



The Institute for Research on Poverty¹ and the Center for Financial Security at the University of Wisconsin–Madison hosted a workshop on “Financial Decision-Making, Poverty, and Inequality” on May 21 and 22, 2014. The event brought together researchers and practitioners for a focused, evidence-based conversation about how household financial management and access to financial assets, loans, and transactional accounts and products can serve to support families in their goal to be financially secure. The target group was low-income families, most of whom are unable to save for longer-term objectives. Meeting consumption needs is typically more of a goal for them than accumulating long-run savings. But each week and month, they still need to balance the books as well as make ends meet. The workshop was an opportunity to better understand how programs that might help families balance the books operate “on the ground” and how they are growing in retail financial markets. The goal was to generate insights for interventions aimed at financial access and, for some, asset building among low-income households. This issue of Fast Focus summarizes the workshop presentations and discussion; poses some provocative questions; and looks at the role of research and practice in helping low-income families stabilize their incomes, expenses, and budgets.

June 2014

Getting by: Earning, spending, saving, and borrowing among the poor

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In the last few decades, strategies for promoting financial security and economic mobility have evolved from income subsidies to asset building and, more recently, to financial literacy and financial capability. Learning how struggling low-income families make ends meet and work toward their goals to be financially secure was discussed at a workshop that brought together researchers and practitioners for a focused conversation about “Financial Decision-Making, Poverty, and Inequality” on May 21 and 22, 2014. Launching the workshop was a presentation by Jonathon Morduch from New York University on the ongoing Financial Diaries Project, a breakthrough study that provides a “deep dive” into the fiscal lives of low-income families with frequent interviews over more than a year. The workshop also featured

four panels, each of which included a researcher, a program leader, and a funder or policymaker, that explored “Emergency Savings,” “Credit and Liquidity,” “Technological Solutions,” and “Policy Responses and Alternatives.” The goal of each session was for each panelist to offer no more than 10 minutes of high-level insights or background, followed by 60 minutes of moderated discussion led by the session moderator. Organizers actively encouraged conversations across panels to enable themes to emerge, and sought to facilitate an open dialogue and broad participation with all 35–40 people at the workshop.

Financial Diaries: Volatility

The workshop began with a presentation about the U.S. Financial Diaries (USFD) project² by Jonathon Morduch, professor of public policy and economics and managing director of the Financial Access Initiative at the New York University Wagner Graduate School of Public Service. The study is following more than 230 low- and moderate-income households at four different sites across the country and collecting detailed data on their financial activities and how they make ends meet when faced with a negative cash flow. Field researchers visit households at least every two months over the course of a year.

Fast Focus is an occasional, electronic-only supplement to *Focus* on recent poverty research.

The USFD survey employs a methodology similar to that followed by earlier Financial Diaries studies conducted outside the United States, in Bangladesh, South Africa, and elsewhere.³ It has several unique and key aspects that differentiate it from similar studies. First, the intimate and ongoing engagement over time between field researchers and participating households engenders trust and sharing of personal details that are crucial to understanding the data. Second, frequently discussing earning, spending, saving, and borrowing with households captures not only financial information but also reveals special issues and hard-to-see strategies not uncovered by annual or monthly surveys. Finally, field researchers' engagement with households over time makes it possible to back-fill data and ask important follow-up questions.

Findings so far are telling and in some cases unexpected. For example, in the international studies and in the preliminary stage of the U.S. study, investigators have been struck by how many assumptions about the poor have not been true among the sample. For example, many believe that people who don't have enough resources live from hand-to-mouth, do not plan for the future, and cannot save, whereas Financial Diaries researchers found that households want to, can, and do save. Also, being poor is not just about low incomes. The poor face a triple "whammy" of low incomes, irregular and unpredictable incomes, and lack of appropriate financial tools. Morduch and colleagues chose to conduct the USFD study because it presented an opportunity for greater methodological rigor; to make an opening in discussion on poverty, inequality, and finance; to generate high-frequency data on the financial habits of the poor; to explore questions around saving versus storing value; and to revisit basic consumption smoothing questions.

An important finding in the USFD study also permeated discussion at the workshop: low-income families face extreme volatility in income and expenses. USFD researchers found a pattern of income volatility among the sample that was hidden in larger U.S. surveys. Just over half (51 percent) of households missed an important source of money that was counted on over the course of a year. The high level of financial uncertainty and unpredictability and the lack of control over much of the variability create difficulties even for those households whose incomes are adequate on average over the course of a year. When asked whether "financial stability" or "moving up the income ladder" is more important, 77 percent of USFD participants chose "financial stability."⁴ Researchers are looking for the causes of the income volatility, and finding that the definition of a "month" in a family's financial life matters; when money comes in makes a big difference; and unsteady hours caused earnings irregularity for part of the sample.⁵

Expenditure volatility, in addition to income volatility, among USFD participants is a problem. Nearly half (47 percent) of households had a vehicle maintenance or repair payment of more than \$100. In addition, many families experienced health shocks that exacerbated both income and

expenditure volatility. The mismatch of needs and income makes it hard for low-income households to budget and save; it's difficult to have a meaningful budget when there is so much unpredictability. Researchers are finding very little slack in participants' finances. Nearly all (97 percent) households had a least one month with excess spending; 48 percent had an overdraft in the last year and 23 percent had had two or more; 78 percent did not pay off their credit cards in full every month; and 34 percent had a credit card near its maximum.⁶

Evaluations of saving, borrowing, and bill paying among USFD families have so far revealed that three-fourths of households have saved less than one month's income for emergencies.⁷ For borrowing to make ends meet, many households used informal instruments—savings at home, borrowing from family and friends, and lending to family and friends were the most common. And these debts were the first ones a borrower paid back, as they regarded family loans as the most secure borrowing source in times of financial difficulty. Among those with loans, 55 percent used their credit card to cover expenses in the absence of cash; 41 percent took a loan from family or friends; 30 percent had student loans; 28 percent had vehicle loans; 21 percent had a mortgage; and 10 percent had a payday loan.⁸ Paying the bills also represents a struggle for most USFD participants. Often, expenses do not meet income and each month they must choose which bills to pay late. As shown in Figure 1, while none were late repaying payday loans, 34 percent made a late mortgage payment; 14 percent were late on their rent; 13 percent made their auto loan payment late; and 11 percent were late paying their utility bill.⁹

Emergency Savings: The key is cash-flow management

The first workshop panel explored the topic of "Emergency Savings." It was moderated by Mary Fairchild of the National Conference of State Legislatures. The panelists were David Sieminski of the Consumer Financial Protection Bureau;¹⁰ Mae Watson Grote of the Financial Clinic;¹¹ and Michal Grinstein-Weiss, faculty at Washington University in St. Louis.¹² The main theme of this discussion was that given the income and expense volatility low-income families face, and their general inability to have control over their work hours, the main financial decision they face is related to cash flow management. People who are liquidity constrained learn to time payments with a great level of granularity, even down to the minute. But they also use financial tools and products to manage cash flow, including small dollar loans and unrestricted savings. Small dollar loans are offered in a robust, but high-cost, market (e.g., payday loans). Savings are often stored informally, including using strategies like a "money guard" (having someone else hold your savings for you so you will not be tempted to spend the funds) or a preloaded debit card (so as not to overspend and incur debt). Families use borrowing and saving to make ends meet when an unexpected expense or income drop occurs, including

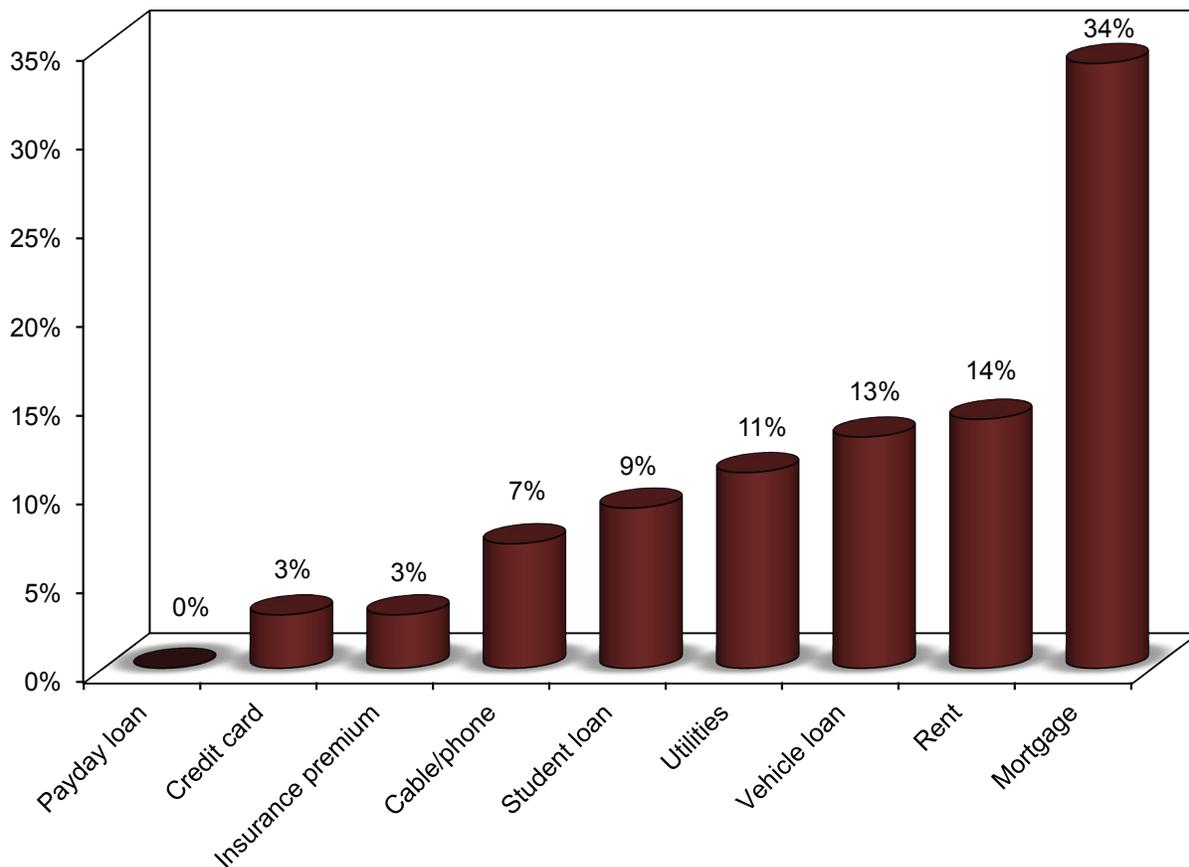


Figure 1. USFD participants: Which bills were paid > 5 days late.

Source: Morduch 2014.

relying on help from family and friends. Cash flow management that relies on an extended family and social network is very common, yet not well understood in the household finance research.

A common assumption in some policy discussions is that all savings activity is positive. Yet many programs prescribe savings restricted for certain purposes, and these forms of savings do not help—and may even exacerbate—short-run cash flow management. The counter position that low-income people focus their limited incomes only on current consumption also proves to be a limited view. Saving is much more of a continuum, with some very temporary savings (stored cash through the end of the week) used as a means to defer consumption. Other savings are accumulated over a few months or up to a year. Account balances will be volatile over time as cash flow ebbs and tides. A key theme of this discussion was that saving is an activity, not an event. People seem to gravitate toward goal-driven strategies to save, but are realistic that savings are there when the unexpected happens. And of course, the unexpected (e.g., sudden layoff, car repairs, or medical bills) does happen. One form of “savings” is the lump sum Earned Income Tax Credit (EITC) offered in the federal (and some states) tax code.¹³ People like the EITC because it is fairly predictable, and because the tax refund mechanism enables them to both prepay and postpone bills.

Creditors seem to have also become accustomed to the EITC refund flow, so this appears to be a trusted form of financial management in low-income communities. In general, strategies to support emergency savings need to have simple and easy-to-use systems. The oft-discussed behavioral interventions and principles such as “opt out” and “off the top” need to recognize that getting the marginal low-income consumer to take part in saving programs is difficult. As much as possible, the “plumbing” of systems should be designed to make saving easy, predictable, and unrestricted.

Credit & Liquidity: Borrowing, saving, and lending are complements not substitutes

The second workshop panel, which was moderated by Michael Collins, explored “Credit and Liquidity.” Panelists were Ida Rademacher of the Corporation for Enterprise Development,¹⁴ Janet Gordon of the Federal Deposit Insurance Corporation,¹⁵ and Fenaba Addo, faculty at the University of Wisconsin–Madison.¹⁶ Economists often frame borrowing as “consumption smoothing” so that families can continue spending even if income drops or expenses spike. To be sure, families engage in borrowing for this reason. But low-income families do so at finer time periods than we might expect, even week-to-week. They also may have a very hard time predicting income or expenses in the next few months.

This has several implications. One is that people will save and borrow at the same time. They will use a payday loan to make the rent while also lending money to someone else in their network who is in greater need over a longer time frame. They may not use savings, even savings with no real interest income, and instead borrow at high rates of interest because doing so may preserve their access to informal forms of liquidity as a reliable source of last resort assistance for tomorrow's unexpected financial shock. In part because of lack of reliability for other income flows, private and public, balancing the books thereby becomes a managerial task requiring a complicated in-flow and outflow of well-timed funds to make ends meet.

The second implication of this pattern of saving and borrowing is that it contributes to stress. Families worry about how to manage cash flow and maintain consumption while juggling creditors and the needs of their extended social network. This seems likely to have consequences for issues like mental health, child development, food insecurity, and domestic abuse that are not well documented in the existing research.

The psychological aspects of savings and debt holding are worth deeper exploration. One view is that accumulating savings becomes a foundation that changes preferences and emboldens households to change their behaviors towards a stronger future orientation (e.g., greater interest in education, starting a small business, civic engagement). Another view is that debt, since it restricts consumption and creates long-term demands for cash flow management, harms a household's ability to attend to their finances and engage in behaviors that drive long-run financial security. These views suggest outcomes that are more likely to contribute to or deter from long-run earnings, and ultimately social mobility in both directions. Debt entails highly salient risks, since nonpayment can result in repossession of durable goods, collections actions, and legal entanglements. While the ideas surrounding the consumer perception of saving and debt resonated in the discussion, the mechanisms behind how people "feel" about saving and borrowing and the resulting behaviors remain relatively unstudied.

Technological Solutions: Promises and pitfalls

Ken Taylor of the Wisconsin Council on Children and Families moderated the third panel, which explored "Technological Solutions" to promote financial capability among low-income households. The panelists were Jeanne Hogarth of the Center for Financial Services Innovation;¹⁷ Frank Kaplan of NetSpend;¹⁸ and Hanns Kuttner of the Hudson Institute.¹⁹ It is perhaps too easy to overstate the role of technology in financial decision-making, given the proliferation of cell-phone "apps" that promise financial security yet linger unopened on most consumers' phones. But technology has transformed how money moves in the economy, possibly more for low-income families than others. Clearly payment systems have changed dramatically in consumer markets.

The number of ways to pay for purchases and services has grown, with a reduced reliance on cash and checks. This has resulted in shorter "float" times as transactions are processed, and therefore a need for closer attention to cash flow management. A growing number of employers use direct deposit and most public assistance is now delivered electronically, including "EBT" payment cards. Payment cards are not widely understood in the financial education or program field, but offer a wide array of options and alternatives, including built-in borrowing and saving, and an opportunity to monitor spending by third parties. The emergence of mobile phone-based payments, retailer/merchant-specific payment networks, and automated payment processing and check cashing predict further changes ahead. Researchers, program managers, financial educators, and policymakers need to better understand payment systems and how these systems affect financial management and cash flow management among low-income families.

The workshop discussion of the future suggested innovations on the horizon such as health insurance companies issuing payment cards and public assistance programs offering cards with features like re-loadability and saving mechanisms. There are a number of concerns with these tools, however, including how well low-income families understand their features and know when to incorporate technology into their cash management strategies. The fees and transparency of costs related to various payment cards and programs is also a concern. While there is truly no "free" way to manage cash flows (for a low-income consumer a typical bank account will include a range of fees and charges), some payment systems could track low-income people into a low-quality, high-cost segment that is hard for people to later exit. And while the monitoring possibilities for EBT's may suggest invasion of privacy, they may also allow us to monitor the flow of funds intended for millions of disabled and older beneficiaries who cannot manage their own resources and thus must trust a "representative payee" to manage their cash flow.

Policy Responses & Alternatives: Fostering innovation while protecting consumers

The fourth panel, moderated by Timothy Smeeding, explored "Policy Responses and Alternatives," especially the role of policies and regulations in helping low-income households manage their finances and protecting them from exploitation. The panelists were Beadsie Woo of the Annie E. Casey Foundation;²⁰ Jim Gatz of the U.S. Treasury Department Office of Consumer Policy;²¹ and Jonathan Mintz of the Cities for Financial Empowerment Fund.²² Since the financial crisis and Dodd-Frank Act reforms in financial services, the tension between innovative ways to access credit and concerns about fees and abuse has been paramount. Much of the discussion was about specific policies and programs, but one theme that emerged was that the rules that financial regulators issue matter a great deal for how consumers and firms behave. With the changes in the role of regulators in the

past few years, there has been more attention on basic consumer financial service, as well as greater ambiguity about what might be permissible. To the extent that regulations can become more firmly established, this ambiguity will be diminished—but quickly making rules without considering the implications for low-income families would be counterproductive and harmful.

As regulations restrict one form of credit access, consumers seem to find alternative avenues to access liquidity. It is not always clear that regulating one form of high-cost credit drives consumers to a lower-cost source, or that such restrictions support cash flow management. While there are a number of model programs and community-based nonprofit strategies in the field, the capacity and scope of these programs remain quite limited. This is likely to be an ongoing issue for this regulatory field and should be of concern to policymakers.

A wide range of policy applications related to financial decision-making for low-income families came up in the workshop. For example, the role of Chapter 7 and 13 bankruptcy regulations and exemptions in choices people make related to saving and borrowing was discussed. Another issue was related to tax filing and the ease with which people can alter withholdings. Child support obligations and the treatment of back child support owed among low-income families was another area of great interest. How banking regulations treat small dollar loans or overdrafts was also discussed, including the murky area of judging borrower ability to pay.

Public programs, public benefits, and programs sponsored by municipalities continue to be leverage points for accessing low-income families and supporting their financial decision-making when it is needed most. Best practices in these fields deserve wider documentation and dissemination, and stronger research is needed that shows the return on investment for the public from facilitating higher-quality financial planning and decisions.

While policies targeting workplace-based strategies are often discussed as examples of innovative approaches to promoting financial capability, for low-income workers these approaches have limits. As low-income workers exhibit greater mobility in employment and attachment to multiple sources of income, new approaches to stabilizing cash flows might be targeted to the self-employed and independent contractors, including tax and legal advice, as well as access to flexible payment plans for health insurance.

The theme of volatility was also discussed. While a large majority of households in the USFD clearly valued the predictability of fixed expenses and stable incomes because these limit volatility and reduce the risks of cash flow management, many also valued the occasional lump sum payment, like EITC refunds. People seem to want a reliable source of one-time funds for durable goods or lumpy expenses, as a form of savings, precisely because it can help limit the nega-

tive effects of fluctuations in earnings and other sources of cash income.

In the end the workshop came back to the realization that low-income families not only manage cash flows as a response to volatility, but also have to manage overall low average incomes across the entire year. Behind the volatility then was the issue of low pay, intermittent work, and the need for stable incomes to support an overall higher level of consumption for families and children.

Provocative questions

The “Financial Decision-Making, Poverty, and Inequality” workshop began with the observation that in the last decade strategies for promoting economic mobility have evolved from a focus on income subsidies to asset-building, then to financial literacy and financial capability. All of these issues remain salient for the lives of low-income families, but cash flow management is increasingly seen as central regardless of income or asset level. Clearly higher and more stable incomes are the primary ingredient for reducing instability; but this solution may not be possible in a world of low-wage work, changing families, and emergency needs brought about by an unreliable job or vehicle, or expected expenses such as rent, and other payment flows. While it is possible there are forms of financial knowledge and skills/capabilities that would enhance people’s ability to manage payments, volatility is a fact of life for low-income families who live on the edge.

The workshop concluded with a number of provocative questions, as follows:

- Is money put into “savings” actually savings if it gets spent on an emergency a few days later, or, if there are no savings at all, is it because the emergency took place just before the savings decision? Is it possible that for many low-income families the major problem is just spreading assets and debts so at the end of the year the books are balanced?
- Given changing labor markets, how long can families use credit as a substitute for higher and more stable income?
- Are income and expense volatility predictable enough that low-income families can begin to plan for the unexpected?
- Who should not save? Are there some families who simply need basic assistance to meet food, clothing, and shelter needs, and for whom financial decisions are too far afield from their day-to-day context?
- What is the role of debt for low-income families with a poor income trajectory? Is there “good” debt? Or is all debt a band-aid?

- What determines, all else equal, why a low-income family is able to emerge from poverty—is it all luck or does financial decision-making play a significant role?
- What makes some families resilient in the face of economic shocks while others flounder?
- How extensive is intra-family borrowing and what mechanisms do families use to check credit, perform collections, and manage defaults?
- What is the psychology of debt and savings, and does each impact behavior in ways that extend beyond access to resources (stress, confidence, future orientation, etc.)? Does the stress of volatility impede executive functioning or cognition? Does it negatively affect family relations and children?
- How fast is new technology coming into the marketplace and how quickly and how well are low-income families adapting to its availability?

While we began a conversation on these questions, they remain important to continue to explore for policy, research, and practice.

Conclusions: Beginning a conversation across research and practice

In the end, financial security is the accumulation of but hundreds of smaller decisions over the course of weeks, months, and years, combined with unpredictable shocks—positive and negative. Financial products are tools that can aid in financial decision-making, but are not a solution in and of themselves. Innovative programs and services, if well-designed and targeted, have the potential to help people make choices that are consistent with their personal financial goals, but there is not an obvious universal strategy to promote improved financial well-being. We lack a definitive “vaccine” to inoculate low-income families from being victims of fraud and predation, as well as from their own decisions that turn out to have been in error. Financial well-being may be a subjective notion that is driven by income and expense volatility, or perceptions of volatility, rather than absolute levels of income, consumption, or wealth. Ultimately, developing methods for stabilizing budgets, incomes, and expenses would be invaluable to otherwise high-stress, low-income families living on the edge between solid financial ground and a steep financial precipice. ■

¹Funding for this event was made possible in part by grant number AE00102 from the U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation (ASPE), which was awarded by the Substance Abuse and Mental Health Services Administration (SAMHSA). The views expressed in written conference materials or publications and by speakers and moderators do not necessarily reflect the official policies of the Department of Health and Human Services; nor does mention of trade names, commercial practices, or organizations imply endorsement by the U.S. Government.

²<http://www.usfinancialdiaries.org/>

³See the brief, J. Morduch and R. Schneider, “The USDF Methodology: The Financial Lives of Low-Income Americans,” U.S. Financial Diaries Project, n.d., available at <http://www.usfinancialdiaries.org/sites/default/files/publications/USFD%20Methodology%20Brief%2012.2%20Printer%20Friendly.pdf>.

⁴J. Morduch and R. Schneider, “Spikes and Dips: How Income Uncertainty Affects Households,” U.S. Financial Diaries Project, n.d., available at http://www.usfinancialdiaries.org/sites/default/files/publications/Uncertainty_12.2%20for%20web%20print.pdf.

⁵Morduch and Schneider, “Spikes and Dips.”

⁶J. Morduch, “The Great Mismatch: Income Volatility and Spending Shocks of Low-Income Households,” lecture at the Institute for Research on Poverty, University of Wisconsin–Madison, May 21, 2014.

⁷Morduch, “The Great Mismatch.”

⁸Morduch, “The Great Mismatch.”

⁹Morduch, “The Great Mismatch.”

¹⁰See <http://www.consumerfinance.gov/>.

¹¹See <http://thefinancialclinic.org/>.

¹²See <http://brownschool.wustl.edu/Faculty/FullTime/Pages/Michal-Grinstein-Weiss.aspx>.

¹³See, for example, Financial Decision-Making workshop panelist Michal Grinstein-Weiss’s research brief: Grinstein-Weiss, M., Comer, K., Russell, B., Key, C., Perantie, D. C., and Ariely, D. (2014). *Refund to Savings: 2013 evidence of tax-time saving in a national randomized control trial* (CSD Research Report 14-03). St. Louis: Washington University, Center for Social Development, available at <http://csd.wustl.edu/Publications/Documents/RR14-03.pdf>.

¹⁴See <http://cfed.org/>.

¹⁵See <http://www.fdic.gov/>.

¹⁶See <http://www.healthandsocietyscholars.org/1822/16821/284713>.

¹⁷See <http://www.cfsinnovation.com/>.

¹⁸See <https://www.netspend.com/>.

¹⁹See <http://www.hudson.org/>.

²⁰See <http://www.aecf.org/>.

²¹See <http://www.treasury.gov/resource-center/financial-education/Pages/default.aspx>.

²²See <http://www.cfefund.org/>.

Fast Focus is a single-topic brief put out several times a year and distributed electronically (only) by the

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Fast Focus is free of charge, although contributions to the UW Foundation–IRP General Fund sent to the above address in support of *Fast Focus* are encouraged.

Edited by Deborah Johnson.

This publication was supported by Grant Number AE00102 from the U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation (ASPE), and awarded by the Substance Abuse and Mental Health Services Administration (SAMHSA). Its contents are solely the responsibility of the authors and do not necessarily represent the official views of ASPE or SAMHSA.

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