



# Policy Brief

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## Access to Financial Services, Savings, and Assets Among the Poor

Highlights from the forthcoming edited volume, *Insufficient Funds*, Michael S. Barr and Rebecca M. Blank, eds.

Low-income families are financially underserved. The eight commissioned chapters in this volume analyze the financial constraints and choices of low-income families, describe the ways in which they utilize financial services, and discuss policies that could spur better provision of financial services to them. The chapters in the first half of the book describe the financial lives of low-income households. The second half focuses on specific topics in financial decision making: policies to increase saving among the poor, Individual Development Accounts for long-term asset building, the costs and benefits of homeownership for lower-income households, the changing patterns of

## Findings

- ♦ Low-income families have multiple reasons to have to smooth their income over short-term fluctuations due to less stable employment and earnings. As a result, they have an ongoing need for financial services that can make it easier for them to save or to access credit. Indeed, promoting savings among low-income families to facilitate long-term goals like homeownership or pension income may be less important than the benefits that can accrue when savings can be used to smooth income in response to short-term earnings fluctuations.
- ♦ Low-income families often lack access to financial services that middle-income families take for granted. There are a number of reasons why low-income families tend to be unbanked. Financial institutions frequently require credit checks to open an account, set high minimum account balances, and have high overdraft fees—characteristics that are ill-suited to those living paycheck to paycheck. Few low-cost and easily-accessible savings instruments, credit constraints, and higher cost financial products only increase the economic challenges these families face.
- ♦ Check cashing companies, pawnshops, money orders, and payday lenders are among the alternative financial services that appear to be complements to the formal financial sector for lower-income households. Though expensive, they are often more convenient and easier to use than formal financial services.
- ♦ Legal changes that allowed financial institutions to compensate for higher risk by charging higher interest rates, have resulted in more lower-income families being able to obtain mortgage loans and credit cards. While this has improved access for those previously shut-out of these markets, credit card debt and home foreclosure rates have also dramatically increased.
- ♦ While it is not surprising that lower-income families have less wealth than high-income families since they have less capacity to save, for some groups, particularly African Americans and immigrants, income differences alone do not explain the large gap in wealth.

credit card use and debt burden, and finally, the unique experience of immigrants in the U.S. who may face even greater barriers to the formal financial sector than others.

While each of the chapters in the volume focuses on a slightly different topic, there are a number of common themes running throughout. Foremost is the fact that low-income families are financial decision makers who need a range of services. The fact that these families often rely on informal means to manage their financial lives suggests that the formal sector is not meeting their needs. It is also clear that a relative lack of savings and wealth, which is not entirely explained by differentials in income, impacts many aspects of a lower-income family's life. Forced to use high-cost alternatives, future saving is made that much more difficult. Finally, while savings as a vehicle for long-term asset accumulation is important, short-term economic flexibility and consumption smoothing are equally or perhaps even more important for lower-income households.

## How Low-Income Families Manage Their Economic Lives

In order to paint a picture of the asset holdings of lower-income households, John Karl Scholz and Ananth Seshadri look at wealth holdings using two national datasets. They find that net worth among families at the lower end of the income distribution has gradually increased, though so too has debt. Household net worth grows as individuals age, within a cohort as it ages, and each generation has done a little better than the last. Most of these gains, however, are concentrated among the best educated households. Wealth gains for African Americans tend to be relatively low, and the authors include a discussion of why this might be.

A unique data set collected by Michael Barr in a survey of over 1000 low- and moderate-income families in the Detroit area provides detailed information about the financial services utilized by these families. The findings suggest that existing financial, credit and payment systems do not serve these families well, imposing significant costs and reducing opportunities to save. Many households use both formal as well as informal mechanisms to meet their financial service needs, so that they may hold a bank account but also utilize a check-cashing service. Savings patterns also vary significantly among low-income families. While about a third contribute to savings every month, over 40% never save. The chapter concludes with a discussion of strategies to transform the financial services sector to better serve low- and moderate-income households.

A complement to Barr's chapter is a study by Daryl Collins and Jonathan Morduch of households in South Africa who were interviewed every other week for a year. They find that these families, roughly the same income level as those at the bottom quintile in the U.S., are active financial managers. Similar to the result in Barr's U.S. data, these families also use both formal and informal financial instruments. Like their counterparts in the U.S., they also find it difficult to save in a way that allows them to smooth over negative income shocks or meet unexpected cash demands.

Taking a more theoretical approach, Sendhil Mullainathan and Eldar Shafir argue that low-income households exhibit the same fundamental patterns in financial decision making as do middle- and upper-income households, though the institutional context in which these decisions are made, matters. They argue, however, that there is less 'margin' among low-income families to make financial mistakes, so that the consequences of bad decision-making are much higher for low-income families. The authors suggestion

several policies that would make it easier to save and harder to undertake welfare-reducing transactions.

## Policies Addressing Savings, Homeownership and Debt among Low-Income Families

Saving is hard work, and our institutions are largely designed to make it easy to spend, not save. To address the issue of how saving might be increased among lower-income families, Peter Tufano and Daniel Schneider develop a typology of savings policies. They discuss everything from coerced (mandated) savings such as Social Security, to programs that make it hard not to save such as automatic enrollment in employer-sponsored savings plans, to policies that bribe (or provide incentives for) people to save through, for example, savings matches, to programs like lottery-linked savings plans that actually get people excited to save.

The focus on saving is carried over to the next chapter, where Michael Sherraden focuses on Individual Development Accounts (IDAs) as a means of asset-building policy. IDAs are matched savings plans aimed at lower-income households, and over the past decade a variety of communities have experimented with them. The most important message from these experiments is that the poor can save regularly. However, to be successful as a national policy, a number of issues will need to be addressed, including how to make the programs more cost effective, and how to better facilitate savings among low-income families. The chapter ends with a discussion of national savings initiatives.

The biggest asset many families hold is their home. The next chapter, by Raphael Bostic and Kwan Ok Lee, explores homeownership among lower-income households. There has

been considerable growth in homeownership among this group over the past several decades, due largely to expanded credit opportunities in the form of subprime loans. There are risks associated with homeownership however, particularly for lower-income homebuyers. The authors conduct a series of simulations to address the question of whether and under what circumstances homeownership is better (more wealth enhancing) than renting. Their results indicate that homeownership is not always financially advantageous for low-income households, and may involve serious risks, as the recent financial housing crisis as shown.

Opportunities to obtain credit cards have also expanded in recent years, and both credit card usage and debt have risen over time. Relative to higher-income families, the magnitude of such debt is much greater for lower-income families. Ronald Mann looks at the determinants of who acquires credit card debt, and discusses the need for greater requirements to better disclose actual interest rates and fees associated with the credit cards.

While a number of the chapters in the volume discuss differences across sub-populations of lower-income households, the final chapter focuses specifically on immigrants, who may experience greater barriers to the use of formal financial services than others. Una Osili and Anna Paulson look at both the probability among immigrants of holding different types of assets, and the amounts held. They find that immigrants are less likely to hold checking or savings accounts, stocks, or retirement plans than native-born families. The authors explore the reasons for these differences, and discuss ways to better integrate immigrants into the formal financial institutions of the U.S.

## Policy Directions and Conclusions

The chapters in this volume discuss a wide variety of policy initiatives that might help improve the access of lower income families to savings and financial institutions, and that will help prevent serious problems with credit, such as falling into debt traps or losing one's home through foreclosure. The private sector has an important role to play in better serving low-income families. Bank accounts tailored to the needs of lower-income households (low fee, no minimum balance) will expand their use of formal financial services. A greater presence of formal financial institutions in low-income neighborhoods may also be important. Currently alternative financial service providers often outnumber bank branches in these areas. Employers of low-wage workers can also help shape the financial choices their workers make by encouraging the use of direct deposit and offering automatic saving opportunities to employees.

Of course, the public sector can do many things to increase savings and greater use of formal financial services among low-income families. A key role should be to work closely with the private sector encouraging and incentivizing financial institutions to serve lower-income populations. Greater financial education for low-income families should be a priority. The government also plays an important regulatory role, which includes overseeing financial providers to ensure they provide full disclosure with regard to fees and penalties, and implementing better protections for lower-income mortgage holders. The public sector could also encourage saving by lower-income families by making the saver's credit refundable or creating matched savings plans. Perhaps

most important, the public sector provides the programs that assist low-income families meet retirement, education, and medical needs they cannot afford. Stable funding for Social Security is critical, as is broadly available health insurance and educational subsidies such as Pell Grants. The Earned Income Tax Credit, which lifts many families with children out of poverty, should be expanded to families without children.

Our financial institutions are not well designed to help lower-income families save or acquire credit. To the extent we want these families to have the opportunity for financial stability, we have an obligation to assure that they have access to the banking, credit, and savings institutions that are available to higher-income families.

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## About the NPC

The National Poverty Center is charged with promoting high-quality research on the causes and consequences of poverty, evaluating and analyzing policies to alleviate poverty, and training the next generation of poverty researchers.

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