

Wealth Building for Low-Income Families



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Editor

Saving is important for all households, but especially for those with low incomes.

In fact, if low-income families can find a way to keep consumption steady during economic downswings, the benefits can be significant. One study found that low-income families with \$500 in emergency savings had better financial outcomes than moderate-income families with lower savings. Households that are “liquid-asset poor” are twice as likely to experience material hardship after a job loss, health emergency, or other adverse event.

The personal saving rate—which now stands around 5 percent—provides a broad picture of Americans’ saving habits. What it doesn’t do is highlight the significant differences in saving rates among people with different incomes. Those in the lowest income brackets consistently save smaller fractions of their earnings than high-income households, research shows. After the latest recession, low-income families are finding themselves in an even more perilous financial position than before.

In this time of stretched public resources, policymakers and financial institutions face new challenges in building safe, responsible credit products for people with low incomes. The Federal Reserve Bank of Cleveland and the University of North Carolina’s Assets Building Research Group co-hosted a conference on this very topic in late 2010. The conference brought together top policymakers, researchers, and community development specialists, including Ray Boshara, senior advisor with the St. Louis Fed.

Lower Savings = Higher Stress

The virtues of saving extend beyond straightforward financial stability; they also encompass less tangible indicators of well-being.

This is not surprising—if you are wealthy, then you are more likely to feel comfortable about your financial situation than you would

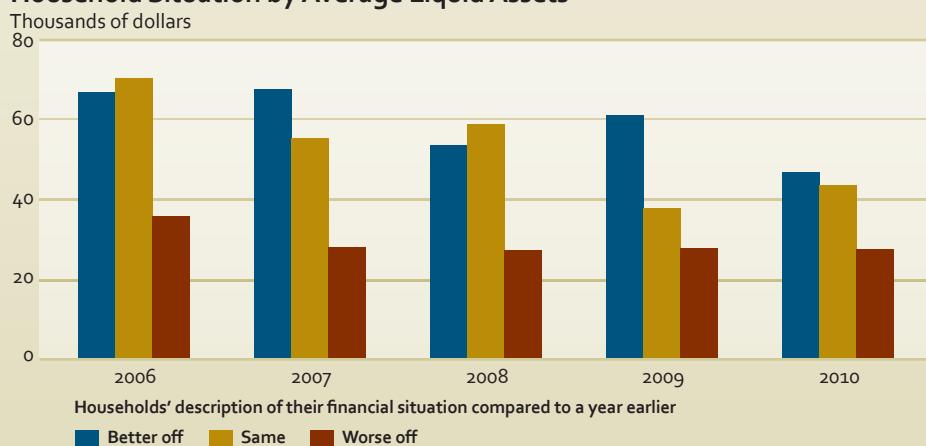
be if you were poor. In fact, this intuition is validated in the Ohio State University’s *Consumer Finance Monthly* survey.

The survey asks respondents how much better off they are, compared with a year earlier. When the results are broken down by average liquid assets per household (which includes savings, checking, and money market accounts), it’s clear that, in any given year, those who say they feel better off have considerably higher average assets than those of the respondents saying they feel “worse off.”

So while it’s intuitively clear, it has also been shown empirically that stress and a lack of savings go hand-in-hand. To improve the well-being of people on low incomes, addressing the saving problem would be a good first step.

Sources: Center for Human Resource Research at the Ohio State University; Federal Reserve Bank of Cleveland.

Household Situation by Average Liquid Assets



The Next Generation of Credit Products for People with Low Incomes

Product/Provider	How It Works	Benefits
Individual development accounts (IDAs) Various providers	A nonprofit association sponsors a saver, who opens an IDA at a financial institution and participates in financial education classes. The sponsor matches every dollar the saver deposits in the IDA.	Research shows that IDAs help connect disadvantaged populations to mainstream financial services and have a positive effect on their saving.
Piggymojo www.piggymojo.com	When tempted to buy something non-essential, the consumer texts or tweets piggymojo instead, which notifies the consumer's partner about the money not spent.	Piggymojo provides a concrete way to save in the moment and reinforces the saver's decisions with positive feedback.
AutoSave New America Foundation's Asset Building Program with MDRC, a nonprofit organization	Employers set up a channel for workers to deposit a portion of each paycheck directly into a dedicated, flexible savings account.	Because it is integrated with the regular paycheck, AutoSave removes inconvenient barriers to saving and makes the process seamless and habitual.
BankOn USA Dozens of independent programs nationwide	Participating financial institutions charge low-income customers reduced or no fees to open accounts, waive monthly minimum balance requirements, eliminate certain overdraft charges, and accept government identification cards from other countries.	BankOn helps low-income people avoid predatory lenders and expensive check-cashing services.

One of the keys challenges, Boshara says, will be to provide low-income people with saving tools that don't shield them from broader market forces. In the wake of the financial crisis, the knee-jerk reaction might otherwise be to avoid looping low-income people into saving programs for fear that they would lose everything in the event of another crisis. According to Boshara, that's precisely the wrong conclusion.

"If you're not subject to the losses, then you don't win from the gains, either," he explains. "Before the crisis, we extended credit and homeownership opportunities to people who weren't ready for them. The problem was not enough access to mainstream financial services. We can do wealth-building more responsibly for low-income people."

As many as half of all Americans—most of them in the bottom half of the income distribution—do not save at all, largely because they lack access to saving instruments. Employers who pay low wages are less likely to offer 401(k) plans, for example, let alone direct deposit of wages into employees' bank accounts. This disconnect between low-wage earners and the formal financial services industry forms a significant part of the problem.

The question is why people with low incomes don't engage in formal saving plans. Is it because of their lack of interest—or the financial industry's failure to provide targeted services?

"Industry folks say the demand isn't there," maintains David Newville, senior policy analyst with the Center for Financial Services Innovation. "There is sometimes not a lot of interest in delivering a new savings project" by the private industry.

Nonetheless, Newville says, a number of saving programs aimed at people with low incomes are being developed. Some of the more familiar ones are listed in the box above. ■

Asset-building strategies



Learn more about asset-building strategies in a summary of the Federal Reserve Bank of Cleveland's conference, "Saving Strategies and Innovations for Low-Income Households," at www.clevelandfed.org/saving_summary