

Inclusion in Asset Building: Research and Policy Symposium

Commentary on Empirical Research on an Asset Building Policy: A Microeconomic Perspective

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Discussant Comments



Center for Social Development



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This commentary considers recent empirical research on an asset-building policy from a microeconomic perspective, places it in the larger context of programs that assist low income individuals, and suggests avenues for additional research.

Individual Development Accounts (IDAs), which were developed by Michael Sherraden (1991), enable low-income individuals to accumulate savings for long-term goals, such as home ownership, post-secondary schooling, and business capitalization. These goals are often beyond the reach of low-income individuals, not only because they have limited personal finances, but also because they often do not have adequate access to credit. In addition to encouraging saving, IDAs are one means, among a number, to encourage low-income individuals who are currently “unbanked” to enter the mainstream financial sector (Caskey, this volume).¹ Participation in the mainstream financial sector has numerous advantages including lower transaction costs, stronger consumer protection, and an opportunity to earn interest on accumulated funds (Caskey, this volume; Hogarth and Lee, this volume). It has also been suggested that IDAs may have beneficial psychological effects, by shifting individuals’ focus from the “here and now” toward the future.

The conference papers provide a first empirical look at the effect of IDAs, using data from the American Dream Demonstration (ADD), along with the effect of other savings opportunities on the behavior and decisions of low-income individuals. These studies, along with other work, provide evidence that the poor respond favorably to savings opportunities. Schreiner et al. (this volume) found that the average participants in the American Dream Demonstration (ADD) made a net monthly deposit of \$24.40, which translates into around \$880 per year at a match rate of 2:1. While these figures are suggestive, they do not indicate how much would have been saved in the absence of the ADD program. Stegman, Faris and Gonzalez (this volume) look at this question by comparing the savings behavior of individuals who have the characteristics of the ADD population, whether or not they are currently participating in the program. They found that the ADD program induced one-half of participants to save more than they would have in the absence of the program, while it induced the other half to save less.² One would expect that total accumulated savings, *including* the match, would be the same or greater for ADD participants. Oddly, however, they did not find this to be the case for a substantial fraction (one-third) of ADD participants, a finding that remains to be resolved.

Instead of focusing on savings per se, Moore et al. examined how ADD participants accumulated funds for deposit. They found that participants did so by adjusting their consumption and work activities in a variety of ways, including shopping more carefully, eating out less, reducing discretionary expenditures and working more. They also found that a non-negligible fraction postponed doctors’ visits or delayed paying bills, which raises some cause for concern.

¹ In addition, banking practices might be altered, including offering branch “outlets,” accounts with low minimum balances, fee-based check cashing, Christmas club type accounts, and deposit-secured emergency loans (Caskey, this volume).

² This latter effect is possible because the match allows participants to put less of their own money in the bank and still accumulate the same or a larger total amount of funds.

In addition to IDAs, the Earned Income Tax Credit (EITC) provides a potential savings opportunity since virtually all recipients receive it in a lump sum. Smeeding, Ross, and O'Connor (2000) asked a sample of Chicago residents who anticipated a tax refund (largely the EITC) what their top priorities for the refund would be. Notably, they found that nearly 50 percent of recipients planned to save at least a portion of it. In related work, Beverly et al. (this volume) examined a sample of low-income individuals who were offered a chance to open a savings account at the same time that they received tax preparation assistance. They found that a number of previously "unbanked" individuals decided to open an account when they learned they would receive an EITC refund, providing additional evidence that the poor respond favorably to savings opportunities when they are at hand.

In the conference papers, with the exception of Smeeding (this volume), it is assumed that the asset-building policies targeted at the low-income population exist in isolation. While this is a useful initial assumption, a next step in the research agenda is to examine asset-building policies and their effects in the broader context of programs designed to assist the low-income population. This is important because commitment to a new program may potentially divert resources from existing programs, whether private or public, especially in times of economic downturns. In addition, there may be potential conflicts in policy goals. And, policies may have unintended as well as intended consequences

In designing programs to assist the poor, policymakers have attempted to increase incomes or provide in-kind transfers to meet basic needs, and sought to encourage (or at least not discourage too much) paid work, while trying to limit the number of individuals eligible for the programs, and hence costs. However, it has not been possible to accomplish all three at the same time. This has been termed the "iron triangle of welfare." For instance, if the tax rate imposed on welfare benefits for each additional dollar is reduced, say from 100 to 50 percent, this has the benefit of encouraging work, but it also increases the number of individuals eligible for the program and hence program costs. Or, if the maximum benefit is reduced, this keeps program costs down but many more families will be in poverty. It is also worthwhile noting that policies, with the exception of the IDA, have not been explicitly designed to encourage asset-accumulation, and in fact, major state and federal welfare programs discourage individuals from doing so; eligibility rules typically require that assets, in addition to income, fall below a certain threshold, or they place a limit on the value of owned vehicles.

The conference points to two additional policy goals: 4) move individuals from the alternative financial sector ("unbanked") to the mainstream financial sector ("banked"); and 5) encourage savings/asset accumulation. Not surprisingly, those with the lowest incomes also have the lowest asset levels (Haveman and Wolff, this volume) and are much more likely to be "unbanked." (Hogarth and Lee, this volume; and Caskey, this volume). These goals, along with the three stated earlier, raise additional potential policy conflicts that warrant consideration.

First, there is a potential conflict between asset accumulation and poverty alleviation. There are two things that one can do with income, either spend it or save it. Encouraging asset accumulation necessarily means that individuals must defer consumption. While Moore et al. (this volume) found that IDA participants typically accumulated savings by becoming a smarter shopper or reducing discretionary expenditures, they also found that some participants did so by

postponing doctor and/or dentist visits (though this was significantly less likely for those with children). Given the importance of preventive medicine, these latter behavioral strategies may potentially worsen participants' health outcomes. They also found that some participants postponed paying bills, which can negatively affect their credit ratings and further reduce their likelihood of participating in the mainstream financial sector. They also found that some individuals increased their debt, either by charging more goods on their credit cards or borrowing from family and friends, though these strategies were quite rare.

Smeeding (this volume) raises this same issue somewhat differently. Is the Earned Income Tax Credit (EITC) an income or an asset transfer? *For a single dollar, it must serve one or the other purpose; it cannot serve both.* For the poorest individuals and families, the EITC may function as an income transfer program only. For instance, Rebecca Blank (2000) indicates that for a family comprised of a minimum wage worker (full-time, full-year) plus 2 to 3 children in 1998, the EITC just raised their income to the poverty level to cover basic needs, leaving few if any funds to meet long-term goals. On the other hand, for those who have higher incomes and are at the upper end of eligibility for the EITC, the EITC might be viewed as an asset transfer.³

Second, there is a potential conflict between asset accumulation and cost containment in welfare programs. As noted, IDAs and other asset accumulation “vehicles” provide incentives to save. In response, individuals may, for instance, spend less of their own money on food and instead make greater use of food stamps or local area food banks. These actions would serve to increase the number of food program participants and hence the financial burden placed on these programs. If IDAs are made more widely available, other costs might rise (or at least not decrease) as well. For instance, Schreiner et al. (this volume) point to the benefits but also the high cost per participant of providing close contact between IDA staff and participants in the ongoing demonstration projects. It is possible that such costs could be as high in a larger-scale program, since efficiency gains may be difficult to realize. Also, in a larger-scale program there would be an increased risk of fraud and the costs associated with it because a much larger and perhaps more varied set of withdrawal requests would have to be reviewed.

Third, there is a potential conflict between asset accumulation and encouraging paid work. IDAs encourage paid work since the program matches earned income that is saved. Indeed, Moore et al. (this volume) find that paid work increased among program participants. On the other hand, this effect may be dampened by the fact that individuals need less money than before to accumulate the same dollar amount of savings (see Stegman et al., this volume).

In future work, I would suggest that attention be paid to the following points. First, a tenet of microeconomics is that individuals respond to incentives (see, for instance, Pollak, 1998). It is important not only learn more about how individuals respond to asset opportunities but also to focus on what is given up in doing so. Moore et al. (this volume) provide a good start at looking at these types of issues, though their sample size is small and their study group is restricted to program participants, who may be more motivated to save than the general population. In addition, it is important to recognize that policies have feedback effects. For instance, the

³ However, for those with higher earnings in the phase-out range of the EITC, the value of the credit is smaller.

generally low level of assets held by the low-income population, as discussed in Haveman and Wolff (this volume), may, in part, reflect a rational response to the availability of unemployment insurance and the presence of the federal/state safety net (TANF, food stamps, etc.) That is, individuals might maintain lower asset levels given the very existence of these programs. Also, as noted, deferred consumption may lead to greater take-up rates in the food stamp program and greater demands placed on area food banks.

Second, it is important to keep in mind that the studies presented here consider the effects of asset accumulation on the behavior of individuals who have voluntarily participated in a savings program. Program participants are those likely to be the most motivated to save in general, or have a particular interest in one of the long-term goals targeted by the program (home ownership, post-secondary schooling or business capitalization). As various authors indicate, the behavioral responses they identify may not accurately reflect the behavior of any randomly chosen unbanked or poor individual who is given a savings opportunity. This is not to say that looking at the behavior of participants is inappropriate or uninteresting, but rather that extrapolation of findings to the broader population must be done with care.

Third, the conference papers raise some question as to the possible uses of accumulated IDA funds. IDAs, by and large, encourage three specific activities. Though their lists differ somewhat, Smeeding (this volume) and Beverly et al. (this volume) point to a much wider array of activities that might enhance “social and economic mobility,” including purchasing a car or a computer, moving to a better neighborhood, paying off medical bills, or putting funds aside for retirement. Many of these activities seem worthwhile as well. Is it feasible to expand the current list of long-term goals that are encouraged by IDAs? IDAs might also be expanded to allow for emergency withdrawals (unmatched funds only) that arise, even for those who have the best intention of saving toward long-term goals. This modification might also increase the take-up rate for IDAs, and in turn, increase the fraction of low-income individuals participating in the mainstream financial sector.

Fourth, it would be useful to understand why the EITC is taken as a lump sum by virtually all recipients. Is it because they want forced savings? Or is it because they are not aware that the EITC can be received in increments, or because their employers are reluctant to do so? Smeeding (this volume) raises this question but does not address it here.

Fifth, it is important to take account of the interaction between IDAs and state and federal welfare program rules regarding income thresholds, asset limits, work incentives, and family structure incentives. Of particular interest here are rules regarding the treatment of assets. If, for instance, monies in IDAs are disregarded in determining eligibility for welfare programs such as TANF and Food Stamps, this will serve to increase the number of individuals eligible for these transfer programs, thereby potentially increasing their costs.

In conclusion, an asset-based policy holds much promise. A microeconomic perspective also indicates that much remains to be learned about its effects on incentives, possible feedback effects, and its interrelationship with other programs that seek to meet the needs of low-income individuals.

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