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Institutions and Inclusion in Saving Policy

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Chapter 12

Institutions and Inclusion in Saving Policy

Michael Sherraden and Michael S. Barr

Credit is important, especially for purchasing a home, but credit is only one pathway to asset accumulation—the other is saving. The poor must save, not only to qualify for and pay off credit, but also for key purchases such as clothing for the start of a child's school year; life course events, such as births, weddings, and funerals; and emergencies, such as car repair, illness, or job loss.[1] Saving and credit are complementary, often intermingled, and both are important. For most households, including low-income households, asset accumulation requires saving as well as credit.[2]

Recent applied research has contributed to our understanding of the potential importance of saving by low-income households. Caskey (1994) carried out pioneering studies of alternative financial services, such as pawnshops and check-cashing outlets, with important implications for saving policy for the poor (Caskey, forthcoming). Barr (2004) provides an extensive analysis of how changes in the

1. Rutherford (1998, 2000) provides an excellent study of saving purposes and practices among the poor in developing countries. To our knowledge, no one has done this type of study as carefully in the United States, though Caskey's research (1994, forthcoming) is an important contribution.

2. See Rutherford (2000) and Consultative Group to Assist the Poorest (2002), for excellent discussions in the context of developing countries, and Schreiner and Morduch (2003) for the U.S. context.

alternative financial sector, banking sector, and payment and distribution networks could increase opportunities for the poor to get access to the mainstream financial sector and save. Stegman (1999) recognizes that electronic banking may provide opportunities to make individual development accounts available to the poor. Beverly, Tescher, and Marzahl (forthcoming) find that recipients of the Earned Income Tax Credit (EITC) can be encouraged to save, at least for the short term, upon receipt of their tax refund. Smeeding (forthcoming) finds that EITC recipients think of their lump sum payment differently from their ordinary income—they tend to use it for larger payments or purchases. The EITC, due to its large size and lump sum distribution, could be a significant source of financing for saving and asset building. In the individual development accounts research we discuss below, low-income households were able to save.

Yet saving by the poor is a largely overlooked topic in the United States. This may be understandable because savings deposits by the poor are often small, perhaps easy to dismiss as unimportant. The explosion of credit availability has rightly garnered attention, though available credit, especially predatory lending, does not always help low-income households. Means-tested income support and other policies often play a negative role in saving, because of asset limits that discourage saving (Ziliak, 1999; Hurst and Ziliak, 2001). In addition, some supporters of means-tested programs have feared that a focus on asset building might weaken political support for income transfers and the social safety net. This stance is well intentioned, but has contributed to keeping asset-building policies for the poor off the political agenda.

As a result of these and other factors, U.S. public policy has largely ignored or marginalized saving policy for the poor. This is particularly striking given the recent rhetoric of the Bush

administration about the “ownership society” (discussed later in this chapter). The administration has proposed a dramatic expansion of tax-preferred savings vehicles, but this expansion largely benefits the highest-income taxpayers whose net saving behavior is least likely to be influenced by the policies. The administration has included a small proposal that would expand saving opportunities for the poor, but the overall thrust of the plan is highly regressive. Instead of focusing on additional saving proposals that benefit the upper end of the income scale, public policy should focus on building wealth among the least well-off. A sound policy would aim for inclusion of everyone in saving and asset accumulation.

In this chapter we first develop an institutional theory of saving, which is provisional and in need of more empirical testing. We then explore in practice how existing institutions promote dis-saving among the poor. We also look at how policies to change these institutional structures could promote saving among these households.

[1]Toward an Institutional Theory of Saving[end]

Basic assumptions about how people behave shape our understanding of economics and our views about the role of law. Traditional economic models of rational choice view decisions as made by optimizing rational agents with perfect foresight. Research in psychology and behavioral economics provides alternative explanations for decision-making, such as the importance of default rules, framing, and heuristics. By contrast, the public debate is largely consumed by “culture of poverty” theories of social deviance, laziness, and imprudence as describing the poor. These differing frameworks affect how one views a wide range of phenomena, including saving. The behavioral economic insight can be used not only to understand individual choice, but also, perhaps, to design institutions to influence individual

decision-making. Our task in this chapter is to explore the contours of an institutional theory of saving and to relate such a theory to the reality of the lives of poor people.

[2]Are the Poor Different?[end]

Are the poor different from the nonpoor? We ask this question because it is fundamental to thinking about options for inclusive saving policy. A great deal of social science theory and political discourse, explicitly or implicitly, treat the poor as different from the nonpoor. Conservatives tend to see the poor as deficient in ability, motivation, and morals, to be corrected by greater individual responsibility. Liberals tend to see the poor as victims of social and economic circumstances, who require special programs to cope with these circumstances.

We take a somewhat different approach. We acknowledge that the poor are different, at least insofar as they do not have as much money, and that many poor people have myriad problems that may have pushed them into poverty or keep them poor. However, in contrast to much of social science theory and political discourse, our view in this discussion of saving is that many of the poor are not different from many of the nonpoor. We take this perspective as a normative stance, and as a practical position. The normative stance is that, until everyone has the same institutional opportunities and public subsidies for asset accumulation, it is not possible to know whether their reactions to institutional structures would be different from others. For example, it is a disservice to an employed yet impoverished single mother who is not offered a 401(k) in the workplace to suggest that she is different from the nonpoor because she does not have retirement savings. Our practical position is similar. It may be possible to create inclusive policies and products for saving that are successful for many low-income households (indeed, we think

this is highly possible). If this is the case, there would be little need to focus on how the poor might be different from the nonpoor, as it relates to saving, because it would not matter.

[2]Model of Institutions and Saving[end]

Our theoretical perspective places primary emphasis on purposeful institutional arrangements that structure and support asset accumulation.[3]

Research on saving is extensive but inconclusive (Korczyk, 1998; Carney and Gale, 2001).[4] No theoretical perspective has been found to have strong and consistent empirical support. Neoclassical theories, represented by the life cycle hypothesis (Modigliani and Brumberg, 1954) and the permanent income hypothesis (Friedman, 1957), assume that individuals and households are focused on expected future income and long-term consumption. Many variations have been developed. For example, "buffer-stock" models of saving (Carroll, 1997; Caroll and Samwick, 1997; and Ziliak, 1999), emphasize a precautionary motive for saving, particularly for younger households and for those facing income uncertainty. Overall, these economic theories assume that people are forward-looking and concerned about consumption patterns, preferences are stable, people have perfect information, and everyone makes rational decisions.

Behavioral theories emphasize financial management strategies and self-imposed incentives and constraints (for example, Shefrin and Thaler, 1988). These theories modify conventional economic

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3. The following discussion builds on an emerging body of work at the Center for Social Development at Washington University. The role of institutions in saving by the poor was initiated by Sherraden (1991); detailed in Beverly and Sherraden (1999), and Schreiner and others (2001); and extended in Sherraden, Schreiner, and Beverly (2003).

4. This review of saving theory and research borrows from Beverly and Sherraden (1999).

models in two ways. First, behavioral theories do not assume that wealth is completely fungible. Shefrin and Thaler (1988) propose that individuals use systems of mental accounts and that propensity to spend varies across accounts. Second, behavioral theories do not assume that individuals have perfect information and always behave rationally. Instead, these theories suggest that individuals sometimes have trouble resisting temptations to spend. Therefore, individuals may create their own behavioral incentives and constraints (Shefrin and Thaler, 1988), such as a Christmas Club saving account.

Behavioral theories suggest that saving is likely to increase when precommitment constraints are available. Such mechanisms make it difficult to choose current consumption at the expense of future consumption (Maital, 1986; Maital and Maital, 1994; Shefrin and Thaler, 1988). A common precommitment constraint is payroll deduction. When pension plan contributions are deducted from an individual's paycheck, temptations to spend that money in the short term are almost eliminated. The individual no longer has to make, on a monthly or biweekly basis, a conscious decision to postpone consumption. Other precommitment constraints include overwithholding of income tax (Neumark, 1995) and undertaking home mortgages (Maital and Maital, 1994).

Psychological and sociological theories do not assume that consumer preferences are fixed, but rather change with economic and social stimuli (for example, Duesenberry, 1949; Katona, 1975; Cohen, 1994). Katona (1975) has noted that saving is a function of two sets of factors: ability to save and willingness to save. As in standard economic theory, the emphasis on ability to save acknowledges that some individuals, because of limited economic resources or special consumption needs, find it more difficult to defer consumption than others. At the same time, the decision to save also requires willpower (in contrast to standard economic theory, where people figure out the optimal plan and then implement it).

Psychological theory focuses primarily on this choice, as influenced, for example, by families (Cohen, 1994), peers (Duesenberry, 1949), and past saving experiences (Furnham, 1985; Katona, 1975).

Turning to empirical evidence, life cycle and permanent income models have mixed support, but they especially fail to explain patterns of saving in low-income households. Few behavioral, psychological, or sociological propositions have been rigorously tested. Overall, evidence is mixed and incomplete.

For the purposes of this discussion, we offer a simple institutional model of saving. In our simple model, institutions are the products of laws and other formal mechanisms. Institutions, which are formal and purposeful, have a defined structure and rules, designed to alter behaviors and outcomes for individuals.[5]

Individuals in this model reflect all of their cultural and social background and context, sociodemographic characteristics, and particular experiences. In neoclassical economic terms, individuals are fully informed and rational actors. In behavioral economic terms, humans are viewed as more complex, more like real humans, and they are sometimes irrational actors (Thaler, 2000). We lean toward the behavioral understanding. Also, we do not view preferences or abilities as fixed. In studies of saving

5. The term "institution" is often used in the social sciences in general, unspecified ways, to mean something like social organization, both informal and formal, above the individual level. Some discussions focus on the emergence of institutions out of culture, or in some cases, out of individual cognition. Most influential in recent years has been the "new institutional economics," with origins in the transaction cost economics of Coase (1937) and led today by North (1990). See also, Powell and DiMaggio (1991), Smelser and Swedberg, (1994).

behavior it will be important to measure individual characteristics. However, in the present formulation, we do not focus on changing individual characteristics, but on changing institutions.[6]

In the model, actions result from individuals interacting with institutions. Similar analyses of institution-individual interaction occur commonly in economic analysis of markets, as well as in social psychology, anthropology, and other fields of study. In this chapter, as a simplification, we take the typical approach used in economics and assume that the interaction occurs. Just as supply and demand reach equilibrium in microeconomics, the market of institutional-individual interaction finds its own equilibrium.[7]

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6. In neoclassical theory, people have preferences and then make decisions in the context of constraints and prices. This is a simple theory, widely applicable, and has proven to be enormously successful. Behavioral economics has recently reconsidered this view. According to the behaviorists, individuals are not always all-knowing, not always rational, and preferences are not fixed. Essentially, behavioral economics is specifying new aspects of the individual for study. In this paper, we are trying to do something similar, but with the other half of neoclassical theory. We are trying to specify the vague area with which individuals interact, known as "constraints." We aim to describe a richer, more detailed understanding of factors that individuals face in making choices. In economic reasoning, individual preferences (neoclassical view) or cognitions and emotions (behavioral view) determine action. But it can work the other way around. Sometimes an institution will change the action of an individual, and then she changes her preferences. For example, participation in a 401(k) plan will result in accumulating balances that can change a participant's time horizon and assessment of possibilities regarding the future. This is the opposite of the standard economic understanding, which is that future orientation leads to saving. Both views are probably correct to some extent, that is, forward-looking cognition causes saving, and savings cause forward-looking cognition, a virtuous circle (Sherraden, 1991, Yadama and Sherraden, 1996).

7. In fact, we think this market interaction is important and necessary to study. What conditions do institutions offer in the market? How is it that individuals make decisions to participate? Behavioral economics is beginning to shed important light in this area.

[2]Framework for an Institutional Theory of Saving[end]

From an institutional perspective, saving and asset accumulations are in large part the result of structured mechanisms involving "explicit connections, rules, incentives, and subsidies" (Sherraden, 1991, p. 116). For the nonpoor, these mechanisms include deductions for home mortgage interest and property taxes, exclusions for employment-sponsored pension contributions and earnings, tax deferments for Individual Retirement Accounts and Keogh Plans, and employer contributions and tax deferments for employee pension plans. People with higher marginal tax rates are more likely to participate in tax-deferred savings programs (Joulfaian and Richardson, 2001).[8] Low- and moderate-income households, with little in existing saving, do not have the same access or receive the same incentives from institutions that promote and subsidize asset accumulation (Sherraden, 1991; Howard, 1997; Seidman, 2001). For example, the poor are less likely to have jobs with pension benefits. Even if they do, they receive few or no subsidies because they have low or zero marginal tax rates and the tax benefits are not refundable.

Institutions that influence saving consist of formal laws and regulations, financial enterprises, and financial products. One way to look at what institutions do is that they reduce the cost of saving (a neoclassical view). Another is that institutions reduce levels of cognitive processing on the part of individuals (a behavioral economics view; see Thaler, 2000). In some cases, for example, when firms provide automatic direct deposit of a portion of income into a retirement account unless the employee opts out, institutions may reduce transaction costs close to zero, and obviate the need for any cognitive

8. For many middle- and upper-income households, participation in tax-preferred saving plans may simply shift savings assets from non–tax-advantaged to tax-preferred plans.

processing. In this case, the institution is doing all of the choosing and acting and the individual is essentially passive.

Individuals in the model consist of all of their sociodemographic characteristics, accumulated culture and experience regarding saving, cognitive capacity for financial matters, and emotions regarding money and saving. In this discussion, the target of intervention is not the individual. However, this does not mean that knowledge of individuals is irrelevant. Knowledge of individuals can lead to design of institutions that are more effective in causing saving behavior. For example, we know that individuals overall feel losses more strongly than they feel gains, which would suggest a bias toward security of saving balances rather than always aiming for high returns. Institutions cannot be equally successful with all individuals. The design task is to cause the most saving behavior by the most individuals who are targeted under a particular policy.

Action in the saving model results from the interaction of institutions and individuals. (Schreiner and others, 2001). Outcomes are savings and other forms of asset accumulations that are, in turn, likely to lead to other outcomes—economic, social, and psychological—for individuals and families.

[2]Elements of an Institutional Theory of Saving[end]

Institutional perspectives are not new in the social sciences (for example, Gordon, 1980; Neale, 1987), but they are usually not well specified. We offer seven constructs that we believe are important aspects of institutions designed to promote saving and asset accumulation: access, information,

incentives, facilitation, expectations, restrictions, and security. These seven constructs have emerged from our research on individual development accounts (IDAs).[9]

IDAs are saving programs targeted to people with low incomes, with subsidies in the form of matching funds upon withdrawal (Sherraden, 1988, 1991). Matched uses of IDA withdrawals typically include homeownership, post-secondary education, and microenterprise. IDAs have become more common during the past decade. More than forty states have an IDA policy of some type, and there are perhaps 400 community-based IDA programs. At the federal level, IDAs were included as a state option in the 1996 welfare reform act, and a federal IDA demonstration created by the Assets for Independence Act began in 1998. Despite this policy activity, coverage is quite limited; the total number of IDA participants in the United States at this writing is less than 50,000. IDAs are in the early stages of development, and much remains to be learned about whether and how they can be effective in building assets of the poor.

The results we discuss here are from a study of IDAs in the American Dream Demonstration (ADD).[10] In presenting findings on IDAs below, we emphasize that this is not a study of total household saving, but only IDA saving. The possibility exists that IDA saving can increase while total household

9.The first four of these—access, information, incentives, and facilitation—were identified by Sherraden and appeared in Beverly and Sherraden (1999). Expectations later emerged from qualitative research on IDAs (Sherraden and others, 2000). In Sherraden and others (2003), we added limits, which we now call restrictions. Security is emerging in IDA qualitative research (Sherraden and others, 2003), and in savings programs in developing countries (Rutherford, 2000; Schreiner and Morduch, 2003).

saving or net worth does not increase. In the current study, we cannot test for reshuffling of savings and other forms of assets. Nonetheless, the results may be suggestive for theory about household savings, especially because these are low-income households with, on average, few other financial assets, and thus little to reshuffle.[11] We turn now to the meaning and explanatory potential of these constructs.[12]

[3]Access[end]

Access refers to eligibility and practicality. To take current examples, only a small number of low-income people can participate in IDA programs, and few low-income households have access to 401(k) plans at work.[13] Regarding practicality, distance is a major barrier to financial services in rural areas. Differential access to asset accumulation by race is the central theme in Oliver and Shapiro (1990, 1995) and Shapiro (2004). Half the population does not have access to a pension plan in the workplace, and they are not randomly distributed by race and class. In these circumstances, it is not fully informative to interpret saving and asset accumulation outcomes as resulting solely from individual characteristics and choices. Some people have greater access than others.

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10. ADD is funded by a consortium of eleven foundations. The Corporation for Enterprise Development (CFED) undertook the demonstration, and the Center for Social Development (CSD) at Washington University in St. Louis designed and is overseeing the research. The saving period for the demonstration was 1997–01.

11. While reshuffling of assets is less likely among people with few assets, it is nonetheless possible. Schreiner and others (2001) discusses reshuffling in greater detail.

12. The discussion of institutional constructs that follows borrows from Sherraden and others (2003).

13**.** Some participants in IDAs focus on the institutional nature of the IDA program. During one pre-IDA focus group, one mother who was on welfare said “oh, I get it. It’s like a 401(k), only for us.” Low-income households are more often in disadvantaged positions relative to these saving features (Caskey, 1994; Bernheim and Garret, 1996; Beverly and Sherraden, 1999; Barr, 2004).

There is limited economic evidence regarding the effects of access on saving, in part because it is difficult to disentangle the effects of access from the effects of unobserved individual characteristics. For example, if workers consider the availability of pension plans when they evaluate job offers, then those who work for firms that offer pension plans may value retirement saving more than the average individual. This would create a positive association between access and saving, even if access has no independent effect. However, some researchers (Cagan, 1965; Carroll and Summers, 1987) have concluded that institutionalized saving opportunities promotes saving by calling attention to the need for and benefits of saving.

[3]Information[end]

Information refers to knowledge about the policy or product, as well as knowledge that may contribute to successful performance. Bayer, Bernheim, and Scholz (1996) find that more frequent corporate-sponsored retirement seminars were associated with both higher participation and higher levels of contributions to 401(k) plans. Bernheim and Garrett (1996) report that participation rates were 12 percentage points higher for companies that offered financial education, and 20 percentage points higher for employees who chose to attend. Education increased new savings as a percentage of income by 1.7 percentage points. The effects were greatest for people who saved little before they received education. In another study, Bernheim, Garrett, and Maki (2001) report that financial education for teens increases savings rates when they become adults. In research on IDAs, Schreiner, Clancy, and Sherraden (2002) and Clancy, Grinstein-Weiss, and Schreiner (2001) find that up to eight hours of general financial education is associated with strong increases in net savings amounts in IDA programs. Some financial education appears to have a positive payoff, but extensive financial education might not be better.

Because financial education is expensive, these data can contribute to resources being used more efficiently.

[3]Incentives[end]

Incentives are financial rates of return, as well as nonfinancial payoffs for participation. In the latter category can be factors such as peer relationships, status, or opportunity to learn. The net effect of financial incentives on saving is a subject of debate. An increase in the rate of return will not necessarily increase saving. There are two key issues. First, changes in the rate of return on savings may simply result in the reshuffling of the form of assets, with no new saving. Second, for net savers, an increase in the after-tax rate of return has two contradictory effects. On the one hand, individuals may choose to save more because the price of current consumption increases relative to the price of future consumption (the substitution effect). On the other hand, with higher rates of return, individuals can save less and still enjoy the same amount of future consumption (the income effect).

Empirical evidence regarding the effect of incentives on saving among the nonpoor is mixed (see Engen, Gale, and Scholz, 1996; Hubbard and Skinner, 1996; and Poterba, Venti, and Wise, 1996; Feldstein, 1995; Hubbard, Skinner, and Zeldes, 1995; Powers, 1998). For low-income households, in contrast, reshuffling is less likely because they are less likely to have savings and other assets to reshuffle. Empirical analysis simulating the effects of private pension plans suggests that pensions do not offset personal saving among lower-income (less-educated) workers (Bernheim and Scholz, 1993). Schreiner, Clancy, and Sherraden (2002) find that higher match rates in IDA programs are positively associated with fewer unmatched withdrawals and staying in the program, but they are not associated with amounts of saving. This latter finding is consistent with data from 401(k)s, where savings amounts do not increase

with match rates beyond a low level (Basset, Fleming, and Rodriquez, 1998; Kusko, Porterba, and Wilcox, 1994).[14]

[3]Facilitation[end]

Facilitation refers to any form of assistance in saving, for instance, when depositing is done for the participant, as in automatic payroll deduction. Direct tests are rare, but one study provides strong, direct evidence that facilitation affects saving behavior. Madrian and Shea (2000) studied 401(k) participation and contribution rates in a company that began automatically enrolling employees in their 401(k) plan. Before the change, employees had to sign up to participate in the 401(k) plan. After the change, employees had to choose to opt out of the plan if they did not want to participate. Although none of the economic features of the plan changed, participation was significantly higher under automatic enrollment. Participants were also likely to stay with the default contribution rate and fund allocation. Other evidence on the importance of facilitation is the common practice of using the income tax withholding system as a kind of saving plan. Millions of households withhold more than the taxes they owe. More evidence is needed to determine whether this is because they plan for a lump sum refund, despite the strong economic disincentive (the cost of forgone earnings on the money), or overwithhold inadvertently. Direct deposit can also be used to facilitate saving. Direct deposit is positively associated with being a saver, i.e., staying in the IDA program (Schreiner, Clancy, and Sherraden, 2002), and IDA

14. To complicate matters, some types of incentives have limits or caps. For example, participants in 401(k)s may have tax incentives for putting money aside for retirement, but only up to a cap. These caps create analytical challenges in that they may create censoring effects in saving outcomes. Public policy always has caps for saving subsidies, for instance, limits on how much can be deposited annually into a 401(k) account. These caps in fact may decrease savings below desired levels, though these censoring effects are seldom studied.

participants point to positive effects of direct deposit in their saving performance (Sherraden and others, 2005).

[3]Expectations[end]

Expectations are embodied in institutional features such as saving targets and social pressure of staff and peers. In saving behavior among the poor, this is largely unresearched. The only data we have are qualitative reports of some IDA participants that they view the match cap as a monthly target savings amount, and that staff and peer often encourage them to do so. Some IDA participants state directly that they are trying to fulfill these expectations (Sherraden and others, 2005). A large body of social-psychological research confirms that people tend to try to do what others expect them to do. Schreiner, Clancy, and Sherraden (2002) and Schreiner (2001) report that IDA holders in the ADD who faced higher savings targets or caps were less likely to make unmatched withdrawals and more likely to be successful savers. Under the heading of expectations we also include contracts, or legalized expectations (Vittas, 1992). A growing portion of saving in the United States is contractual, including 401(k)s, 403(b)s, and similar retirement programs.[15]

[3]Restrictions[end]

Restrictions are likely to affect saving performance. Contrary to neoclassical thinking, savers often prefer restrictions. Restrictions are of two main types: restrictions on access and use. Regarding restrictions on access, there is a growing literature in behavioral economics on the desirability of putting funds out of easy reach. It may be that savers prefer to put money away in places where they cannot get to

15. There are extensive contractual saving policies in some other countries. For example, the Central Provident Fund of Singapore is a mandatory, defined-contribution saving policy for retirement, homeownership, medical care, insurance, education, and investment (Asher, 1991; Sherraden and others, 1995).

it because it would be drawn upon by family and friendship networks if it were available. We have heard this often from IDA participants; family and friends may draw down household assets more among the poor and people of color (Stack, 1974; Chiteji and Hamilton, forthcoming). We hear often from IDA participants that they are glad that the savings are out of reach, because otherwise it would be drawn down due to social obligations.[16]

Regarding restrictions on use, most subsidized saving policies specify such restrictions. For example, 529 saving plans are for college education and 401(k) savings are not available until retirement. Such restrictions are a limitation on choice, but there are situations in which the account holder prefers restrictions. In research on IDAs, participants translate such restrictions into goals. For example, if the money is available only for homeownership, then this tends to focus their saving effort toward that goal (Sherraden and others, 2005 and forthcoming).

[3]Security[end]

All families need a safe place to put their money. Rutherford (2000) details examples of savers in developing countries who are willing to accept a negative rate of interest in exchange for security of their savings. In research on IDAs, the security of knowing that savings are safe and available for the future is mentioned by some participants during in-depth interviews (Sherraden and others 2005 and forthcoming). Other important types of security relate to investment-specific risks, general market risks, macroeconomic risks, and political uncertainties, faced by all savers. Some public policies, such as Social Security, can protect extensively against market and macroeconomic risks, though beneficiaries are

16. Restriction on savings being drawn upon by social networks of course may have negative social consequences. We cannot evaluate this, except to report that many IDA participants express appreciation for the restrictions.

subject to political risk that their benefits would be cut. Similar protections are uncommon in defined contribution retirement plans, or other forms of asset accumulation held by individuals.

[3]Other Institutional Elements[end]

Lastly, we should note what we do not know. Unobserved factors associated with IDA programs are correlated with saving level. The average monthly net deposit (AMND) in IDAs, controlling for all observed factors, can be as much as $20 per month different across IDA program sites. The overall AMND average is $19, so these differences from unobserved factors across sites are large (Schreiner Clancy, and Sherraden, 2002**).** We do not know what the unobserved factors are, or how much each one matters, but the size of the effects strongly suggests that IDA programs probably vary in unobserved ways that affect savings performance. For example, the level of staff commitment, the quality of financial education, or the vision and leadership of the executive director may contribute to saving performance.

[2]Toward Measures[end]

The constructs above are an attempt to begin specifying an institutional theory of saving. This project is in an early stage of development, and much more remains to be done. The aim is to work toward an informative and useful set of institutional constructs that, if supported by research, can help to specify better theory and guide policy. Eventually, constructs can be refined into measures. Measures might then be combined into an index of institutionalization, which could be used to compare various saving policies within a country or in comparative research across countries. Such developments would help change the vague idea of institutions into a tool for analysis, knowledge building, and policy decisions.

An omnibus measure that we call “degree of institutionalization” might also be useful for comparing saving policies. If we imagine saving institutions ranging on a continuum from negative to positive in terms of how much savings they generate saving, we might have the following seven types: discourage saving; neutral on saving; encourage saving slightly; encourage saving aggressively; contractual saving, opt-in; contractual saving, opt-out; and automatic or mandatory saving.

With respect to the category *discourage saving*, means-tested social programs in the United States have asset limits that are a disincentive for saving among low-income households. Sherraden (1991) argued that asset limits in means tested programs should be abandoned or greatly eased. During the 1990s, almost all states eased asset limits in many programs, but much more can be done to reduce discouragement of saving by the poor.

Neutral on saving refers to public policy that neither discourages nor encourages saving. This is an ideal type, useful in theory, but probably impossible to find in practice. Next are *two levels of encourage saving—slightly and aggressively*. Without specifying the difference, we make the point that the extent of encouragement can matter. Policies can slightly encourage saving, for example, a small interest rate, or aggressively encourage saving, for example, large public subsidies, public information campaigns, and universal direct deposit.

Moving toward the more institutionalized end of the continuum are *contracts, where we identify two levels—opt-in and opt-out*. Individuals may need or want constraints on the ready availability of their money, and are therefore willing to enter into contracts to have the money put out of reach. This is the case, for example, in 401(k)s. The first level of contractual saving is *opt-in*, referring to individuals being asked if they want to participate. The next level is *opt-out*, referring to individuals being signed up

automatically, with the option of quitting. Research has reported higher participation rates when 401(k) plans are presented as opt-out rather than opt-in. Automatic or mandatory saving is already a part of U.S. policy in the sense of mandatory contributions toward Social Security.

While the institutional theory of saving we propose, and the measures to test it, are only tentative at this point, we believe they can make useful contributions to saving policy.

[1]Toward a Saving Policy for the Poor[end]

We now explore the existing institutional context for financial decision-making by low- and moderate-income households. We contend that institutional constraints facing such households mostly fall into the category "discourage saving" outlined above. We then analyze ways to change those constraints.

[2]Unbanked and Underbanked[end]

The poor, like everyone else, often require a wide range of financial services, including saving services.[17] Some may think that the poor cannot—or even should not—save. After all, when incomes are low, the necessities of food and shelter may take every available dollar. But this is a great misconception of the financial life of the poor. Even people who are poor must save small lump sums for routine payments, including rent, clothing for school, and home or automobile repairs, and occasionally must have larger sums for major life events, such as births, marriage, illness, accidents, and deaths. Many low-income families save for major goals of household development, such as moving to a better neighborhood, purchasing a car to be able to drive to a better job, buying a computer and Internet access,

17.This section builds on Barr (2004) and is adapted with permission.

purchasing a home, or capitalizing a microbusiness. In this section, we illustrate how institutional saving features discussed above in theory can deter or promote saving by the poor in practice.

Today, instead of a regular means to save, the poor largely face institutionalized dis-saving from high-cost financial services. Access to basic financial services is critical to success in the modern American economy. Nearly 10 million U.S. households—9.5 percent of all U.S. households—do not own a bank account (Kennickell, 2000; Aizcorbe, 2003).[18] Twenty-two percent of low-income families—over 8.4 million families earning under $25,000 a year—do not have either a checking or savings account (Kennickell, 2000). Most of the unbanked[19] are low-income: 83 percent of the unbanked earn under $25,000 a year (Vermilyea and Wilcox, 2002). The unbanked are more concentrated in low-income neighborhoods (Dunham, 2001).

Households are more likely to be unbanked when they have lower incomes, less wealth, less education, are not working, are younger, have more children, rent their home, and are a racial or ethnic

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18. The General Accounting Office (GAO), using the 1998 and 1999 Survey of Income and Program Participation (SIPP) estimated that "about 11 million benefit recipients, over half of all federal benefit check recipients in 1998, were unbanked. This estimate is substantially higher than Treasury's 1997 estimate, which showed that 24 percent of federal beneficiaries (5.2–6.5 million) lacked bank accounts" (GAO, 2002) GAO extrapolates from its SIPP estimates to suggest that among all U.S. adults, 22.2 million households, or 55.9 million individuals, are unbanked, representing 20 percent of all households and 28 percent of all individuals.

19. We use the term "unbanked" to refer to individuals who do not have an account (savings, checking, or otherwise) at a depository institution. The "underbanked" are those with an account at a depository institution, but who also rely for their financial services on other financial services providers (such as check cashers, payday lenders, and refund anticipation lenders) that largely serve low- and moderate-income neighborhoods. Problems faced by the "unbanked" and "underbanked" overlap significantly, but diverge in important respects that we explore. We use the term "bank" generically to refer to all depository institutions, including commercial banks, thrifts, and credit unions. Where differences among these types of depository institutions matter, we use the specific terms.

minority.[20] Broadly speaking, the most common reason persons cite for lacking a checking account is not having enough money to be able to afford the costs of account ownership (Caskey, forthcoming).[21] Other unbanked persons said that they distrusted banks, did not want to deal with banks, or had privacy concerns (Rhine, Toussaint-Comeau, Hogarth, 2001). Families living in neighborhoods with higher concentrations of blacks or Hispanics are less likely to own a checking account. Among the banked, low-income minorities are less likely than whites to have a checking account, but more likely than whites (all else being equal) to have savings accounts. By contrast, proximity to a bank branch seems not especially predictive of being banked (Vermilyea and Wilcox, 2002).[22]

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20. Findings from demographic surveys of the unbanked vary regionally (Caskey, 1994; Dunham, 2001; Greene, Rhine, Toussaint-Comeau, 2003; Hogarth and O'Donnell, 1999; Hogarth, Lee, and Anguelov, 2004; Rhine, Toussaint-Comeau, and Hogarth, 2001). These descriptions of the unbanked do mask heterogeneity of the population. For example, mentally ill unbanked persons or prisoners face a host of problems making it difficult to bring them into the banking system that we do not address here. Nor do we address policy responses to persons who choose not to use banks because the individuals are engaged in illegal activity, or wish to hide their income from spouses, for example.

21. The most commonly cited reasons for lacking a bank account are "do not have enough money" (50 percent of respondents in Booz-Allen Hamilton, Shugoll Research, 1997); "no savings" (53 percent of respondents in Caskey, forthcoming); "do not write enough checks to make it worthwhile" (28.4 percent of respondents in Kennickell and others, 2000); "do not have enough money" (12.9 percent of respondents in Kennickell and others, 2000), "bank fees are too high" (23 percent of respondents in Caskey, forthcoming); "bank minimum balance requirements are too high" (22 percent of respondents in Caskey, forthcoming); "high minimum balance requirements and fees" (Vermilyea and Wilcox, 2002). In one study, 62 percent of respondents cited unfavorable account features and costs (Rhine, Toussaint-Comeau, and Hogarth, 2001).

22. Data are insufficient to determine whether the racial neighborhood effect is related to any reluctance by neighborhood merchants to accept checks from minorities or from any person in minority neighborhoods, or is related to consumer preferences (Vermilyea and Wilcox, 2002).

The period 1995 to 1998 marked a decline in the percentage of low-income families who are unbanked from 25 to 22 percent (Kennickell and others, 2000).[23] Economic growth in the 1990s improved the job prospects and incomes of the poor, although these gains eroded significantly in recent years (U.S. Census Bureau, 2002).[24] Policy changes in the EITC increased the take-home pay of low-income workers and helped to increase labor force participation. Welfare reform, beginning with waivers for states to use welfare-to-work strategies and culminating with the 1996 Welfare Reform law, increased the percentage of welfare recipients entering the workforce. Greater workforce attachment and higher incomes may have increased the benefits of bank account ownership and also may have provided more low-income persons with the wherewithal to meet bank minimums or afford bank fees. Account ownership grew most quickly among groups at or below the poverty threshold and the next largest gains came from those just over the poverty line (Hogarth, Lee, and Anguelov 2005).

[2]Institutional Context for Dis-saving[end]

The consequences of not having access to mainstream financial services can be severe. Lack of access to bank accounts and structured saving mechanisms make it more difficult for low-income families to save. The unbanked face high costs for basic financial services, which reduces effective take-home pay.[25] For example, a worker earning $12,000 a year would pay approximately $250 annually just to cash payroll checks at a check-cashing outlet (Dove Consulting, 2000), in addition to fees for money orders,

23. The percentage of unbanked families continued to decline somewhat through 2001 (Aizcorbe and others, 2003).

24. Median household incomes dropped, and the poverty rate increased, in 2001 and 2002 (DeNavas-Walt and others, 2003; Proctor and Dalaker, 2003).

25. Total estimated fringe banking transaction costs, including check cashing, payday lending, pawn loans, rent-to-own transactions, and auto title lending are $5.45 billion annually (Carr and Schuetz, 2001).

wire transfers, bill payments, and other common transactions.[26] Almost all of the checks cashed at check cashers pose relatively low risk: nearly 80 percent of checks cashed at check-cashing outlets are regular payroll checks; another 16 percent are government benefit checks (Dove Consulting, 2000).[27] A large portion of these checks could presumably be direct deposited into bank accounts at relatively low cost—if low-income people had bank accounts.

The costs of these basic financial transactions reduce the effectiveness of federal income transfer programs and may undermine public initiatives to move families from welfare to work. Studies of the EITC suggest that higher take-home pay from the EITC helps to induce labor force participation (Hotz and Scholz, 2001),[28] But high-cost financial services reduce effective take-home pay and thus may also diminish the effectiveness of the EITC. One survey found that 44 percent of a sample of EITC recipients in inner city Chicago used a check-cashing service to cash their government refund check (Smeeding, Phillips, and O'Connor 2000). Nationwide, in 1999, nearly half of the $32 billion in EITC refunds provided to over 18 million low-income families were distributed through refund anticipation loans, costing EITC recipients $1.75 billion for tax preparation services, electronic filing, and loan fees (Berube and others, 2002).

Similarly, some studies suggest that welfare programs that encourage work, coupled with policies that let families keep more of their earnings before benefits are reduced or eliminated, have helped to

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26. The use of check cashers may vary considerably by region, and by urban or rural location. (Dunham, 2001; Rhine, Toussaint-Comeau, and Hogarth, 2001; Hogarth, Lee, and Anguelov, 2004; Stegman and Faris, 2001).

27. Check cashers focus on these checks to reduce credit risk. These operations, however, often also require additional efforts to reduce credit and fraud risk.

28. Empirical work is needed on the labor force effect, if any, of high-cost financial services.

increase workforce participation and job retention (Blank, 2002). Yet the positive effects of welfare reform may be undermined by high-cost financial services. Although states have switched to the EBT for welfare recipients, once these households begin earning income, or leave the welfare rolls, they often lack access to the banking system, and pay high fees to cash their income checks.[29] Even in the bulk of states that have moved to EBT for welfare payments, welfare recipients may still face high costs for financial services. First, administrative problems in some state programs make it hard to withdraw sufficient funds for bill payment (for example, monthly rent). Second, most EBT programs do not link recipients to bank accounts, which means that these recipients need to find other means to convert their work income to cash to pay bills, save funds, and access credit. Third, payroll checks and EITC refunds may still push them toward high-cost transaction services. Lastly, welfare recipients may be dissuaded from opening a bank account because they believe that their bank account balances will cause them to exceed state welfare program asset limits (Caskey, 1997; Hogarth, Lee, and Anguelov, 2004).[30]

In addition, low-income families must save if possible to cushion themselves against personal economic crises, such as injury or loss of a job, and for key life events, such as buying a home, sending their children to college, or retirement. Low-income households face key barriers to saving (Banerjee, 2001). Because they are poor, they face higher opportunity costs for putting their funds toward savings rather than current consumption. Because the poor accumulate little, financial institutions face high costs in collecting their savings relative to the amounts saved, and are thus reluctant to expend resources to

29. There is some evidence that check cashers may see the welfare-to-work population as a new market (Fox and Mierzwinski, 2001).

30. In some states, account balances will cause recipients to lose eligibility under some circumstances (Corporation for Enterprise Development, 2002).

open accounts for them, and they may offer low returns on savings, further reducing incentives the poor have to save. Low-income families, particularly those without bank accounts, often lack regular mechanisms to save, such as payroll deduction plans, further reducing the likelihood that they will do so (Beverly and Sherraden, 1999).

In a survey of New York and Los Angeles low-income neighborhoods, 78 percent of the banked held some form of savings, broadly defined, while only 30 percent of the unbanked had savings. Obviously, the ability to save is a function of income. But differences hold even across income ranges: being banked is highly correlated with saving (Vermilyea and Wilcox, 2002). This may suggest that bank account ownership makes it easier for households to save. Bank account ownership may be correlated with a propensity to save. That is, households who want to save open bank accounts. Thus one would need to measure differences in propensity to save in order to determine whether account ownership itself is a strong factor in increasing savings.[31]

Bank accounts can be important entry points for the provision of regular savings plans for low-income workers through payroll deduction. Still, most low-income workers work for firms without savings plans or are themselves not covered by such plans even when their employers have savings plans (Ameriks, Caplin, and Leahy, 2002). In addition to the fact that low-income unbanked families lack an easy mechanism for regular savings, the tax system, through which the bulk of government savings benefits are provided, largely subsidizes savings for higher-income households. The Treasury Department estimates that more than two-thirds of tax expenditures for pensions go to households in the top 20

31. For evidence that financial planning influences wealth accumulation, see Ameriks, Caplin, and Leahy (2002).

percent of the income distribution, while the bottom 40 percent get only two percent of the tax benefit (Orszag and Greenstein, forthcoming).

Furthermore, without a bank account, it is more difficult and costly to establish credit or qualify for a loan. A bank account is a significant factor—more so, in fact, than household net worth, income, or education level—in predicting whether an individual also holds mortgage loans, automobile loans, and certificates of deposit (Hogarth and O'Donnell, 1999).[32] After controlling for key factors, one study determined that low-income households with bank accounts were 43 percent more likely to have other financial assets than households without bank accounts (Gale and Carney, 1998). Low-income persons without bank accounts face higher costs of credit than low-income persons with accounts,[33] and in any event, low-income households generally face higher costs of credit than households with higher incomes (Banerjee, 2001). Moreover, the savings products that low-income individuals do have access to generally provide low levels of return, and in turn may drag down savings rates. This lower saving rate is a problem itself, and further increases the cost and reduces the availability of credit to these households.

Low-income families find it difficult simply to make ends meet each month and lack access to short-term credit at a reasonable cost to smooth out earnings. The main complaint of low-income families, for example, in Caskey's (forthcoming) study, was the "insecurity and stress associated with living from paycheck to paycheck." Most low- and moderate-income households manage to spend all their income

32. There may be personal characteristics of those owning bank accounts—such as propensity to plan, budget, be thrifty, and save—that are not fully captured by this analysis and that may account for better savings and credit outcomes.

33. Credit scoring innovations may increase the benefits of account ownership for low- and moderate-income persons. W.A. Lee, "Debit Scores May Gauge Subprime Market," *American Banker*, February 28, 2002, p. 10.

each month (Hogarth, Lee, and Anguelov, 2004; Rhine, Toussaint-Comeau, and Hogarth, 2001). Bank account ownership will not suddenly change that, but account ownership may make it easier for low-income households to manage their finances, save even if in modest amounts, and access lower-cost forms of credit.

It is difficult to untangle causation, but a lack of account ownership is linked to credit problems. Either unbanked low-income persons have lower propensities to plan financially than other low-income households, or lack of a bank account makes it harder to plan and save. In turn, once credit problems emerge, credit-impaired individuals have a harder time getting access to bank accounts. In Caskey's (forthcoming) survey of low-income households, 42 percent of unbanked households were two months late on bills in the last year, compared with 28 percent for banked households, while 41 percent of unbanked households were contacted by a debt collection agency in the past year, compared with 25 percent for banked families. When low-income unbanked families need to borrow, they must turn to expensive forms of credit. Only 14 percent of unbanked poor families carry credit cards that might help them smooth out payment for short-term increases in consumption or to weather occasional dips in income, while 59 percent of low-income banked households carry credit cards (Caskey, forthcoming).

Account ownership in and of itself is no panacea. Some low- and moderate-income individuals with bank accounts often lack savings, and may turn repeatedly to payday lenders (who charge, on average, 474 percent APR), and to other forms of high-cost credit (Fox and Mierzwinski, 2001).[34] Given the lack of health insurance, low-income families without savings or access to informal networks of

34. Indiana's Department of Financial Institutions found that consumers took an average of thirteen loans per year, ten of which were rollovers of earlier loans. An Illinois Department of Financial Institutions survey found an average of ten loan contracts over eighteen months.

family and friends often use payday loans when faced with expenses related to birth or illness (Rhine, Toussaint-Comeau, and Hogarth, 2001).

Fourth, low-income families who cash their entire paycheck may face high risk of robbery or theft.[35] By transitioning into bank accounts where they can store a portion of their earnings, withdraw funds in smaller amounts, pay for goods or services directly using debit, and withdraw funds outside of the concentrated time periods during which benefit checks and paychecks are commonly cashed, these families can decrease their exposure to risk of crime.

[2]Changing the Institutional Framework of Saving Policy for the Poor[end]

Promoting low-income household savings is critical to lowering reliance on high-cost, short-term credit, lowering risk of financial dislocation resulting from job loss or injury, and improving prospects for longer-term asset-building through homeownership, skills development, and education. Savings policy should focus on four approaches—account ownership, employer savings plans, IDAs, and fundamental pension reform. First, bank account ownership can be an important step for low-income families to begin to save, for both shorter-term financial stability and longer-term savings goals. Second, payroll deduction plans need to become critical avenues for low-income savings. Third, for intermediate-term saving needs, such as homeownership, college education, or entrepreneurial ventures, IDAs are providing a new means for low-income households to save. Lastly, fundamental pension reform is required to provide low-

35. R. Craver, "Safety and Numbers: Hispanics Caught Between Risks of Carrying Cash and Banking It," *Winston-Salem Journal*, January 22, 2003. C. Davenport, "Seeking a Secure Financial Foothold; Banking Barriers Leave Area Immigrants Vulnerable to Crime, Economic Disparities," *Washington Post*, November 15, 2001.

income families with the opportunity for tax-advantaged savings that are currently skewed toward the more affluent members of our society.

Evidence to date suggests that low-income individuals can save if given the opportunity to do so, at least if offered a significant matching contribution. Some 73 percent of federal employees earning $10,000 to $20,000 annually participated in the federal government's Thrift Saving Plan, and over half of those earning under $10,000 also participated (U.S. Department of the Treasury, 1998). Some 60 to 70 percent of families at the poverty level are current or usual savers (Hogarth; Lee, and Anguelov, 2004; Ferguson, 2002).[36] The 2001 Survey of Consumer Finances found that 30 percent of families in the bottom income quintile saved in the prior year, and 53.4 percent of those in the second-lowest quintile saved (Aizcorbe and others, 2003). Savings account features have an appeal for the unbanked. In a Treasury Department survey of unbanked federal check recipients, respondents were aware that an ETA savings feature would only pay a nominal rate of interest (explicitly posed in the survey as "$2 annually on a $100 deposit"), but this feature would account for approximately 25 percent of the typical respondent's decision on whether to enroll in the ETA (Bachelder and Aguerre, 1999).

Some lower-income individuals use alternatives to bank accounts to facilitate savings. Anecdotal evidence exists that low-income people purchase money orders with their paychecks at the beginning of the month and hold them for later use. In so doing, they convert their income and benefits into a less liquid and more protected form, for bill payment later in the month or as savings for planned and unplanned expenditures in the future.[37] Researchers have also found that low-income taxpayers over-

36. R. W. Ferguson Jr. "Reflections on Financial Literacy." Remarks before the National Council on Economic Education, May 13, 2002. (www.federalreserve.gov/boarddocs/speeches/2002/20020513).

37. Postal savings orders offer protection if lost or stolen and are backed by the U.S. Postal Service.

withhold on their income taxes more frequently than higher income taxpayers; some economists suggest that these taxpayers use withholding as an automatic savings mechanism. This may suggest that demand for savings products among the poor is high enough that some will accept a zero or negative interest rate (Highfill, Thorson, and Weber, 1998).

The way that employer-sponsored savings plans are set up can matter a great deal (Madrian and Shea, 2000; Choi and others, 2004). Automatic enrollment, in which employees are signed up for regular payroll deduction into 401(k) plans unless they choose to opt out, have been increasingly used in larger companies.[38] For those at the bottom end of the pay scale, and in particular for younger workers, as well as black and Hispanic employees, automatic enrollment in pension plans significantly boosts participation and asset accumulation (Choi and others, 2001).[39] Employer-offered default contribution rates, default

38. Hewitt Associations reports that 14 percent of companies used automatic enrollment in 2001, up from 7 percent in 1999, driven in part by a desire to meet IRS "top-hat" antidiscrimination rules (Choi and others, 2004).

39. Automatic enrollment in 401(k) plans significantly boosted participation rates, to rates well exceeding 85 percent, whereas previous rates had ranged from 26-43 percent after six months and 57-69 percent after three years of employment. However, most participants tended to choose a low default savings rate (2-3 percent) and conservative investment plan (for example, money market fund). Slightly less than half of plan participants continued at the low rate and conservative plan after three years. Thus on average, after three years, given higher participation but lower contribution rates and more conservative plans, there was only a slight positive overall companywide average effect on savings of automatic enrollment. Companies could, of course, set default rates higher (say, equal to rate at which employer match ceases) and let employees switch to lower contribution rates if desired, but there may be some tradeoff in terms of opting out early. As noted above, for those at the bottom of the pay and savings spectrum, however, automatic enrollment significantly increased participation rates and asset accumulation. See also Madrian and Shea (2001) (48-percentage point increase in participation among new employees; 11-percentage point increase overall; automatic enrollment particularly helpful in increasing participation among young, lower-paid, and black and Hispanic employees).. Automatic enrollment was actively encouraged by the Treasury Department in the late 1990s. See also Rev. Rul. 98-30 (1998), Rev. Rul. 2000-8, Rev.

investment plans, rollovers into new pension accounts of low-balance accounts for terminated workers, and employer matches can all increase participation and contribution rates (Choi and others, 2004). In order to foster increased asset accumulation over time, without dissuading lower-income workers from contributing at all, automatic enrollment contribution rates for low-income workers can be set low initially, and then can be increased over time as their salaries increase (Thaler and Benartzi, 2004).

Yet few low-income workers have access to employer-sponsored pension or other savings plans. The Internal Revenue Code provides two-thirds of its pension benefits to the top 20 percent of the population, while the bottom 60 percent gets only 12 percent of any tax benefit (Summers, 2000).[40] Most low-income workers work for firms without savings plans or are not themselves covered by the plan that their employers offer to other employees, in part because of the part-time or seasonal nature of their work (Orszag and Greenstein, forthcoming). Low-income employees may be reluctant to save because they need their wage income, and most low-income workers have lower contribution rates than higher-income ones when they are covered by plans. They also are more likely to work in high-turnover, part-time, or seasonal jobs as to which it is more costly and difficult to establish savings programs. Existing antidiscrimination rules, which the Treasury Department has announced it may make more lenient still, permit wide disparities in the provision of savings plan benefits among employees.

As indicated above, individual development accounts have been introduced and are becoming more widespread. Most states have some type of IDA policy, and in addition to the American Dream

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Rul. 2000-33, and Rev. Rul. 2000-35 (2000); Summers (2000); Economic Growth and Tax Relief Reconciliation Act (2001).

40. L. H. Summers. Remarks at the Department of Labor Retirement Savings Education Campaign Fifth Anniversary Event, Washington, D.C.,. July 18, 2000.

Demonstration, the federal government enacted the Assets for Independence Act in 1998. Despite this policy activity, IDA programs today are small and community-based. The next step is to connect IDA programs and principles with large policy systems. In this regard, tax credits to financial institutions could help to overcome barriers to widespread adoption of IDAs. The Savings for Working Families Act,[41] first introduced by Senators Lieberman and Santorum, is a promising approach. Under the act, financial institutions offering IDAs would receive tax credits annually offsetting up to $500 in match funds and $50 in account administration costs. The current legislation, drafted with an overall cap on accounts, would provide for up to 300,000 new IDAs at a cost of under $500 million.[42] The cap on the number of accounts may limit financial institution interest in developing the infrastructure necessary to support these accounts, and should be removed. If permitted to operate without a cap, this legislation could help to transform financial services for the poor, by moving from small-scale, nonprofit focused efforts to a large-scale, financial-institution driven financial product that meets the longer-term savings needs of low-income families.[43] As with bank accounts for low-income persons, technology will need to play a central role in driving down the costs of IDA provision.[44]

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41. A version of the legislation passed the Senate as Title V of the CARE Act of 2003 on April 9, 2003. See Senate Bill 476, 108th Congress (Sen. Grassley).

42. See Senate Report 108-011, Care Act of 2003 (Feb. 27, 2003).

43. The legislation could also be modified to provide for a similar tax credit to financial institutions for providing low-cost electronic banking accounts for low-income persons. Such a tax credit would be the easiest way to bring the First Accounts pilot to scale if the demonstration proves successful (Barr, 2004).

44. The Doorways-to-Dreams test of an Internet-based back office platform for IDA programs will prove instructive in this regard. See www.d2dfund.org.

[2]Directions for a Universal, Inclusive Saving Policy[end]

As indicated above, banking the poor, and giving them access to saving services and products, depends on public policies working in conjunction with private sector financial institutions. So that this discussion of large-scale policy does not seem entirely speculative, we turn to a proposal for a large, inclusive saving plan in the United States, and a universal, progressive child saving policy in the United Kingdom.

[3]Proposal for Universal Saving Accounts in the United States[end]

President Clinton proposed Universal Savings Accounts (USAs) in his State of the Union address in 1999. In his State of the Union address in 2000, Clinton offered a similar proposal, saying:

[blockquote]Tens of millions of Americans live from paycheck to paycheck. As hard as they work, they still do not have the opportunity to save. Too few can make use of IRAs and 401(k) plans. We should do more to help all working families save and accumulate wealth. That's the idea behind the Individual Development Accounts, the IDAs. We ask you to take that idea to a new level, with new retirement savings accounts that enable every low- and moderate-income family in America to save for retirement, a first home, a medical emergency, or a college education. We propose to match their contributions, however small, dollar for dollar, every year they save.[45] [end]

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45. President Clinton, State of the Union Address, Washington, 2000. Barr, who co-authored this chapter, participated in policy development on USAs and RSAs at the Treasury Department. Before to Clinton's speech, at the request of the Treasury Department and White House, the Center for Social Development provided data and analyses from IDA research in ADD.

The 1999 USA proposal did not take off politically, and it was reconceptualized as the Retirement Savings Accounts in 2000. The RSA proposal channeled tax credits to financial institutions to cover administrative costs of the accounts, plus match funds deposited by financial institutions into the account. Despite the limited political impact, these proposals elevated the idea of inclusive, progressive saving policy to a new level. Occasions when government leaders have made large and progressive asset building proposals have been few. The USA proposal in 1999, which was like a 401(k) for all workers, with deposits and matching funds for those with lowest incomes, was budgeted at an expenditure level of $33 billion a year (roughly the size of the EITC), and RSAs were even larger, at an estimated cost of nearly $55 billion annually.

These proposals are markedly different from President Bush's saving initiatives, which are called Lifetime Saving Accounts and Retirement Savings Accounts. The Bush proposals make little effort at inclusion and are aimed at carving up Social Security, rather than adding to it. If enacted as proposed, the Bush proposals would give still greater saving-related tax benefits to the nonpoor, and little or nothing to the poor.

[3]Child Trust Fund in the United Kingdom[end]

A serious discussion of asset-based policy began in the United Kingdom in 2000 (Kelly and Lissauer, 2000; Nissan and LeGrand, 2000; Institute for Public Policy Research, 2001). In a major policy development in April 2001, Prime Minister Tony Blair proposed a Child Trust Fund for all children in the

United Kingdom, with progressive funding. He also proposed a demonstration of a Saving Gateway, matched saving for the poor.[46] Blair said:

[blockquote]I believe we have already made important strides in extending opportunity for all—through improving skills and work, through improving living standards, and through improving the quality of public services. But now we want to add a fourth element: more people getting the benefit of assets and savings, so that we help spread prosperity and opportunity to every family and community.…We want to see all children grown up knowing that they have a financial stake in society. We want to see all children have the opportunity of a real financial springboard to a better education, a better job, a better home—a better life….[47][end]

The Child Trust Fund would be based on the principle of progressive universalism, wherein every baby would receive an endowment, but those in lower-income families would receive a larger lump sum. In the original proposal, every child in the United Kingdom would receive at birth a deposit into an account, and three additional deposits, ranging from fifty to 100 pounds, would be made as the child grows up. Parents, relatives, or friends could make additional contributions. A limited number of investment options would be available (H.M. Treasury, 2001).[48]

In April 2003, Prime Minister Blair announced that he would go forward with the Child Trust Fund. Beginning in April 2005, each newborn child will be given an account, retrospective to children

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46. The Institute for Public Policy Research (IPPR) has led asset-based policy work in the United Kingdom (for example, Kelly and Lissauer, 2000; IPPR, 2001). Asset-based theory, policy discussion, and IDA research from the United States influenced development of the Saving Gateway and Child Trust Fund in the United Kingdom (see H.M. Treasury, 2001; Sherraden, 2002).

47. Tony Blair, "Savings and Assets for All." Speech given April 26, 2001, 10 Downing Street, London.

48. Nissan and Le Grand (2000) were influential in the Child Trust Fund proposal.

born from September 2002. All children will receive an initial deposit of at least 250 pounds, and children in the bottom third of family income will receive 500 pounds. Additional government deposits are not yet specified. (H.M. Treasury, 2003). The Child Trust Fund will provide universal and progressive contributions to the child's account, and life-long accumulation.[49] As David Blunkett observed in 2000 when he was Secretary of State for Education and Employment "we are on the cusp of a different way of looking at the welfare state—one which focuses on capital and assets."[50].

[1]Conclusion[end]

Perhaps the rudimentary institutional theory of saving outlined in this chapter will be a useful step forward. A focus on saving and asset-based policy is not intended to replace a focus on income support, or to limit support for credit-oriented policy, but rather to complement income and credit policies. It seems likely that more diverse policy responses will be emerging in the years ahead. This chapter adds to a growing body of work in asking whether savings and assets should play a larger role in public policy, and whether the poor should be included in the saving and asset-based policies that already exist.

In the twentieth century, U.S. public policy extended income supports of many kinds to a larger portion of the low-income population. Public policy and private enterprise have extended credit broadly. The widespread availability of credit in America is a remarkable financial achievement.[51] If the same level of policy commitment and commercial creativity were applied to the goal of extending saving, it is

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49. Precursors to this policy concept can be found in Tobin (1968), Haveman (1988), Sawhill (1989), Sherraden (1991), and Lindsey (1994).

50. David Blunkett. "On Your Side: The New Welfare State as an Engine of Prosperity." Speech given to Department of Education and Employment, London. June 7, 2000.

51. As detailed in other chapters in this volume, not all credit is quality credit. Nonetheless, the sheer availability of credit in the current U.S. political economy may be unprecedented.

possible that millions of low-income Americans who today have little or no savings, would begin to save and accumulate assets.

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