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BANKING THE POOR: OVERCOMING THE FINANCIAL SERVICES MISMATCH

Michael S. Barr

Low-income households often lack access to bank accounts and face high costs for transacting basic financial services through check cashers and other alternative financial service providers. Twenty-two percent of low- and moderate-income American households do not have a checking or savings account. Many other "underbanked" families have bank accounts but still rely on high-cost financial services.

These households find it more difficult to save and plan financially for the future. Living paycheck to paycheck leaves them vulnerable to medical or job emergencies that may endanger their financial stability, and lack of longer-term savings undermines their ability to improve skills, purchase a home, or send their children to college. High-cost financial services and inadequate access to bank accounts may undermine widely shared societal goals of reducing poverty, moving families from welfare to work, and rewarding work through the Earned Income Tax Credit.

The basic problem is our financial services mismatch: the mainstream financial system is not well designed to serve low- and moderate-income households. Traditional checking accounts often carry high account fees, high minimum balances, and high overdraft or insufficient-fund fees. Paper checks are held for a relatively long time before deposits are cleared. And millions of households who have had problems managing their accounts in the past are stuck in Chexsystem, a private clearinghouse used by most banks to block such individuals from opening new accounts.

The costs of financial exclusion are great. It is inefficient for the national economy. It is costly for low-income households. And it promotes dissaving rather than saving.

We need to shift our focus away from checking accounts and toward debit-card-based products and services that are lower cost and lower risk. Taking the paper check out of the equation and moving to direct deposit, ATM and point-of-sale withdrawals, and automatic money orders would lower costs and drive the risk of overdraft way down.

Congress should encourage the private sector to offer low-cost, electronically based bank account products with a new tax credit. The tax credit would be based on performance. Financial institutions could receive a tax credit equal to a fixed amount per account opened. Additionally, the credit could include a dollar-for-dollar incentive for banks to match the monthly savings contributions of low-income account holders, up to a fixed amount. Bank accounts with debit-card access, but no checks, could provide a means for lower-income households to receive their pay through direct deposit, pay their bills automatically, and set up regular savings plans as a cushion against emergencies.

It is time to transform financial services for the poor. Bank account ownership contributes to optimal income-redistribution policies because it increases the take-home pay of the low-wage working poor. Better access to financial services is critical for low-income persons seeking to enter the economic mainstream.[1]

NOTE

1. For further background, see Michael S. Barr, "Banking the Poor," *Yale Journal on Regulation* 21, no. 1 (2004): 121–237.

INDIVIDUAL ASSET POLICY

Individual asset policy is an important policy arena for reducing racial wealth disparities. For generations certain policies in the United States have helped provide resources to support the aspiring middle class and well-to-do Americans build assets. As we discussed, the array of homestead acts greatly facilitated the building of America's middle class. Land-grant colleges, Veterans Administration benefits, the GI Bill of Rights, and mortgage interest deductions also provide important asset-building foundations. It is hard to imagine that many Americans would have been able to plan for the future, buy homes, prepare for retirement, send their children to college, and weather unexpected financial storms without access to these important asset-building resources. The magnitude of direct and indirect governmental resources devoted to these resources is startling. Through the tax code that allows individuals and families lower rates or to exclude taxable earnings, the taxpayers financed $335 billion worth of asset policies for the nonpoor in fiscal year 2003, most of which accrued to wealthy families.[15]

The kind of individual asset-based social policy that will affect racial wealth disparities must be directed to poor individuals and families to help them build assets, just as the government subsidized the movement of the World War II generation into the middle class and homeownership and helped the well-off consolidate their wealth.[16] The major policy tool to accomplish this has revolved around various configurations of individual development accounts (IDAs).

Asset-based social policy attempts to facilitate savings and the accumulation of financial assets for low-income families and the poor who are usually excluded from traditional asset-building opportunities. Although asset-based social policy is still in its infancy, it has become a widely discussed policy tool and has a fairly impressive set of achievements. Michael Sherraden, the major architect of IDAs, discusses this policy in Chapter 12.

The concept of IDAs has increasingly morphed into a comprehensive set of supports to asset building over the life course. Children's Savings Accounts, for example, would enable youth to enter young adulthood with a sizable asset that they can use for education or homeownership, while traditional IDAs would help families hoping to pay for a home or their children's higher education, and retirement accounts would enable seniors to have greater independence and control over their financial life in their twilight years. (President Clinton proposed Universal Savings Accounts in his 1999 State of the Union address.)

Supporters insist that all these accounts must be universal yet progressive. Universality enables the program to create broad-scale social support that a poverty-focused program would have difficulty garnering. Including progressivity in the design of these programs would enable them to provide significantly more resources to the poor. For example, matches would be provided for contributions by low-income households. This would enable them to generate greater rates of savings and asset accumulation than those without matches. To the degree that African Americans and Latinos are disproportionately consigned to the lower classes, they would theoretically be eligible to build assets at a faster rate and thus reduce, but certainly not close, the racial wealth gap. These mechanisms have demonstrated significant potential to begin the process of asset building that can launch families on the road to economic success and stability, even if by themselves IDAs may not reduce wealth inequality.

While these policies are gaining legitimacy and policy traction in a short period, they face innumerable obstacles. So far, these programs have been implemented on a small scale, in terms of hundreds or thousands of participants. To make a difference, they must be implemented on a large scale, with millions of participants. However, these programs require significant funding that is unlikely in the current budget context. For example, a Children's Savings Account that would provide every child with a $1,000 account at birth and create the opportunity for the accumulation of up to $18,000 by age 18 would cost approximately $30 billion a year. Moreover, there is no definable political constituency that has made individual asset building a prime focus of its energies.

REGIONAL EQUITY

Racial segregation has traditionally been a limiting factor in the ability of African Americans to grow wealth. Segregation imposes a further "tax" on minorities—particularly African Americans—that is driven by underfunded communities, poor schools, and economic isolation (see Angela Glover Blackwell's discussion in Chapter 19).

Individual communities cannot reduce racial inequalities alone. The region should be the focus of action, the only entity with sufficient economic resources and political power to address these tough problems. As john powell puts it, "The community's work is on target, but the dynamics of inequality are region-sized."[17]

Regional solutions would directly attack racial segregation, isolation from jobs, and poor schools. If inner-city communities increase the economic and racial diversity of their communities, create economic opportunities for low-income residents to connect to the job-rich suburbs, and create a functioning and attractive public school system, the value of housing assets would likely increase, helping reduce the insidious processes that thwart the development of wealth among black inner-city households.

Some regional strategies that have been successful include inclusive zoning to increase the supply of affordable housing across a metropolitan region; transportation policies that connect isolated inner-city communities with job-rich suburbs and exurbs; and innovative approaches to educational equity that break down racially isolated schools, enable equal funding across regions or districts, and promote small schools that are anchored in neighborhoods. These are among the menu of regional strategies that could help stop the continued devaluation of the assets of many African Americans.

PROGRESSIVE TAXATION AND ASSET BUILDING

How are we going to pay for great ideas of asset building and bring them to scale, especially considering all the pressing issues and big-ticket items facing our nation, such as health care, the minimum wage, housing, or education? Rather than thinking about this question in terms of contending worthy needs jockeying for pieces of the pie, a brief examination of asset building in America's history and current social investments is instructive. This perspective allows for broader horizons for asset policy and opportunities to strengthen coalition building rather than promoting turf battles or fighting about what need or crisis deserves most attention.

In the United States one major avenue of social mobility and economic success has been policies and practices that provide resources to middle-class and well-to-do Americans to build assets. At critical times these structured opportunities served as indispensable springboards for mass mobility. Various policies have greatly facilitated building America's middle class, especially in acquiring homes, property, and businesses, sending young adults and veterans to college, planning for their future, and building a financial assets foundation: homestead acts, land-grant colleges, Veterans Administration benefits, the GI Bill of Rights, mortgage interest tax deductions, and others. However, if one examined only direct government expenditures, the social investments that enabled middle-class success would be hidden.

Similar policies abound today, etched in the tax code, largely out of view of public understanding and awareness. For example, the national social investment in housing is not primarily targeted at affordable housing or concerned with housing for low-income families; instead, the greater social investment is aimed at subsidizing homeownership through mortgage interest tax deductions, which highly favor families at upper-income levels. In other areas, too, the great magnitude of government assistance for asset acquisition and growth benefits those who already own property or businesses and/or those at the highest income levels. As previously noted, in aggregate, the public funded $335 billion worth of asset policies for the nonpoor in 2003, using conservative estimates. This wealth budget dwarfs direct government expenditures that encourage asset building for most American families. CFED's[18] analysis highlights how our nation invests $1 in direct expenditures for asset development at the same time it invests $642 to encourage and reward asset building through the tax code. Federal policies exacerbate wealth inequality and help widen the racial wealth gap by their top-heavy and lopsided distribution scheme.

The news has not improved over the past couple of years, as CFED's preliminary analysis for 2006 demonstrates that the wealth budget has risen to about $362 billion and the distribution has gotten more lopsided and top heavy. Families with incomes over $1 million, roughly 1 percent of the population, received 45 percent of the wealth budget benefits. Those in the top fifth (income of over $80,000) of the income distribution took in about 88 percent of these benefits.

The budget that builds wealth needs to become a contested terrain, not the entitled province of the well-to-do. Good asset-building lessons, best practices, and effective social investment cases can be drawn from how the wealth budget has operated in the American experience. The absolutely vital focal point needs to be how to spread effective asset-building incentives to families that are struggling or just making ends meet, as well as to groups that have been systematically excluded from these opportunities in the past. A modest goal might be to increase the percentage share of the benefits accruing to 60 percent of families from the current meager 3 percent to 10 percent in the next decade. Capping the home mortgage interest deduction and limiting it to primary residence is a worthy reform. Allowing a flat deduction for families who cannot or do not itemize deductions is another among a host of reforms to more equitably distribute asset-building opportunities written into the tax code.

This broader context of spreading asset-building opportunities to broad sectors of the population, that is, democratization of the wealth budget, provides a different sense of how government invests in individuals, families, businesses, and communities. Fairness in distribution of tax benefits is an anchoring theme for progressive taxation, in addition to the traditional concern of who is taxed at what rate. Taxing corporate profits, capital gains, investment earnings, dividends, and other ways that money expands itself over taxing work and earning itself provides a principal direction for progressive tax policy.

Many resources already exist, and this section identified deep sources of resources to pay for big-ticket asset-generating initiatives such as Children's Saving Aaccounts or first-time homeownership accounts. Other areas can be targeted for reform. An obvious candidate is to reform the estate tax in a way that simultaneously is fairer (thresholds and exemptions) and engages public support and that links it to providing opportunities to new generations of Americans.[19] Most relevant are reforms structured around reasonable exemptions grounded in a philosophy that passing along great advantages and wealth runs against the deep American spirit of fairness, equality, new starts, and opportunity. Equal opportunity and a level playing field for all cannot thrive side by side with great inherited wealth.

CONCLUSION

The racial asset gap threatens to permanently consign large portions of the African American population and other racial minorities to lives with restricted opportunities. In a society that is increasingly privatizing citizenship by making access to good education and health care more and more a function of wealth, these racial disparities in asset holdings mean less opportunity for social mobility and secure lives than ever before. The proposals just discussed will in no way equalize asset holdings, but they will lessen the gap in significant ways. These proposals will help better connect African Americans and the poor to the mainstream credit system and markets and enable the poor to save and accumulate assets that they can use to purchase a home, pursue education, or start a business; connect them to their regional economies so that they have access to jobs, quality education, and racially and economically diverse communities; and enable the federal government to invest not only in the asset-building opportunity of the rich and well-off, but also of the poor and least advantaged. These proposals place closing the racial wealth gap at the forefront of the civil rights agenda of the twenty-first century.

NOTES

1. With the publication of *Assets and the Poor* by Michael Sherraden (Armonk, NY: M.E. Sharpe, 1991), *Black Wealth/White Wealth: A New Perspective on Racial Inequality* (New York: Routledge, 1995, 2006) by Melvin Oliver and Thomas Shapiro, and *Being Black, Living in the Red* by Dalton Conley (Berkeley: University of California Press, 1999), the notion that assets and wealth are important and independent elements of economic status was firmly established.

2. Rakesh Kochhar, "The Wealth of Hispanic Households, 1996 to 2002" (Pew Hispanic Center, 2004).

3. Thomas Shapiro, *The Hidden Cost of Being African American* (New York: Oxford University Press, 2004), 36–41.

4. Oliver and Shapiro, *Black Wealth/White Wealth.*

5. Joint Center for Housing Studies of Harvard University, *State of the Nation's Housing 2004* (Cambridge, MA: Harvard University, 2004).

6. Kochhar, "Wealth of Hispanic Households."

7. Shapiro, *Hidden Cost of Being African American.*

8. Joint Center for Housing Studies of Harvard University, *State of the Nation's Housing.*

9. Roberto Querica et al., "The Impact of Predatory Loan Terms on Subprime Foreclosures" (Center for Community Capitalism, 2005).

10. Mark Duda and William Apgar, "Mortgage Foreclosure Trends in Los Angeles: Patterns and Policy Issues" (report prepared for Los Angeles Neighborhood Housing Services, 2004).

11. National Community Reinvestment Coalition, "Pre-approvals and Pricing Disparities in the Mortgage Marketplace" (June 2005).

12. Javier Silva, "A House of Cards: Financing the American Dream" (Demos, January 9, 2005); Tamara Draut and Javier Silva, "Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the 90s" (Demos, 2003).

13. Michael Barr, "Banking the Poor," *Yale Journal on Regulation* 21 (Winter 2004): 121–237.

14. Keith Erns et al., "Quantifying the Economic Cost of Predatory Payday Lending: A Report from the Center for Responsible Lending" (Center for Responsible Lending, February 24, 2004).

15. Center for Enterprise Development, "Hidden in Plain Sight" (2004); Christopher Howard, *The Hidden Welfare State* (Princeton: Princeton University Press, 1997).

16. Trina Williams Shanks, "The Homestead Act: A Major Asset-Building Policy in American History," in Michael Sherraden and Lisa Morris, *Inclusion in the American Dream* (New York: Oxford University Press, 2006).

17. john powell, "Racism and Metropolitan Dynamics: The Civil Rights Challenge of the 21st Century" (briefing paper prepared for the Ford Foundation, Institute on Race and Poverty, August 2002), 5.

18. CFED was formerly known as the Corporation for Enterprise Development.

19. Oliver and Shapiro, *Black Wealth/White Wealth*, Tenth Anniversary Edition (New York: Routledge, 2006); William Gates, Sr. and Chuck Collins, *Wealth and Our Commonwealth: Why America Should Tax Accumulated Fortunes* (Boston: Beacon Press, 2002).