going to allow you to give a speech on multiple goals, not a single one of you, okay, so be prepared, I want one answer. I want you to try to tell us what’s the most important goal. You suggested, Becky, it might be short term consumption smoothing, but — so you can come back to that if you want, but that’s the question for all of you, and then what’s your favorite tool for achieving that goal. You know, Peter put forward this very nice set of tools, all with
nice catchy names, you know, from sledgehammers to barns, communal barns, but, you know, Bill got into some issues about how, you know, the tools maybe should be related to the goal. Maybe we don’t want to have a form of candy, like a lottery, to encourage people to save if we have some goals other than pure savings in mind, so this is what I’m trying to get at. So, Becky, let’s start with you for a few more comments on goals and tools.

MS. BLANK: So I am not going to say smoothing short term consumption because I think that gets into a lot of savings things and I’m hoping someone down there will say that, let me talk about something else, because it’s partly a response to Bill’s first question.

I actually think one of the really important goals here is to increase the number of people who are involved in the formal financial sector, which is to increase banking, increase the number of banked individuals who have in some way checking accounts, savings accounts, something that connects them to a formal financial institution.

SPEAKER: Why do you want them to do that?

MS. BLANK: I want them to do that for several reasons. I think, first of all, it’s really important to have a place to keep money safe, you know. Very few of us, when we cash, you know, get our check at the beginning of the month are
going to spend it all immediately. I mean you need a place to keep your money, you need a place out of which you can pay bills, a way to simply handle money, and you – in this world, that means some form of a financial institution that you don’t pay for every time you want to cash a check, every time you need to, you know, pay some sort of bill in some way or another.

Secondly, banks give you access if, indeed, they provide products that are friendly to low income families, should be giving you access to a series of bank services that include check cashing, short term credit lines, savings vehicles, you know, it gets you the opportunity to find out about, to be educated on, and to potentially have access to a number of things that at certain points in peoples’ lives, hopefully they’re going to have the capacity to take advantage of. So I, you know, plus the ability to earn interest, as well, on the money, so that’s my goal. And then the nice thing about this is that there are multiple tools.

SPEAKER: Can I just push you a little bit?

MS. BLANK: Sure.

SPEAKER: Why is it that that’s not occurring right now? What are the sort of failures, market failures if you will, or personal failures that are preventing that?

MS. BLANK: Jane talks about this, it’s, you know, very clear in the Detroit area study, as well as in a variety of
other pieces of research, that a lot of people consider bank accounts too expensive and too risky, risky in the sense that if they get an overdraft, they end up paying, you know, $50, and $50 is a big amount of money for a lot of low income families, or in many, you know, that issue, there’s an issue of people, say you walk into banks, you get this from immigrants a lot, and they’re made to feel, you know, very much not welcome, you know, people don’t want their money, I mean they’re, you know, intimidated by, if not actually treated badly, in their own view, by people.

There’s a convenience issue here of folks saying, well, gosh, you know, the pay day lender is right there and there’s not a bank nearby. There’s a whole number of reasons why people don’t use banks, but the most important one, to me, is that banks have not worked very hard in the recent past, and I do think this is changing to provide a set of services that are particularly tailored for low income families and low income individuals, that they price their products in such a way that make them simply less accessible and less valuable to those, if not more expensive to those individuals.

SPEAKER: Okay. Bill, do you agree with that? Are there reasons why banks are pricing this product in a way or delivering it in a way that makes it hard for low income people to use it, or should they be doing something different?
MR. GALE: Well, I thought I was asking the questions.

SPEAKER: Yeah.

MR. GALE: Let me go on that note, it would be very useful to know whether the alternative financial sector, the pawn brokers, the liquor store owners that sell banking services, whether they make excess returns.

SPEAKER: Yeah.

MR. GALE: If they don’t, then that alters the nature of the debate somewhat. The argument that people are getting exploited would suggest that there’s excess returns out there. If those can be documented, that would help clarify what’s going on. In terms of what’s most important, I want to come back to something that Peter said, which is that you need to meet people where they are. You can design fancy instruments, you can come up with complex theories, but if people aren’t ready to absorb them, they’re not going to work. They’ll make nice papers, but not good implementation initiatives.

And so I think that - so what the most important goal is, of course, depends on where everybody is. And from my feel for it, I don’t think retirement saving for low income households right now is such a big deal. A, they’ve got Social Security, B, they’ve got huge amounts of much more immediate concerns.
And so I think just — not as an expert on low income households, just through introspection, I think getting the constant buffeting out of the day-to-day life is probably the single most important thing you can do. So I’m going to claim the short term consumption smoothing answer, because I don’t see how people can reasonably plan for the median term or the long term if they’re just constantly fighting battles every day.

So I don’t know exactly what the right solution there is, but something — there is sort of an — I’m thinking sort of loosely, sort of an ordering of needs, and it’s hard for me to see how people can save for a home or a business or a retirement or their kids’ college when, you know, they’re a one car accident away from losing their job, and so focusing on the sort of very mundane, day-to-day stuff I think would be the first step in order to get people to a position where they could focus on the medium term and the longer term.

SPEAKER: Okay, Peter.

MR. TUFANO: The good news about coming third is you get to repeat stuff. You know, so I’m going to think about goals from the perspective of business and then consumers, because I think about both. From the business side, my goal is that there is a sweep of products that form basic financial functions at a fair price. And I need to define the word fair.
Fair, to me, means that it’s at a price where there are no excess returns, but that means that it’s sustainable as a business proposition. And when I said basic, I mean just that, you know, a no risk transaction account, where risk means no risk of loss and no risk of fees, a simple savings account that transforms money from today until tomorrow without, again, risk of loss, a simple credit account. So my goal on the business side is to create a suite of products delivered, and I don’t care whether it’s by banks or not, I’ll maybe disagree with some folks. I want the functions to be delivered. Some of the most egregious financial products right now are being pedaled by banks. So the fact that it happens to say bank on it, to me, is no stamp of anything.

So overdraft protection, for example, has the highest APR’s of any product offered in the financial sector right now. The FDIC’s survey that came out in November said that the average overdraft was $36, and the average fee was $27, and the time to remediate is a few days. That boggles the imagination with the APRS on that product.

SPEAKER: In your view, does this, you know, excess return, predatory lending, whatever you want to call it, which I presume there’s some of, is it interacting with the behavioral thesis that people are a little ignorant about the fact that they’re paying too much for these things?
MR. TUFANO: Absolutely; so that actually goes to the other side of the equation. So if I want to, you know, a basic set of business – a basic set of financial products on the other side, you know, maybe goal is not putting it strongly enough, but dream would be the, you know, households and individuals have basic financial management skills in order to make intelligent decisions. So, for example, I’m going to go back to the overdraft example; we did a case study in a bank in Indiana, and 89 percent of individuals use overdraft either zero, one, or two times a year in that bank, and 11 percent use it over 50 times a year. Fifty times a year times $25 per incident is an extraordinarily high cost of basic banking services.

So, you know, the bank is set up to maximize their profits from that class of customers and cross subsidize others, and the customers are unwittingly bearing all those costs because they’re not able to manage their money any better.

So do some of these business models depend on less than fully informed customers or customers that have severe constraints? Absolutely. And so, therefore, what you have to do is just to try to relieve the constraints by the consumer and improve their financial management skills so they can see, for example, that that’s a $1,200 checking account and not a free checking account, which is the way it was presented. So the goals are both educate the consumer so they make better
decisions, and provide a basic set of products so that they can have something good to pick from.

SPEAKER: Jane, I see you nodding your head on those answers; what would you add or –

MS. DOKKO: So I mean I think the advantage of going last is that I can say I agree with everything that’s been said. And the thing that I wrote down was, I think, you know, the most important goal, at least in my mind, is to reduce the number of financial mistakes that low income households make, because as Becky pointed out, you know, these mistakes can compound or cascade upon other kinds of problems that low income households have with, you know, with their income, with their household structure.

And in some sense, there’s a huge, you know, efficiency loss in the sense that, you know, the financial mistakes that households make, you know, just can reduce the efficiency and the efficacy of social insurance programs and other anti-poverty programs.

And, you know, I don’t think we have a sense for how big that efficiency loss is, but given sort of the high costs that households, you know, can incur in both the banking and non-banking sectors, I mean it could potentially be quite large. And so, you know, as far as tools go, I mean I guess I’m an empiricist, and so I’d like to see sort of evidence on sort of
like what works and what doesn’t work. I think there’s fairly compelling evidence that defaults and sort of changing the environment that households are – make financial decisions and I think there’s compelling evidence that that works. I think that there isn’t, you know, such compelling evidence on incentives.

I also don’t think that there’s very compelling evidence on financial education. And so, you know, you can’t really, you know, “train” low income households to behave better, and these are, you know, all very controversial words that I’m using, but, you know, that’s sort of how we talk I guess as economists.