

Assets and Liberty: Encouraging Healthy Savings Habits for Low-Income Households

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Abstract: Our current welfare system places too much of an emphasis on income and consumption over wealth and assets. The United States has a long history of encouraging asset accumulation for all classes. We also have a long tradition of promoting both formal and fair equality of opportunity. Assets are an important determinant for many life outcomes, and an important consideration for fair and formal equality of opportunity. As such, they deserve special consideration in the discussion of poverty and for the promotion of fair equality of opportunity. Especially given that such a large percentage of the population can be considered “asset-poor,” we should evaluate new programs that encourage low-income households to save at some basic level. This paper analyzes several programs’ effectiveness in dealing with the issue of asset poverty.

1. Introduction

Savings are a crucial decision for any household. There are many reasons that households set aside possible consumption now for more consumption in the future. Economists have devoted a wide range of literature detailing the reasons that people save. Ordinarily, people save for retirement, to invest in their children, or to invest in their own education. Another important motivation for saving is the “pre-cautionary motive” to protect against the unexpected expenses that can be part of everyday life. Building up a healthy amount of savings and low credit can help prevent these expenses, such as a job loss or car troubles, from becoming major life crises with cascading effects. Many households are currently saving too little. This has left them in particularly vulnerable positions to meet the new challenges of the global economy.

This reality is currently ignored by most of our welfare system. Because our current measurement of poverty only measures income, it only captures the income-poor at the exclusion of the asset-poor. One group found that almost half (43.9%) of Americans do not have enough liquid assets to cover basic expenses for three months of unemployment.¹ This group of Americans is working hard but just barely getting by. Furthermore, they are in a precarious position and more reliant on government support if an unfortunate event were to happen.

What if anything is wrong with this? Some may say that if we provide a comprehensive safety net, then it should not matter if people need to rely on existing programs in the event of a one-time tragedy. Relying purely on a social safety net however ignores the importance that family assets can have on a wide range of life outcomes. Children who come from families with more assets are more likely to go further in school, and do better (Conley 2001).² For this basic

¹ Jennifer Brooks and Kasey Wiedrich, “Assets & Opportunity Scorecard,” January 2013.
http://assetsandopportunity.org/scorecard/about/main_findings/

² Dalton Conley, “Capital for college: Parental assets and postsecondary schooling,” *Sociology of Education* (2001): 70-1

reason, among many others, encouraging a healthy level of assets is important for protection equality of opportunity. Beyond promoting equal opportunity, encouraging assets is important for promoting liberty. Households with a certain level of assets will have more freedom to invest that money in ways that will be the most personally rewarding. A basic level of assets would give the person working pay-check to pay-check the ability to invest in more education or start a business. Assets can give people the ability to live the life they truly want to live.

This idea is based on a wide range of literature known as asset-based egalitarianism. Some extreme measures call for distributing a capital grant to every American at the age of 18. These measures are somewhat farfetched currently, but intermediate steps are already being used to promote savings, a development which shows some public support for the idea of asset-based egalitarianism. However, our current welfare system's emphasis on income as the definition of poverty places obstacles on asset accumulation and can discourage savings. Other institutional factors also effect the poor's access to the formal financial sector, further discouraging savings.

In this paper, I intend to argue that a more comprehensive definition of poverty that takes assets into account with underpinnings of asset-based egalitarianism is the best way to promote equal opportunity and liberty. Then, I will explain how the current welfare system discourages savings by placing too much of an emphasis on income and consumption, while at the same time encourages savings for middle- and upper class Americans. Next I will examine other institutional hindrances to saving for low-income households and finally look at programs that are currently being used in the United States and other countries that can be used to incentivize savings, provided by a broad range of institutions, including employers, governments, banks, and community non-profits. For this paper, assets generally refer to simple savings accounts accumulated over time. This paper does not argue for pushing families into more complex

financial products and stocks and simply focuses on the most basic level of savings, including an emergency fund, modest savings for retirement and possibly a home. These types of products are normally safe and provide families with a good foundation to invest in other forms of capital, such as education.

2a. Effects of Wealth Inequality on Opportunity

The statistics on wealth inequality in America are staggering. As of 2007, the wealthiest 10% of Americans owned 73.1% of all wealth in the country.³ What is even more shocking is that this disparity is larger than income inequality, where the richest 10% earn 47.1% of all income.⁴ This results in an income Gini coefficient of .574, but a wealth Gini coefficient of .834.⁵ We should view the statistics on wealth inequality with some caution. Wealth is both a function of income and time. Younger households will obviously have much lower wealth than older households. But these statistics bring about the important distinction between income and wealth. In modern American political discourse, we sometimes forget to talk about wealth in favor of income. Of course, we should not abandon our focus on income, but we should not ignore the ways in which wealth impacts income and overall well-being. There are many benefits to wealth that are not captured by income, and its greater inequality should be concerning.

America has a rich history of encouraging asset accumulation, for all classes. The Homestead Act gave settlers land in the West at no cost, if they were willing to move west. Today, tax deferred retirement and savings accounts play an important role in family financial planning. By providing tax incentives to families that invest into IRA's and similar accounts, the

³ Edward N Wolff, "Recent trends in household wealth in the United States: Rising debt and the middle-class squeeze." 44.

⁴ Ibid 44.

⁵ Ibid 44.

government is in effect subsidizing asset accumulation and savings. Other types of accounts encourage parents to set aside money for their children's college education. One state, Alaska, even goes so far as to provide a basic income through the Alaska Permanent Fund. While the dividends distributed in the Alaska Permanent Fund may not be enough to meet basic annual needs, an Alaskan child who puts 100% of his or her dividend check directly in a savings account could have anywhere from \$18,000-20,000 saved up by the time they reach 18.⁶ This is a sizeable amount for a young adult that they could put towards college education, a gap year or starting a business. Policy makers and the public clearly recognize the importance of assets, at least to a basic degree.

America also has a long commitment to protecting equal opportunity. Egalitarianism is the claim that all people have the same moral worth and deserve to be treated equally.⁷ The United States has, since its inception, been devoted to protecting egalitarianism through equal opportunity. The American Dream is built off of this idea that through your own personal effort, you can rise through the ranks without impediment from the social structure.

2b. Formal versus Fair Equality of Opportunity

An important distinction has arisen in what counts as equality opportunity. Many argue that simple formal equality of opportunity is all that is required. The famous economist Milton Friedman is one well-known supporter of this idea. In *Free to Choose*, Friedman argues that best interpretation of this idea is the expression from the French Revolution: *Une carrière ouverte aux les talents*—a career open to talents.⁸ For Friedman, equal opportunity is an important component of liberty. There should be no formal laws preventing a person from pursuing

⁶ Scott Goldsmith, "The Alaska Permanent Fund Dividend: an Experiment in Wealth Distribution" *9th International Congress, BIEN, Geneva* (2002): 5-6, accessed March 28, 2013.

⁷ Richard Arneson, "Egalitarianism", *The Stanford Encyclopedia of Philosophy* (2009), accessed March 14, 2008 <http://plato.stanford.edu/archives/spr2009/entries/egalitarianism/>.

⁸ Milton Friedman and Rose Friedman, *Free to Choose* (New York: Harcourt Brace Jovanich, 1979), 132.

opportunities that align with their idea of the good life based on arbitrary personal characteristics. By using the French phrase “a career open to talents” he emphasizes that talent should be the determining factor of dividing resources, and the government is only required to intervene insofar as to prevent open, formalized discrimination against certain groups. Friedman does admit that there are informal social practices that limit the opportunities of some who are not born into the “right” family or have the “right” race.⁹ However, he decries the more extreme measures that many Western governments have taken in the cause of promoting equality of opportunity as the government promoting equality of outcomes, which limit liberty.¹⁰ He also argues that the rising economic tide has gradually diminished these pressures and helped open previously closed positions to new groups.¹¹

Other modern thinkers however challenge this idea that simple formal equality of opportunity is enough. In John Rawls’ estimation, fair equality of opportunity requires “not merely that public offices and social positions be open in the formal sense, but that all should have a fair chance to attain them.”¹² This requires a much broader approach for government than simply making sure groups are not discriminated against by law. The idea of fair equality of opportunity is based off the assumption that if talents were randomly distributed, someone born into one social class would have roughly the same chance of succeeding in a specific career as someone born in a different social class.¹³ In many instances, fair equality of opportunity is not met in America even when there are no formal barriers limiting opportunity. For example, the school achievement gap between white and black students is well documented.¹⁴ If there were

⁹ Ibid 133

¹⁰ Ibid 135

¹¹ Ibid 133

¹² John Rawls, *Justice as Fairness: a Restatement*, ed. Erin Kelley (Cambridge: Harvard University Press, 2001), 43.

¹³ Ibid 44.

¹⁴ Christopher Jencks and Meredith Phillips. “The black-white test score gap,” *Brookings Institution Press* (1998): 1-2.

fair equality of opportunity in educational achievement and attainment (which of course has important ramifications for success later on in life) such a gap would be minimal. Fair equality of opportunity is often a justification for social policies, such as affirmative action, that seek to encourage underrepresented minorities in many fields and occupations. Though such policies are sometimes controversial, their existence shows that the United States is committed to at least formal equality of opportunity and in many instances tries to also promote fair equality of opportunity.

2c. Violations of Fair *and* Formal Equality of Opportunity

Just one example of how assets can change equal opportunity—suppose there are two families with exactly equal incomes, but each can barely make ends meet. They are living pay-check to pay-check and usually do not have enough resources at the end of each month to put any away for savings. Both families have two children in elementary school and one parent that works full time. The only difference is that the first family has a small amount of savings (roughly equal to three months of expenses, the generally agreed upon threshold for not being asset poor) that they were able to build up when the second parent was able to work part time. However, since the recession, that parent lost their job, taking some of the slack out of the family budget. Because the parent was only working part time, their extra income was not enough to change the family's access to other resources, such as schools or a nicer home. It only gave some slack in the budget and room for the family to save. Now, let's say the second parent in each family began searching for a new job, but unfortunately the check engine light came on in each family's second car and it requires thousands of dollars in repairs. The family with some emergency assets is able to pay to have the car repaired without much trouble, and life continues as normal. The family with no assets though must either take out expensive loans to pay the cost,

or go without the second car. Without the second car, the second parent cannot drive to interviews, or has to borrow the primary car, which causes the working parent to miss a day of work, costing the family more money they do not have. Also, without the second car, their children are not able to participate in the after school tutoring programs to which they have been accustomed. Without that extra help, the children fall behind in school, lessening his chances later in life.

This arrangement (sometimes known as “income smoothing”) testifies to the way a small amount of assets can help create stability for households and prevent unforeseen expenses from having a cascading effect on other parts of the family’s life. Assets can have impacts on childhood attainment and also adult job achievement. In this example, the second family was prevented from interviewing for the same job as the first family because of insufficient savings to cover an unexpected cost. The job may have been open to talents, as Friedman argues that it should be, however it excluded a certain applicants because of a lack of assets. Substitute “check engine light” in this short example with any of the long list of unexpected expenses that families routinely face, such as medical expenses or accidental financial fees, and this same situation plays out in millions of American families. If it can be proven that the second family did not have assets due to reasons beyond their control, then it would show how fair equality of opportunity was also violated. It is easy to image that the family did not accumulate savings due to simple lack of information, or as will be explained later, they were not defaulted into a program by their employer, as many high earning families would have been.

This example also shows how our current society places too much emphasis on income rather than assets in addressing issues of fair equality of opportunity and welfare. Income is just a stream of resources, and requires an employer or provider (such as a government). It is also

determined in part by human capital, an asset in and of itself. Wealth however, captures past income and gives families resources even in the absence of a provider. Wealth plays an important role in perpetuating unfair inequalities that limit fair equality of opportunity. Wealth is buildup of past income streams, so if there were inequalities in past income, there may be lingering inequality in assets.¹⁵

There has always been a large income gap between white and black workers in this country, and that gap had been decreasing in most of the post-war period until the 1980's.¹⁶ However, while the average white household earned twice that of the average black household, the wealth of the average white household was five to ten times higher than the average black household.¹⁷ Clearly, differences in income cannot completely explain the large difference in wealth between white and black households. Furthermore, declining income inequalities are not the answer to this difference in assets. If the government simply forced the average black household to earn as much as the average white household, the problem would not be solved.

Wealth continues to impact many life outcomes, such a college attainment. It has been repeatedly shown that parental assets are a contributor to college attendance rates and in some cases college success.¹⁸ ¹⁹ This creates a cycle that becomes hard to break: wealth impacts education, education impacts future income and income impacts future wealth accumulation.

These are only examples where fair equality of opportunity may be limited for asset poor households. There are many examples where low-income households have been denied formal

¹⁵ Thomas Shapiro. "The Importance of Assets," in *Assets for the Poor*, ed. Thomas Shapiro and Edward N. Wolff (New York: Russell Sage Foundation, 2001), 12.

¹⁶ June O'Neill, "The role of human capital in earnings differences between black and white mean," *The Journal of Economic Perspectives* 4 (1990): 45.

¹⁷ Robert Barsky, John Bound, Kerwin KoCharles and Joseph Lupton, "Accounting for the black-white wealth gap: a nonparametric approach," *Journal of American Statistical Association* 97, no. 459 (2002): 673.

¹⁸ Conly (2001): 70-1

¹⁹ William Elliot and Sondra Beverly, "Staying on course: The effects of savings and assets on the college progress of young adults," *Journal of Education* 117, no. 3 (2011):374

equality of opportunity. The most egregious example, perhaps, is the process known as “redlining” in the credit market, through which some low-income neighborhoods are completely excluded from applying for some forms of credit, such as mortgages.²⁰ While this phenomenon is widely documented and the government has taken steps to reduce it, low-income households are still less likely to hold bank accounts, and face higher financial fees because of their reliance on alternate financial services.²¹ These higher fees place unnecessary financial burden on households, further reducing incomes and reducing the amount of income available for savings. Also evidence indicates that the poor are often excluded from most government induced savings incentives. Larry Summers found that the bottom 60 percent of workers only received 12% of tax benefits for pension and retirement accounts, and the top 20 percent of workers received 60 percent of the benefits.²² More recently, Oya Celasun at the International Monetary Fund (IMF) has suggested that rising inequality over the last several decades has decreased savings rates as low-income households save less to make up for stagnant incomes.²³ All of these examples point to market conditions that limit the poor’s ability to save due the institutional forces. In some conditions, such as redlining, institutional forces within banks denied low-income (and often minority groups) formal equality of opportunity in applying for loans and mortgages. Our tax system and increasing inequality point to more violations of fair equality of opportunity by decreasing low-income households’ access to programs and institutions that encourage asset building.

²⁰ Joseph Stiglitz and Andrew Weiss, “Asymmetric information in credit markets and its implications for macroeconomics,” *Oxford Economic Papers* 44 (1992): 163

²¹ Michael Barr, “Banking the Poor,” *Yale Journal on Regulation* 121 (2004):123

²² Michael Sherraden “Asset-Building Policy and Programs for the Poor” in *Assets for the Poor*, ed. Thomas Shapiro and Edward Wolff (New York: Russell Sage Foundation, 2001): 303

²³ Oya Celasun, “How Inequality Affects Saving Behavior,” *IMFdirect*, September 13, 2012, <http://blog-imfdirect.imf.org/2012/09/13/united-states-how-inequality-affects-saving-behavior/>.

Clearly, if Americans believe there is an obligation to protection equality of opportunity, whether that is formal or fair equality of opportunity, there are issues that need to be addressed in our current system. Assets are important for determining educational attainment and achievement for college graduates, and helps to prevent small unfortunate events from becoming major life crises. Mitigating wealth's effects on the life events is important for ensuring fair equality of opportunity. Even for those who stick with protecting just formal equality of opportunity, there are many shortfalls in the system. I will seek to address some of these issues in access in more detail throughout the rest of this paper.

2d. Economic Reasons for Savings

Saving and asset building are clearly an important decision made by any family, but many families chose to save different amounts. Just anecdotally, there are many reasons why people save. Savings allow people to save for retirement, children and new purchases. There is also an extensive literature devoted to formalizing these hypothesize of why people save on a micro level. Keynes listed eight motives in his *General Theory* (1936). The chief among these are often referred to as the pre-cautionary motive and the life-cycle motive.²⁴ Under the pre-cautionary motive, a family will save in preparation for unexpected expenses and under the life-cycle motive will save when income is higher than expected with the expectation to borrow or use up those savings when income is lower (such as during retirement).²⁵ Given the instability of the global economy, job loss is an example of an unexpected income shock that many families face. A family with lower savings will have fewer assets to draw from to continue consumption once other sources of income such as unemployment benefits run out. This important effect is

²⁴ Martin Browning and Annamaria Lusardi, "Household saving: Micro theories and micro facts," *Journal of Economic Literature* 34, no.4 (1996): 1797.

²⁵ Franco Modigliani and Richard Brumberg, "Utility analysis and the consumption function: An interpretation of cross-section data," *Franco Modigliani* (1954): 6.

often called income smoothing. Without assets, unexpected bumps in the road can become life-changing catastrophes.

Even for those who do not believe that assets are important for addressing issues of fair equality opportunity, the argument and policies presented later in this paper are still important. At the most basic level, everyone (at least every economist, and most people) will agree that savings are important. The accumulation of capital is important for building a productive economy that can raise the standard of living for everyone, and increasing household savings equals more investment. In January of 2013, the national savings rate stood at 2.4%, which seems low.²⁶ Historically, the US savings rate has been far lower than many other industrialized countries as well.²⁷ For issues that are too complicated to look at in this short paper, Americans save very little compared to our fellow OECD peers. Though the savings rate ticked back up during the Recession, it was at times hovering near zero percent for much of the 2000's, which by many objective standards is too low.²⁸ In the incidences where families do not save simply out of lack of information, a paternalist would argue that we should encourage that family to save.

Not only would addressing these issues of information be good for families, it would be good for the economy overall. This need not be an argument merely about the ethics and morals behind asset accumulation. It makes sense from an economic efficiency stand point as well. On the macro level, savings are important for economic growth. In a seminal piece on economic development, Robert Solow showed how savings rates per capita lead to increased capital

²⁶ "Personal Savings Rate," St. Louis Federal Reserve, last modified March 29, 2013, accessed on March 14, 2013. <http://research.stlouisfed.org/fred2/data/PSAVERT.txt>

²⁷ U.S. Congressional Research Service Report, "Savings Rates in the United States: Calculation and Comparison," by Craig K. Elwell (RS21480, September 14, 2010): 3

²⁸ St. Louis Federal Reserve

accumulation and thus higher living standards for the entire population.²⁹ Many countries, including China, Japan and South Korea, all examples of how economic development can be successful, pushed for higher savings rates to produce growth. By excluding a large section of the population from typical savings behaviors, the United States is missing out on potential savers and thus savings that could lead to capital accumulation. Including this large group of the population could have tremendous effects for the entire country. On a micro level, a lack of savings can lead to higher uncertainty, which can be a drain on households and take away from productive pursuits. Anecdotally, there is the story of the single mother who cannot make it work because of a blown tire that she cannot repair because she has no savings. Internationally, studies show that income uncertainty leads to households taking on less risky investment choices, which limits economic growth and incomes for the poorest in society.³⁰ Low-income households also waste large amounts of money on unnecessary financial fees.³¹ Overall, increasing savings could give households more chances to smooth income, save money on unnecessary financial fees (and thus putting that money to more productive pursuits), make the necessary investments in human capital, and increase capital and living standards in the economy overall. Tapping this huge market of potential savers could have drastic impacts on the macro US economy, even completely ignoring the ethical considerations.

3. Hindrances to Savings

If savings are important and should be encouraged, to what degree does the current system disincentivize savings? Our current welfare model places a heavy emphasis on

²⁹ Robert Solow, "A Contribution to the Theory of Economic Growth," *The Quarterly Journal of Economics* 70 (1956).

³⁰ Anjini Kochhar, "Explaining household vulnerability to idiosyncratic income shocks," *The American Economic Review* 85 (1995):159

³¹ Michael Barr (2004): 123.

consumption and cash transfers.³² Any sort of policy, especially a cash transfer, can change incentives and behaviors of the recipients. The economic theory behind how recipients will react is mixed. For example, using Modigliani and Brumberg's life-cycle savings theory, Social Security should simply be compulsory savings because it forces worker and employers to contribute to the program.³³ However, currently Social Security operates as a transfer from current workers to retirees, so private savings could actually decrease.³⁴ To get around this ambiguous effect, consider a much more concrete example in the case of direct transfer programs such as unemployment benefits and TANF. In these instances, guaranteed support from the government would make the pre-cautionary motive for saving less important.³⁵ Recent empirical work is beginning to show that means tested welfare programs and asset limits may in part explain the low savings rates for low-income households.³⁶

Though there is only a small amount of literature devoted to the subject, there seems to be consensus that cash transfers with asset limits do in fact discourage savings. Typically asset limits for cash transfer programs are set to exclude home equity and some portion of the fair market value for any car, usually in the form of an exemption (for example, the first \$1,000 of your car value would not count against asset limits, but any amount over \$1,000 would). During AFDC, the federal government set the benchmark asset limit to be followed by the states at \$1,000 in assets, plus vehicle exemptions up to \$1,500.³⁷ Prior to 1981, state limits greatly varied from this federal guideline though, however after the Omnibus Budget Reconciliation Act of

³² Sherraden (1991): 5.

³³ Sheldon Danziger, Robert Haveman and Robert Plotnick, "How income transfer programs affect work, savings, and the income distribution," *Journal of Economic Literature* 19 no. 3 (1981): 980.

³⁴ Ibid: 981.

³⁵ Ibid: 981.

³⁶ Erik Hurst and James Ziliak, "Do welfare asset limits affect household saving? Evidence from welfare reform," *The Journal of Human Resources* 41 (2006): 46.

³⁷ Ibid: 49.

1981, budgetary pressure caused states to increasingly adopt federal suggestions.³⁸ Clearly, \$1,000 dollars in assets is not a very large amount, and may encourage families to carry fewer liquid assets.

Following TANF and welfare reform, the government gave states more room to experiment with asset limits. However, by the early 2000's, nine states had kept asset limits at \$1,000, 22 states had strengthened asset limitations to between \$500-1000, and 20 states loosened asset requirements to above \$1,000.³⁹ As of 2010, Louisiana, Virginia and Ohio have eliminated asset limits to qualify for TANF.⁴⁰ The main argument for asset limits is that people who should not qualify for welfare will be able to cheat the system and receive state benefits, when they could easily rely on previous assets. One study from Virginia however showed that the state spent \$127,200 on a total of 40 families that were able to qualify for TANF after the elimination of asset limits, but that the state saved \$323,500 in administrative costs.⁴¹ Clearly, a simple cost benefit analysis of the case in Virginia could show the benefits of eliminating asset limits and the relatively small amount of applicants that would apply if asset limits were eliminated. Even the most emphatic budget hawk would argue that the reduction in red tape could create some benefits.

As far as other cash transfer and assistance programs, the Supplemental Nutrition Assistance Program (SNAP, more popularly known as Food Stamps) also has asset limits. For most, it is generally limited to \$2,000 in liquid assets, but for certain families with elderly or

³⁸ Ibid: 49.

³⁹ Ibid: 49.

⁴⁰ Laura Pereya, "TANF's Counterproductive Asset Tests: Eliminating the Tests will Help Families While Helping States Save Money," *Center for American Progress*, May 6, 2010, accessed May 28, 2013
<http://www.americanprogress.org/issues/poverty/news/2010/05/06/7846/tanfs-counterproductive-asset-tests/>

⁴¹ Ibid.

disabled members, it can be higher.⁴² Also, as is the case with TANF, SNAP brings with it a large vehicle deduction that can be changed by the states.⁴³ Furthermore, some states use the asset limit in different ways. Massachusetts for example only applies the asset requirement for families that do not meet the work requirement, however the work requirement is hardly ever enforced, meaning asset limits are also not usually enforced.⁴⁴ Social Security Insurance has similar limits of \$2,000 for individuals and \$3,000 for couples.⁴⁵

The empirical effects of asset limits on savings are not well studied. The two best studies were conducted by Elizabeth Powers, who studied female households in the AFDC program and Hurst and Zeliak using welfare reform. Powers found that between 1978 and 1983, savings decreased by \$.25 for every \$1 decrease in the asset limit.⁴⁶ Hurst and Zeliak show that even since the relaxing of asset requirements due to welfare reform, the poorest households have not increased savings.⁴⁷ They also find that asset limits only affect the poorest households—the near poor still do save even in response to asset limit changes.⁴⁸ They theorize that this means that households that believe they may have to rely on public assistance respond to asset limit changes, while households that do not plan to be on public assistance will not.⁴⁹

These findings show that households do in fact respond to asset limits in a way that is consistent with the lifetime consumption theory. Under this theory, households save in a way that

⁴² “A Quick Guide to SNAP Eligibility and Benefits,” Center on Budget and Policy Priorities, last updated January 31, 2013, accessed May 28, 2013, <http://www.cbpp.org/cms/index.cfm?fa=view&id=1269>

⁴³ Ibid.

⁴⁴ “SNAP Food Stamps: Financial Eligibility,” accessed May 29, 2013, <http://www.massresources.org/snap-financial-eligibility.html>.

⁴⁵ “Understanding Supplemental Social Security Resources—2013 Edition,” last updated February 19, 2013, accessed March 28, 2013, <http://www.socialsecurity.gov/ssi/text-resources-ussi.htm>

⁴⁶ Elizabeth Powers, “Does means-testing welfare discourage saving? Evidence from a change in AFDC policy in the United States,” *Journal of Public Economics* 68 (1998): 33

⁴⁷ Hurst and Zeliak (2006): 70

⁴⁸ Ibid: 70

⁴⁹ Ibid: 70

is consistent with their expected lifelong income.⁵⁰ If higher savings will disqualify a household from applying for cash transfer programs, decreasing their lifetime consumption, they will not save in order to maximize income. This would show that households that do not save are actually behaving in rational, profit maximizing ways, and that if the correct incentives were in place, they would respond appropriately. While more research is needed to validate these previous studies, it appears as if asset limits do disincentive savings. States should move in the direction of abolishing asset limits for government assistance, or begin to loosen them. Not only could it encourage savings, it could help eliminate red tape and administrative costs, as has been the case in Virginia.

4 Promoting Savings

If assets are important, and current social institutions hinder savings, we must create a system in which all households, but especially low to moderate income households, are able to save as easily and as much as higher income households. Systems to encourage savings fall into several main categories. First, the government could force savings, as was meant to be the case with Social Security. Next, the government could subsidize savings, which would most likely be the most effective method, although most costly. In this category, I will review two main programs, one in the US and one in the UK that are very promising. Short of subsidizing savings, the government and institutions can make it hard not to save, by using opt-in defaults and bundling different services. Finally, financial institutions can play a better role in reaching out to low-income clients.

4a. Subsidized Savings

⁵⁰ Browning and Lusardi (1996): 1797

Individual Development Accounts (IDA's) are one innovative program recently implemented by the US federal government. IDA's were created as a part of the American Dream Demonstration (ADD), which recognized current government programs that encouraged savings (such as 401(K) plans and IRA's) did not encourage low-income Americans to save. While IDA's are very innovative policy, they are currently not widely used.⁵¹ The basic design of the programs involves potential clients, a nonprofit and a partner bank. A local nonprofit decides to engage in the IDA program and raises the money for matching funds through grants (largely government, but not excluding private donors).⁵² The nonprofit then advertises and accepts clients based on clients past financial history. In order to be eligible in Virginia, clients must have total household income less than 200% of the federal poverty line and less than \$10,000 in household net worth, excluding house and car.⁵³ The client then agrees to a financial savings goal towards either a mortgage down payment, college expenses, or business startup costs. They are required to make a contribution towards that goal every month, no matter how small as well as participate in financial education programs provided by the non-profit during the length of the program. The local partner bank then opens a savings account for the client, with a few special restrictions. The client cannot withdraw from the account until he or she reaches their financial goal, except in the case of emergency.⁵⁴ Participation in an IDA program is meant to count towards the partner bank's Community Reinvestment Act requirements, as well as give them the opportunity to cross-sell other products, such as mortgages.⁵⁵ Over the course of the

⁵¹ Comptroller of the Currency Administrator for National Banks, "Individual Development Accounts: An Asset Building Product for Low-Income Consumers," *Community Development Insights*, February, 2005: 4

⁵² *Ibid*: 4.

⁵³ Virginia Department of Housing and Community Development, "Virginia Individual Development Accounts Program Design," revised December 2012: 22.

⁵⁴ Comptroller of the Currency (2005): 4.

⁵⁵ *Ibid*: 4.

financial goal, the nonprofit will contribute up to \$4,000 dollars at a two-to-one rate in Virginia.⁵⁶ This will leave the client with up to \$6,000 by the end of the program.

Overall, the client can receive up to \$4,000 from government and nonprofit provided funds. Some might say that this could also be achieved through cash transfers, and may be more effective by this method. However, by forcing clients to use a savings account with a partner bank with special restrictions, the cash reward becomes less liquid. Also because of the restrictions on what the money may be applied toward, it is meant to build human capital in clients or give them a substantial amount toward purchasing a home. Furthermore, because the client is forced to contribute money at the same time, they will have more at stake. Mandatory financial classes will also help to build human capital in IDA participants. Finally, a total of \$6,000 accumulated over the course of the IDA participation is a huge increase for most clients.

Virginia eligibility requirements state that the clients must have less than \$10,000 in net worth. \$6,000 is a substantial increase compared to \$10,000. Even if program participants may not come out of the IDA program with enough savings to apply to complete college tuition or a full mortgage down payment, they will come much closer and dramatically increase their assets.

The Child Trust Fund (CTF) is another innovative program, which began in the United Kingdom during 2005. Under the program, the British government gives the parents of newborn children 250 pounds (500 for qualifying low-income families) to deposit in a registered account.⁵⁷ The families can then deposit their own savings for the child up to 1,200 pounds a year, while the government deposits extra money to top off the accounts at the ages of 7 and 11.⁵⁸ At the age of 18, the child (or young adult now) can take the money out tax free and apply

⁵⁶ Virginia Department of Housing and Community Development (2012): 5.

⁵⁷ Alan Findlayson, "Characterizing New Labour: the Case of the Child Trust Fund," *Public Administration* 86 (2008):100.

⁵⁸ *Ibid*: 101.

the funds towards any expense they deem important, whether that be a gap year, new business startup costs or educational costs.⁵⁹ Some authors have noted though that while the program was originally meant to decrease inequality within the UK, it can actually have the opposite effect. If rich parents put in the maximum that they can, their children will have substantially more available to them by the time they are 18 than children of low-income families. Identifying and refining the goals of the program could easily remedy this objection, however, the British government cut the program in 2011 in the face of budgetary pressure and the austerity movement.

The British government contends that the CTF teaches children how to make savings decisions and how to plan ahead by having them hold a fairly large asset. Currently, it is too early to tell whether children that are participating in the program will be more forward-thinking.

Emmerson and Wakefield argue that the programs goals are not well enough defined and that if the goal of the program is to give young adults money to spend on education they should do so by making more means tested college aid available.⁶⁰ This however ignores the liberty aspect to the program. As opposed to IDA accounts, there are no set limitations on the account. At the age of 18, the young children are free to choose to invest that money in whatever will be more beneficial and rewarding to them, even if that means a gap year. Because the individual families have invested their own time and a majority of the money into the CTF accounts, taxpayers should not be concerned that they will possibly waste the money, because the families and children will have as much invested interest in the money as taxpayers.

Both of these programs are very large subsidies, but through financial training (IDA's) and simply holding an asset for 18 years of childhood (CTF) both try to foster personal

⁵⁹ Ibid: 105.

⁶⁰ Carl Emmerson and Matthew Wakefield, "The Saving Gateway and the Child Trust Fund: Is Asset-Based Welfare 'Well Fair'?" (2001): 78.

responsibility and forward financial thinking. Because the Child Trust Fund is so new, there is little evidence of its success. Any data and analysis on its efficacy can only be completed after when the first children born into the program in 2005 come of age and use their funds. IDA participants have been widely researched through the American Dream Act. In a review of other results, Michael Sherraden finds that IDA participation does increase home ownership by 6-11 percentage points.⁶¹ With regards to savings, the results are ambiguous. One study found a negative effect on savings.⁶² However, Sherraden cites evidence that IDA participation does have a small, but statistically significant impact on savings, and that the size of this effect (and the negative effect) could be due to households shifting their assets to less liquid assets such as mortgages, which is the point of the IDA program.

4b. Subtle Opt-In Options

It is fairly hard to avoid the CTF system, unless you simply are not born. But there are other ways to encourage savings outside of these more expensive and heavy-handed plans.

Governments and institutions can simply make it hard not to save. There are generally two ways to do this, default opt-ins and bundling. The basic logic behind default opt-ins is that people tend to “go with flow.” If a certain setting is the default setting, we generally leave it alone. If we consider “saving” the default, then inertia will likely cause more people to save more. This is embodied by the old saying “pay yourself first.” Increasingly, employers are changing 401(k) enrollment plans to require employees to opt-out rather than choosing to opt-in.⁶³ This can however increase administrative costs, and has been shown to decrease contributions of those

⁶¹ Michael Sherraden “Individual Development Accounts and Asset-Building Policy: Lessons and Directions” in *Insufficient Funds*, ed. Rebecca M. Blank and Michael S. Barr (New York: Russell Sage Foundation, 2009): 202

⁶² Gregory Mills, William Gale, Rhiannon Patterson and Emil Apostolov, “What do Individual Development Accounts Do? Evidence from a Controlled Experiment,” Washington, DC: Brookings Institution (2006): 27

⁶³ Peter Tufano and Daniel Schneider, “Using Financial Innovation to Support Savers: From Coercion to Excitement,” in *Insufficient Funds*, ed. Rebecca M. Blank and Michael S. Barr (New York: Russell Sage Foundation, 2009): 157.

participants who stayed in the program.⁶⁴ There seems to be no overall consensus on the effects on total amount saved across all participants but one interesting finding is that among low-income groups, automatic enrollment equalizes participation between racial groups.⁶⁵ There is at least some benefit to default opt-in encouraging some savings in those who would not have otherwise elected to be in the program.

In terms of bundling, it is easy to bundle savings and credit. One example that most middle-class Americans take advantage of is amortizing mortgages. Part of every mortgage payment goes towards building home equity, which is a major asset for most middle class households. Mortgages bundle together a savings program along with credit. One successful program that targets low-income household is a short term Salary Advance Loan offered by the North Carolina State Employees Credit Union (NCSECU) to compete with pay-day lenders. The credit union offers a short-term payday loan, however they also automatically deposited 5% of the loan into a shared savings account monitored by the bank but owned by the client.⁶⁶ The intent is to encourage the client to build up a healthy amount of savings to break the pay-day loan cycle. The program seems to have been successful. Participants have grown their savings from around \$5.5 million to \$9.7 from 2004 to 2006.⁶⁷ This type of program works well because it offers a product that many low-income households need (pay-day lending) but offers an alternative by bundling savings into the original product. These types of programs may be particularly successful in combination with other savings plans and financial education, or could

⁶⁴ Ibid: 158.

⁶⁵ James J. Choi, David Laibson, Brigitte C. Madrian, and Andrew Metrick, "For Better or for Worse: Default Effects and 401(k) Savings Behavior," in *Perspectives on the Economics of Aging* (Chicago: University of Chicago Press, 2004): 124.

⁶⁶ Tufano and Schneider (2009):158

⁶⁷ Tufano and Schneider (2009): 158

allow the client to grow into other products offered by the bank. Other possible examples could also include offering a savings program to families that receive the EITC.

4c. Institutional Design

These possibilities however ignore potential bank involvement. Institutions, outside of direct government intervention, play an important role in shaping how people respond to situations. For example, banks and the market forces they respond to may make it harder for people to save. The administrative costs of dealing with and encouraging small savings accounts may be too great for some banks.⁶⁸ Unless they are able to charge higher fees to make up for administrative costs, it may not even be profitable, but higher fees would make the cost for small savers too great for the programs to make much of a difference to encourage asset accumulation.

A couple of proposals have been suggested to help overcome these problems. Michael Barr suggests coming up with a “gold seal” certification run by the government and offered to local banks.⁶⁹ Such a program may not change the costs of low-income accounts themselves, but it would provide a new incentive to banks. If similar certification programs, many of which have been successful, could serve as a proxy for this type of program, then the results seem quite promising. Just one example, consumers have been tremendously responsive to free trade coffee and willing to offer much more money for the peace of mind it can purchase.⁷⁰ Such a system would certify banks that meet certain requirements and show a commitment to the local community by offering products to low and middle-income clients.⁷¹ This could also lead to new innovation. By carving out a niche of consumers who support (and may be willing to pay slightly

⁶⁸ Michael S. Barr, Sendhil Mullainathan and Eldar Shafir, “Behaviorally Informed Regulation,” in *No Slack*, ed. Michael S. Barr (Washington, DC: Brookings Institution Press, 2012): 272.

⁶⁹ *Ibid*: 272.

⁷⁰ Maria Loureiro and Justus Lotade, “Do fair trade and eco-labels in coffee wake up the consumer conscience?” *Ecological Economics* 53, no. 1 (2005): 136.

⁷¹ Barr, Mullainathan and Shafir (2012): 272.

more for) bank development targeting low to moderate income clients, banks and financial service providers can tailor products accordingly. Without market pressures that force banks to provide typical services that benefit the middle class, we could see a whole new era of innovation in financial services for low to moderate income households, in the same way we have seen innovation in other markets due to market segmentation.⁷² Of course, such a policy would need to be closely monitored by the regulatory agency in charge of designing the criteria for the “gold seal” to insure that banks are actually meeting requirements to low-income households, rather than obtaining the certification simply for marketing purposes.

To supplement the above “gold seal” policy idea, Michael Barr also advocates for a new tax subsidy to change the actual financial incentives for banks, outside of the marketplace considerations that the “gold seal” addresses. Barr envisions a tax subsidy based on performance measured by the number of approved, safe accounts that financial institutions provide to low-income households.⁷³ In conjunction with programs that offer similar subsidies to businesses that provide direct deposit and automatic savings plans to employees, such a program would help change the cost structure that makes small savings accounts used by low-income households more affordable to businesses and financial service providers.⁷⁴ Coupled with the “gold seal” measure detailed above, a two pronged approach suggested by Barr would help change both the cost structures and market forces that make it profitable for banks to only offer services to middle and upper income Americans at the exclusion of low-income Americans. This smart policy would address two of the issues that preclude many from participating in the mainstream financial system.

⁷² Loureiro and Lotade (2005): 136.

⁷³ Michael S. Barr, “Financial Services, Saving, and Borrowing Among Low- and Moderate-Income Households: Evidence from the Detroit Area Household Financial Services Survey,” in *Insufficient Funds*, ed. Rebecca M. Blank and Michael S. Barr (New York: Russell Sage Foundation, 2009): 93.

⁷⁴ *Ibid*: 94.

The above savings plans are only the tip of the iceberg in terms of possible creative policy that can address the lack of savings for low-income households. Overall though, policy will need to be realigned when there is data about the success of such policy, and more research needs to be done into the behavioral economics behind savings and financial decisions. There is evidence that credit providers are already far ahead of government regulators in terms of understanding how consumers react to certain institutional design.⁷⁵ Government regulators and financial service providers need to be able to harness the same understanding of consumers to design better institutions and accounts for low to moderate-income households. Full-reaching policy of course would address other issues of credit and savings, but due to space constraints those will need to be evaluated elsewhere.

5. Discussion and Conclusions

Again, many of the suggestions above are just possible examples of programs that are currently in place that could help address the urgent need to encourage savings in low-income households. Even the implementation of several of these policies could have cascading affects that encourage other new, more innovative policies. Some programs and approaches to encouraging savings allude to other possibilities that we may not even realize until there is more research into behavioral economics and how people make subconscious choices. One other broad policy recommendation would be to make savings fun. Through advertising, companies have been able to convince people to spend their money, often times at the expense of savings. If saving were presented as a fun and desirable option, it would be able to compete with consumption and the United States could perhaps see an increase in the savings rate. Such a

⁷⁵ Barr, Mullainathan and Shafir (2012): 267-8.

program would have to be a broad based effort on part of the government, but the results could be large.

Public discourse also needs to shift away from its current emphasis on income and recognize the importance of assets in determining both fair and formal equality of opportunity. Hopefully, this paper shows the importance of assets in determining many life outcomes, both for children and adults. A basic level of assets would give families more stability and ability to smooth income when times are tough and come out on the other side of that hardship still financially stable. This paper does not argue for some of the more extreme examples of asset-based egalitarianism, such as that proposed by Bruce Ackerman and Anne Alstott, who argue for a capital endowment of \$80,000 to be given to every American at the age of 18.⁷⁶ Instead, it recognizes the importance of assets, but mostly in the context of the problem of the large amount of asset-poor Americans, who may be victim to the detailed effects of assets on fair equality of opportunity. By simply encouraging savings, to the point where most American families have a basic level of savings equal to three months of expenses, American families from all socio-economic classes, would be in a better, more stable financial position. They would be in a position of independence from employers and credit providers and decrease the instability faced by many households, especially given the current macro-economic environment.

Programs such as Individual Development Accounts and the Children Trust Fund represent innovative policy that can play a huge role in eliminating the problems faced by the asset-poor. Because both heavily subsidize savings, they most likely will encourage the highest level of savings compared to other programs detailed in this paper. Another important aspect of both of these programs is that both try to change the way program participants think and make

⁷⁶ Bruce Ackerman and Anne Alstott, *The Stakeholder Society* (New Haven: Yale University Press, 2000).

financial decisions. IDA participants are required to attend financial training classes during the course of the programs, and CTF hopefully builds healthy savings habits in children that participate in the program. Outside of these direct programs, there are many other possibilities that realign the incentives that currently make it easy for middle and upper income Americans to save to include low income Americans. Low-income households are also savers and will participate in these programs if given the chance.

The most compelling part of this argument is that it is applicable to many different lines of thinking. If one does not believe in fair equality of opportunity, there are enough positive economic benefits to encouraging savings for low-income households to save that we should still consider the programs detailed here. Encouraging savings for low-income households will tap a large new market to increase investment in the economy in general. While we have an obligation to encourage savings from an ethical standpoint to promote fair equality of opportunity and liberty, this is one policy through which we can increase both economic growth and efficiency while simultaneously creating a fairer, more equal playing field for American workers and children.

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