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Institutions and Inclusion in Saving Policy

Michael Sherraden and Michael S. Barr

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Michael Sherraden is the Benjamin E. Youngdahl Professor of Social Development and Director of the Center for Social Development at Washington University in St. Louis. Michael S. Barr is an Assistant Professor of Law at the University of Michigan Law School.

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Abstract

Low- and moderate-income households save for routine payments, such as rent, as well as for major purchases, such as a washing machine or a car. Saving also cushions households against the economic consequences of significant life events for these families, including illness or injury, job loss, births and deaths. For some households, saving can be a way out of poverty, through moving to a better neighborhood, purchasing a car to get to better job, or even capitalizing a micro-business. Growing evidence suggests that low-income households save, but surprisingly little attention has been paid to these households in public policies for saving, or in the scholarly research. This article makes two contributions: First, we posit an institutional theory of saving, in which individual saving outcomes can be shaped in large part by the constraints people face. Second, we explore in practice how existing institutions promote dis-saving among the poor, and how new policies could better promote saving and asset accumulation among these households.

Introduction

In this volume many chapters are about credit. Credit is important, especially for purchasing a home, but credit is only one pathway to asset accumulation. Saving is the other. 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 and often intermingled. Both are important. Overall, for most households, including low-income households, asset accumulation requires saving as well as credit.[2]

Recent applied research has contributed to our understand of the potential importance of saving by low-income households. Caskey (1994) has carried out pioneering studies of second tier 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 alternative financial sector, the 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. Two recent studies look at the saving potential of lump sum distributions in the Earned Income Tax Credit (EITC). Beverly, Tescher, & 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. In another study, 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 IDA 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

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[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 as carefully in the United States, however Caskey's research (1994 and 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.

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 & 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 focus in policies that the Bush Administration has offered under the rubric of the "ownership society."[3] 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 tax-preferred saving proposals that benefit the upper end of the income scale, public policy should focus on building wealth among the least well off.

We proceed in two main parts. In part I, we develop an institutional theory of saving. We view this theory as provisional and in need of more empirical testing. In part II, we explore in practice how existing institutions promote dis-saving among the poor, and how new policies to change these institutional structures could promote saving among these households.

Toward an Institutional Theory of Saving

Are the Poor Different?

Are the poor different from the non-poor? We put this question on the table because it is fundamental to thinking about options for inclusive saving policy, services, and products. A great deal of social science theory and political discourse, explicitly or implicitly, treat the poor as different from the non-poor. In this short space we make a few summary observations, and state the perspective that underlies this paper.

[3] See *infra*, Part II.

Neoclassical economics essentially views the poor as different. If people perform poorly economically, they are assumed to have different abilities and preferences, and these are considered stable. Behavioral economics, while seeing individuals as much more nuanced and complex, sees the poor as having cognitions and emotions that do not lead to successful economic outcomes. Social and cultural interpretations consistent with economic perspectives see psychological and behavioral differences, such as short-term time horizon and immediate gratification, arising from a "culture of poverty" that is deeply entrenched (Banfield, 1974).

Sociology views the poor as living in a social structure and adapting to it. The rich and poor develop different consciousness and patterns of behavior as a result of social segmentations. The poor have responded to problematic social and economic conditions with psychological and behavioral adaptations, such as short-term time horizon and immediate gratification, that together create a "culture of poverty" (Lewis, 1966).[4] Behaviors might change if the social structure were to change, though Lewis emphasizes how unlikely this would be, and how entrenched the behaviors are.

Analogous views are reflected in political discourse. Conservatives tend to see the poor as deficient in ability, motivation, and morals, to be corrected by greater individual responsibility. From this perspective, it does no long-term good for public policy to assist the poor; the poor have to make individual changes to improve themselves. Liberals tend to see the poor as victims of social and economic circumstances, though the usual liberal prescription is not to change circumstances but rather to assist individuals with special programs to cope with these circumstances.

We take a somewhat different position in our approach to saving policy. 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 may help to keep them poor. However, in contrast to much of social science theory and political discourse, our view in this discussion of saving and asset accumulation is that many of the poor are not different from many of the non-poor. We take this perspective as a normative stance, and as a practical position. The normative stance is that, until everyone has the same institutional

[4] Banfield (1974) states that a "culture of poverty" leads to dysfunctional behaviors by individuals, and Lewis (1966) posits almost the opposite, that "culture of poverty" behaviors are functional adaptations to social and economic circumstances.

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 non-poor because she does not have retirement savings. Our practical position is similar. It may be possible to create inclusive policies, services, and products for saving and asset accumulation that are successful for many low-income households (indeed, we think this is highly possible). If this is the case, there would little need to focus on how the poor might be different from the non-poor, as it relates to saving, because it would not matter.[5] We are not arguing that low-incomes and low-assets are the only problems facing the poor, or that solving problems of income and assets will redress other barriers faced by the poor. We are simply suggesting that it makes sense to try to design policies that treat people as if they are not different from others, and see if this works.

A Model of Institutions and Saving

Our theoretical perspective places primary emphasis on purposeful institutional arrangements that structure and support saving and asset accumulation.[6] We take this perspective not because we think it is the only possible theoretical view, nor because we can prove that it is more explanatory than other theories (we do not yet know), but because it is a perspective that, if supported by empirical evidence, can guide policy and programs. This may become more apparent below. We first give an overview of other theories of saving, and then focus on an institutional model of saving.

Research on saving is extensive but inconclusive (Korczyk, 1998; Carney & Gale, 2001).[7] No theoretical perspective has been found to have strong and consistent empirical support. Neoclassical theories are at the center of the discussion, represented by the life cycle

[5] The reader may recognize this as a viewpoint of scholars with applied interests, which we admittedly are. We have the perspective that public policies and programs can be effectively designed and implemented, and that individuals, for the most part, have the capacity to respond successfully. Our experience has tended to reinforce this viewpoint, so it persists. The point is not that that the poor might be the same or different from the non-poor (this question is not in fact of interest to us here), but that public policy is often better constructed as if the poor are not so different.
[6] The following discussion builds on an emerging body of work at the Center for Social Development at Washington University. Discussion of the role of institutions in saving by the poor was initiated by Sherraden (1991); detailed in Beverly and Sherraden (1999) and Schreiner et al. (2001); and extended in Sherraden, Schreiner, and Beverly (2003).
[7] This review of saving theory and research borrows from Beverly and Sherraden (1999).

hypothesis (Modigliani & Brumberg, 1954) and the permanent income hypothesis (Friedman, 1957). Neoclassical theories assume that individuals and households are focused on expected future income and long-term consumption patterns. Many variations and additions have been developed. For example, "buffer-stock" models of saving have been presented by Carroll (1997), Caroll & Samwick (1997), and Ziliak (1999), emphasizing a precautionary motive for saving, particularly for younger households and for households facing greater income uncertainty. Overall, these economic theories assume that people are forward looking and concerned about consumption patterns, preferences are fixed or very stable, people have perfect information, and everyone makes rational decisions.

Variations on the standard economic theories include a wide range of behavioral, psychological, and sociological theories. Behavioral theories emphasize financial management strategies and self-imposed incentives and constraints (e.g., Shefrin & Thaler, 1988). Behavioral theories modify conventional economic models in two ways. First, behavioral theories do not assume that wealth is completely fungible. Shefrin & Thaler (1988) propose that individuals use systems of mental accounts and that propensity to spend varies across accounts. In research on individual development accounts, respondents distinguish between short- and long-term saving, which are for different purposes. Second, behavioral theories do not assume that individuals have perfect information, and may behave "irrationally." Instead, these theories suggest that individuals sometimes have trouble resisting temptations to spend. Therefore, individuals may create their own behavioral incentives and constraints (Shefrin & Thaler, 1988). The rules may be external, but individuals may voluntarily place themselves under such restrictions, e.g., a Christmas Club saving account.

Behavioral theories suggest that saving and asset accumulation are likely to increase when mechanisms of contractual saving or other pre-commitment constraints are available. Such mechanisms make it difficult to choose current consumption at the expense of future consumption (Maital, 1986; Maital & Maital, 1994; Shefrin & 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. Variations on pre-commitment constraints may include over-withholding of income tax (Neumark, 1995) and home mortgages (Maital & Maital, 1994).

Maital and Maital (1994) suggest that the desire for this pre-commitment mechanism is a strong motivation for mortgage-financed home purchases, particularly among the lowest income households, who receive little or no tax benefit from the mortgage payments.

Psychological and sociological theories do not assume that consumer preferences are fixed, but rather change with economic and social stimuli (e.g., Duesenberry, 1949; Katona, 1975; Cohen, 1994). Psychological and sociological theories of saving seek to explain saving-related preferences, aspirations, and expectations. In pioneering work, 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, special consumption needs, or other circumstances, find it more difficult to defer consumption than others. At the same time, those individuals who can postpone consumption must choose to do so. This decision requires some degree of 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. Variations on psychological and sociological theories consider the effects of families (Cohen, 1994), peers (Duesenberry, 1949), and past saving experiences (Furnham, 1985; Katona, 1975) on saving-related beliefs, aspirations for saving, and consumption patterns.

Turning to empirical evidence, life cycle and permanent income models have mixed support, but they especially fail to explain patterns of saving and asset accumulation in low-income households, which are typically low or negative. Among other theories, few behavioral, psychological, or sociological propositions have been rigorously tested in a range of empirical settings. Overall, evidence is mixed and incomplete; no single perspective is clearly supported.

For the purposes of this discussion, we offer a simple institutional model of saving. In this model are institutions and individuals, which interact to create action, which is followed by outcomes. This simple model is one version of a central question in the social sciences: the interaction of individual choice and social structure. To oversimplify, individual choice has been the focus in economics, and structure has been the purview of sociology. It was Harvard economist James Duesenberry who once remarked that economics is about how people make choices, and sociology is about how people do not have any choices to make. The social sciences tend to line up on one or the other side of this divide, but as Duesenberry and many

others have noted, the most fertile questions in the social sciences are where structure and choice come together.

In our simple model, institutions are the products of laws and other formal mechanisms, in both the public sector and private sector. Institutions themselves are formal and purposeful. In other words, institutions are designed with defined structure and rules, aiming for particular outcomes.[8] To use the language of applied social science, institutions in this usage are interventions, designed to alter behaviors and outcomes for individuals. Institutions can be created and changed, but at a given moment, or for a given policy, product, or service, can be taken as fixed. To emphasize, institutions are dominant in this conceptualization; they are a formal structure set in place to interact with individuals with the aim of changing actions and outcomes.

Individuals in this model reflect all of their cultural and social background and context, socio-demographic characteristics, and particular experiences. What do individuals consist of? 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; people are complex and their cognition and emotions can affect action. Moreover, we do not view preferences or abilities as fixed. In studies of saving behavior it will be important to measure a wide range of individual characteristics, to see if and how they matter. However, in the present formulation, we do not focus on changing individual characteristics, but on changing institutions.[9]

[8] 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 (1991). In this paper, we do not focus on emergence of institutions, but rather assume that institutions can be constructed, a different concern from most of the new institutional economics and sociological theories of institutions (e.g., Powell & DiMaggio, 1991; Smelser & Swedberg, 1994). At another time we would like to ask how institutions, in the sense that we define them, are put into place, but that is not our purpose at present.

[9] 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. Indeed, it would be hard to find a more productive theory in all of the social sciences. Nonetheless, innovations arise. 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. Behavioral economists are introducing ideas such as wishful thinking, overconfidence, faulty future orientation, use of mental accounts, and the like. Essentially, behavioral economics is specifying new aspects of the individual for study. The whole individual is coming into view (Thaler, 2000, provides an overview). In this paper, we are trying to do something similar, but with the other "half" of neoclassical theory. We are trying to specify the equally vague area that individuals interact with, known as

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 paper, 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.[10] Outcomes result from action. Outcomes can occur at multiple levels – individual, family, community, and society. In this paper we do not pay much attention to outcomes, and when we do we focus only on the individual.

This simple institution-individual model could be applied to a wide range of topics in the applied social sciences.[11] Our interest in this paper is only on saving.

Framework for an Institutional Theory of Saving

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 non-poor, these mechanisms include housing- and retirement-related tax benefits, including deductions for home mortgage interest and property taxes,

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"constraints." We aim to describe a richer, more detailed understanding of factors that individuals face in making choices. We think this is likely to be complex, and worthy of study (as behavioral economists think that individual complexities are worthy of study). In this paper, we focus on the institutions for applied purposes, because *this is the domain of intervention*. We are not aiming to change individuals one by one, so we are more interested in the institutions. Now, let us take this one step further. In economic reasoning, individual preferences (neoclassical view) or thoughts 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 thinking or "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, i.e., forward-looking cognition causes saving, and savings cause forward-looking cognition, a virtuous circle (Sherraden, 1991; Yadama & Sherraden, 1996).

[10] 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. However, in this paper we set these questions aside.

[11] Some readers may look at this institutional theory and conclude that all of it can be understood in the neoclassical economic framework of preferences, constraints, and prices. This is partly true, in the sense that the neoclassical categories can be construed to include just about anything. However, neoclassical theory leaves a great deal of intellectual territory unspecified. The contribution of this institutional theory may be that it attempts to specify the institutional aspects that might be most relevant, e.g., information or facilitation. Also, it could be that some elements in this institutional theory do not fit well in the neoclassical framework, e.g., expectations (neoclassical theory does not provide much room for social influences or the use of mental devices). The value of this institutional theory is to call specific attention to constructs that might be relevant in application, and point the way to testing those constructs, with the aim of creating better policy.

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 & Richardson, 2001).[12] 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, especially mandates and financial incentives; financial enterprises and financial products, with all of their characteristics; and services and supports related to financial products. Institutions have dimensions or constructs that are hypothesized to change saving behaviors and outcomes for individuals. These constructs can be specified as variables and measured. 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 extreme cases (e.g., automatic direct deposit of a portion of income into a retirement account), institutions may reduce transaction costs to zero, and obviate the need for any cognitive processing. In this extreme case, the institution is doing all of the "choosing" and "acting" and the individual is essentially passive.

Individuals in the model of saving consist of all of their socio-demographic characteristics, accumulated culture and experience regarding saving, cognitive capacity for financial matters, and emotions regarding money and saving. In this model, the target of intervention is not the individual. Their characteristics are not immutable – they can learn and change -- but we do not seek to intervene with individuals. The wide variation in individual characteristics and the time required to work with each individual make intervention at this level a practical impossibility if we want to increase saving in millions of households. However, this does not mean that knowledge of individuals is irrelevant. Knowledge of individuals can lead to

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[12] 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.

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 aiming for high returns. Institutions cannot be equally successful with all individuals.[13] The design task is to cause the most saving behavior by the most individuals who are targeted under the chosen policy.

Action in the saving model results from the interaction of institutional characteristics and individual characteristics. This might be analogous to the workings of a market. Saving actions consist of all the activities, both institutional and individual, related to saving. (Schreiner et al, 2001). Our view is that saving is more complex than normally described. In-depth studies with participants in individual development accounts (IDAs) have led to identification of three main stages of saving behavior: allocating, depositing, and maintaining. Each of these stages has distinct strategies, with different attitudes and behaviors (Beverly, McBride, & Schreiner, 2003).[14]

Outcomes result from saving action. Savings are asset accumulations that are likely to have other outcomes – economic, social, and psychological -- for the individual and families, which we leave aside at present.[15]

Elements of an Institutional Theory of Saving

Institutional perspectives are not new in the social sciences (e.g., Gordon, 1980; Neal, 1987), but they are usually not well specified. Here we offer seven constructs that we believe are important aspects of institutions designed to promote saving and asset accumulation. The constructs are: (1) access, (2) information, (3) incentives, (4) facilitation, (5) expectations, (6) restrictions, and (7) security. These seven constructs have emerged from our research on individual development accounts (IDAs).[16]

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[13] An exception may occur with universal and mandatory institutions, which might be equally successful with all individuals, or nearly so. One example is payroll deductions for Social Security retirement in the United States; nearly everyone who has a job "participates" at the prescribed percentage of their income.

[14] In this paper, we do not address this full complexity, though we remain aware of it (e.g., the importance of security for maintaining assets, discussed below).

[15] Sherraden (1991) offers propositions regarding effects of asset holding. There is a sizable but scattered empirical literature that is highly suggestive of positive effects of asset holding, but most studies are not rigorous. This is an area in need of much more research.

[16] The first four of these – *access, information, incentives, and facilitation* -- were identified by Sherraden during the 1990s and appeared in Beverly and Sherraden (1999). *Expectations* later emerged from qualitative research on IDAs (M.S. Sherraden et al., 2000). In Sherraden et al. (2003) we added *limits*, which we now see as misnamed, and have changed this construct to *restrictions*. *Security* is emerging in IDA qualitative research (Margaret Sherraden et

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 vary across IDA programs but typically include home ownership, post-secondary education, and micro enterprise. IDAs have become more common during the past decade. More than 40 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 an effective tool for building assets of the poor.

The results we discus here are from a study of IDAs in the "American Dream Demonstration" (ADD).[17] 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 saving or net worth do 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.[18] We turn now to the meaning and explanatory potential of these constructs.[19]

Access

Access refers to eligibility and practicality. Regarding eligibility, there are of course clear historical instances where access to asset accumulation is different for different people. One example in U.S. history is the Homestead Act, which provided long-term asset benefits on a large scale, mostly for whites. Williams (forthcoming). To take a more current example, a small number of low-income people can participate in IDA programs, but most do not have this option.

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al., 2003), and is a main theme in savings programs in developing countries (Rutherford, 2000; Schreiner and Morduch, 2003).

[17] 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 1997-2001.

[18] While reshuffling of assets is less likely among people with few assets, it is nonetheless possible. Schreiner et al. (2001) discusses reshuffling in greater detail.

[19] The discussion of institutional constructs below borrows from Sherraden et al. (2003).

Few low-income households have access to 401(k) plans at work.[20] Regarding practicality, there are situations where people are technically eligible, but the relevant service point is not practically available to them due to distance, language, level of skill, technology, social exclusion, or other factors. For example, 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 individual choices. Some people, distinct from their abilities and choices, have greater access than others.

While sociological analyses concentrate on structural barriers, there is limited economic evidence regarding the effects of access on saving and asset accumulation. This is largely because, from this theoretical perspective, 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 & Summers, 1987) have concluded that the availability of institutionalized saving opportunities promotes saving by calling attention to the need for and benefits of saving.

Information

Information refers to knowledge about the policy, service, or product, as well as knowledge that may contribute to successful performance. Bayer, Bernheim, & 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 & Garrett (1996) report that participation rates were 12 percentage points higher for companies that offered

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[20] 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." If the institutional constructs discussed affect saving, then it is important to point out that low-income households are more often in disadvantaged positions relative to these saving features (Caskey, 1994; Bernheim & Garret, 1996; Beverly & Sherraden, 1999; Barr, 2003).

financial education, and in firms that offered financial education, participation rates were 20 percentage points higher for employees who chose to attend. Education increased new savings of all types as a percentage of income by 1.7 percentage points, which is a large effect. In all cases, effects were greatest for people who saved little before they received education. In another study, Bernheim, Garrett, & Maki (2001) report that financial education for teens increases savings rates when they become adults. In research on IDAs, Schreiner et al. (2002) and Clancy et al. (2001) find that, controlling for all else, up to 8 hours of general financial education is associated with strong increases in net savings amounts in IDA programs. Thus, some financial education appears to have a positive pay-off, but extensive financial education might not be better. Because financial education is expensive to implement, these data can contribute to policy resources being used more efficiently.

Incentives

Incentives are financial rates of return, as well as non-financial "pay offs" for participation. In the latter category can be factors such as peer relationships, status associated with participation, opportunity to learn, and so on. The net effect of financial incentives on saving is a subject of debate. Neoclassical economic theory does not predict that an increase in the rate of return will 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. 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 non-poor is mixed (see Engen, Gale, & Scholz, 1996; Hubbard & Skinner, 1996; and Poterba, Venti, & Wise, 1996; Feldstein, 1995; Hubbard, Skinner, & 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 et al. (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).[21]

Facilitation

Facilitation refers to any form of assistance in saving, e.g., when depositing is done for the participant, as in automatic payroll deduction. Direct tests of the proposition that facilitation promotes saving are rare, but evidence regarding the effectiveness of direct deposit and payroll deduction is strongly suggestive. One study provides strong, direct evidence that facilitation affects saving behavior. Madrian & 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 quite likely to stay with the default contribution rate and the default 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 foregone earnings on the money) in saving through this mechanism, or over-withhold inadvertently. Direct deposit can also be used to facilitate saving. In IDA research, only six percent of participants used direct deposit (how many had an option to use direct deposit but chose not to do so is unknown). Direct deposit is positively associated with being a "saver" (staying in the IDA program), but there is no significant relationship between direct deposit and net savings amount (Schreiner, et al. 2002). The small direct deposit sample does not provide a

[21] 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, e.g., limits on how much can be deposited annually into a 401(k) account. These caps may in fact decrease savings below desired levels, though these censoring effects are seldom studied.

good empirical test. In qualitative research, IDA participants discuss positive effects of direct deposit in their saving performance (Margaret Sherraden et al., 2004).

Expectations

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 (Margaret Sherraden et al., 2004). A large body of social-psychological research confirms that people tend to try to do what others expect them to do. However, research is needed on expectations regarding institutions and saving behavior. Schreiner et al. (2002) and Schreiner (2001) report that IDA holders in the American Dream Demonstration 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.[22]

Restrictions

Restrictions have a negative connotation, and indeed they restrict options, but restrictions of some type are part of many saving policies, and they are likely to affect saving performance. Contrary to neoclassical thinking, savers often prefer restrictions. Restrictions are of two main types: restrictions on access, and restrictions on 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 it because it would be drawn upon by family and friendship networks if it were available. We have heard this often from IDA participants. Such networks may draw down household assets more among the

[22] 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, home ownership, medical care, insurance, education, and investment (Asher, 1991; Sherraden et al., 1995).

poor and people of color (Stack, 1974; Chiteji & Hamilton, forthcoming). We hear often from IDA participants that they are glad that the savings is out of reach, because otherwise it would be drawn down due to social obligations.[23]

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 market choice in neoclassical thinking, and this is indeed sometimes the case. However, there are other situations where such restrictions are preferred by the account holder. In research on IDAs, participants translate such restrictions into goals. For example, if the money is available only for home ownership, then this tends to focus their saving effort toward that goal. In these situations, the participants view a restriction on use in a positive way as a focusing device for achieving their goals (Margaret Sherraden et al., 2004).

Security

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 (Margaret Sherraden, 2004). 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 retirement in the United States, can protect extensively against market and macroeconomic risks, though beneficiaries are always 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.

Other Institutional Elements

Lastly, we should note what we do not know. Unobserved factors in a given program or site, including program characteristics (such as the strictness of rule enforcement), participant characteristics (such as future orientation), and characteristics beyond programs or participants (such as the condition of the local economy) are correlated with saving level. The average

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

monthly net deposit (AMND), 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 et al. 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 vary in unobserved ways that affect savings performance, for example perhaps in the level of staff commitment, or the quality of financial education, or the vision and leadership of the executive director. Quite likely the IDA programs with higher AMND are different in ways that contribute positively to saving performance.

Toward Measures to Build Knowledge and Inform Policy

The constructs above are an attempt to begin specifying an institutional theory of saving. This theoretical project is in an early stage of development. 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. One can imagine, for example, a scale for each construct with relevant levels of measurement. If empirical evidence suggests that some constructs are more important than others, they might be weighted accordingly. Measures might then be transformed 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: (1) discourage saving, (2) neutral on saving, (3) encourage saving slightly, (4) encourage saving aggressively, (5) contractual saving, opt-in, (6) contractual saving, opt-out, and (7) 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. This observation leads to the additional point that not everyone in a society faces the same set of institutional characteristics regarding saving. Only low-income households face these institutional constraints. Sherraden (1991) argued that asset limits in means tested programs should be abandoned or greatly eased.

During the 1990s, almost all states have eased asset limits in many means-tested 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 a great deal. Policies can slightly encourage saving, e.g., a small interest rate and greater availability of ATMs, or aggressively encourage saving, e.g., large public subsidies, public information campaigns, and universal direct deposits.

Moving toward the more institutionalized end of the continuum are *contracts, where we identify two levels – op-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 towards Social Security. As mentioned above, a growing number of countries have mandatory saving programs for retirement security. There are always major questions of coverage and adequacy in these systems , e.g., Asher (1991) on Singapore; Borzutsky (1997) on Chile; and Rosenman (1997) on Australia. This does not mean that a mandatory saving system for retirement or other purposes cannot be inclusive and progressive (Sherraden, 2003).

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 knowledge and policy. Toward that end, in the next section we explore how existing institutional constraints mostly discourage saving by low- and moderate-income households and explore ways to change those constraints.

Toward a Saving Policy for the Poor

The Unbanked

The poor, like everyone else, often require a wide range of financial services, including saving services.[24] 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, purchasing a home, or even capitalizing a micro-business. 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).[25] Twenty-two percent of low-income families—over 8.4 million families earning under $25,000 per year—do not have either a checking or savings account (Kennickell, 2000). Most of the unbanked[26] are low-income: eighty-three percent of the unbanked earn under $25,000 per year (Virmilyea &

[24] This section builds on Barr (2004).
[25] The 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" (General Accounting Office, 2002; Report to the Subcommittee on Oversight and Investigations, Committee on Financial Services). 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.
[26] We use the term "unbanked" to refer to individuals who do not have an account (savings, checking, or otherwise) at a depository institution. Despite the scope of the title, We also discuss problems of the "underbanked," 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, auto title lenders, refund anticipation lenders, and rent-to-own companies) 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.

Wilcox, 2002) The unbanked are more concentrated in low-income neighborhoods (Dunham, 2001).

Among low- to moderate-income families, 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 minority.[27] 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).[28] Other unbanked persons said that they distrusted banks, did not want to deal with banks, or had privacy concerns (Rhine et al., 2001). Irrespective of the race of the individual, 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 & Wilcox, 2002).[29]

The period 1995 to 1998 marked a decline in the percentage of low-income families who are unbanked from 25 to 22 percent (Kennickell et al., 2000).[30] Economic growth in the 1990s improved the job prospects and incomes of the poor, although these gains eroded significantly in the last two years (U.S. Census Bureau, 2002).[31] 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

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[27] Findings from demographic surveys of the unbanked vary regionally (Caskey, 1994; Dunham, 2001; Greene et al., 2003; Hogarth & O'Donnell, 1999; Hogarth et al., 2004; Rhine et al., 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.

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

[29] 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 & Wilcox, 2002).

[30] The percentage of unbanked families continued to decline somewhat through 2001 (Aizcorbe et al., 2003).

[31] Median household incomes dropped, and the poverty rate increased, in 2001 and 2002 (DeNavas-Walt et al., 2003; Proctor & Dalaker, 2003).

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, 2004).

The Institutional Context for Dis-saving

The consequences of not having access to mainstream financial services can be severe. High-cost financial services reduce income for those least able to afford it. Such services reduce the value of government transfer programs, including the EITC, and may undermine federal and state initiatives to improve workforce participation and reward work. Lack of access to mainstream financial services also undermines the ability of the poor to save, and to access credit, reducing their long-term wealth. Low-income people using check cashers may be more susceptible to robbery because they tend to cash their entire paycheck at regular time periods. Additionally, reducing inefficiencies in the payments system for the poor may have modest positive effects on the economy.

First, the "unbanked" face high costs for basic financial services.[32] 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, wire transfers, bill payments, and other common transactions.[33] Almost all of the checks cashed at check cashers pose relatively low risk: Payroll payments with low credit risk that could be directly deposited by electronic means instead of by check into bank accounts, if low-income persons had them, at significantly lower costs to the payment system, form the bulk of checks cashed at these check cashing outlets: nearly 80 percent of checks cashed at check cashing outlets are regular payroll checks; another 16 percent are government benefit checks, which

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

[33] The use of check cashers may vary considerably by region, and by urban or rural location. (Dunham, 2001; Rhine et al., 2001; Hogarth et al., 2004) Dunham, 2001; Stegman & Faris, 2001). In North Carolina, some 12.5 percent cashed checks at grocery stores. *Id.* Caskey notes that most grocery stores in that state charge fees for cashing checks and that those stores constitute 600 of 1,000 check cashing licenses issued in that state. Thus, a much higher proportion of unbanked households pay to cash checks, either at grocery stores or check cashers (Caskey, 2003).

again pose low risk (Dove Consulting, 2000).[34] 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. High cost financial services reduce effective take home pay. Studies of the EITC suggest that higher take home pay from the EITC helps to induce labor force participation (Hotz & Scholz, 2001).[35] High cost financial services may also diminish the effectiveness of the EITC, a tax incentive that rewards work and helps bring families out of poverty (Joint Economic Committee, 2000).[36] 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 et al., 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 et al., 2002).

Studies have repeatedly shown that the EITC has helped to encourage more low-income individuals to enter the workforce, particularly boosting the employment of single mothers (Hotz & Scholz, 2001). The high price of converting income checks into liquid form (e.g., cash) may reduce the efficacy of the EITC in encouraging workforce participation because it reduces take home pay (and reduces it more, the more the person earns), or at the least these transaction costs significantly increase the taxpayer's costs (the "compliance" costs) of the program.

Similarly, although the jury is still out on the long term effects of the 1996 Welfare Reform law, 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 increase workforce participation and job retention (Blank, 2002). Yet, the positive effects of the EITC and welfare reform on workforce participation and income generation may be undermined by high-cost check-cashing services that reduce the effective income of those who are beginning to earn an income as well as former welfare recipients. Although states have

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

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

[36] In addition to the federal EITC, a number of states have state EITCs, usually structured as a percentage of the federal credit. The federal EITC was responsible for lifting 4.7 million individuals out of poverty in 1998 (COUNCIL OF ECONOMIC ADVISORS, 1998).

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.[37] 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 (e.g., 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, to save funds, and to access credit. Third, payroll checks and EITC refunds to these individuals, if they are working, may still push them towards high cost transaction services. In turn, 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 et al., 2004).[38]

Second, low-income families need to save 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 increased saving (Banerjee, 2001): their low income leaves them little opportunity to save. 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 will thus be reluctant to expend the resources to open accounts for them or will offer them low returns on their savings, further reducing any incentives the poor have to save. Low-income families, particularly those without bank accounts, often lack any regular mechanism to save, such as payroll deduction plans, further reducing the likelihood that they will do so (Beverly & Sherraden 1999).[39]

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

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[37] There is some evidence that check cashers may see the welfare to work population as a new market (FOX & MIERZWINSKI, 2001).

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

[39] One means to change this pattern is for foundations or governments to provide matching funds; increasing the size of funds saved will make account provision more cost effective for financial institutions and thus more widely available for low-income households.

income ranges: Being banked is highly correlated with saving (Vermilyea & Wilcox, 2002). This may suggest that bank account ownership makes it easier for households to save. Of course, bank account ownership may be well 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.[40]

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

Third, without a bank account, it is more difficult and more 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 & O'Donnell, 1999).[41] 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 & Carney, 1998). Low-income persons without bank accounts face higher costs of credit than low-income persons with accounts,[42] and in any event, low-income households generally face higher costs of credit than households with higher incomes (Banerjee, 2001). In effect, low-income individuals must pay more to transform their labor into productive capital and are thus "under-rewarded for their talent" (Banerjee, 2001). Moreover, as noted above, the

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[40] For evidence that financial planning influences wealth accumulation, see Ameriks et al (2002).

[41] 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.

[42] 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*, AM. BANKER, Feb. 28, 2002, at 10.

savings products, including bank accounts, that low-income persons do have access to generally provide low levels of return, which reduces their income growth. Furthermore, banks have little incentive to collect the relatively meager savings of the poor and so do not seek out their deposits, thus leaving low-income persons with higher opportunity costs for their capital (since they have less of it). These higher costs may in turn 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, which is at least in part a function of their savings.

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 each month (Hogarth et al., 2004; Rhine et al., 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 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 &

Mierzwinski, 2001).[43] Given the lack of health insurance, low-income families without savings or access to informal networks of family and friends often use payday loans when faced with expenses related to birth or illness (Rhine et al., 2001). As an alternative to payday loans, banks could offer loans with automatic withdrawals from pay directly deposited into accounts, but with significantly longer terms than payday loans.

Fourth, low-income families who cash their entire paycheck may face high risk of robbery or theft (Craver, 2003; Davenport, 2001). 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.

Toward a Saving Policy for the Poor

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-based 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-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

[43] Indiana's Department of Financial Institutions found that consumers took an average of 13 loans per year, 10 of which were rollovers of earlier loans. An Illinois Department of Financial Institutions survey found an average of 10 loan contracts over 18 months.

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 et al., 2004; Ferguson, 2002). 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 next quintile saved (Aizcorbe et al., 2003). Savings account features have an appeal for the unbanked. In a Treasury 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 & 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 more illiquid and more protected form, either for bill payment later in the month or as "savings" for planned and unplanned expenditures in the future.[44] Researchers have also found that low-income taxpayers over-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 et al.).

The way that employer-sponsored savings plans are set up can matter a great deal (Madrian & Shea, 2000; Choi et al., 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.[45] 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 et al., 2001).[46] Evidence suggests that employer-offered default contribution rates, default investment

[44] Postal savings orders offer protection if lost or stolen and are backed by the USPS.

[45] 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" anti-discrimination rules (Choi et al., 2004).

[46] Automatic enrollment in 401(k) plans significantly boosted participation rates, to rates well exceeding 85%, whereas previous rates had ranged from 26-43% after six months and 57-69% after three years of employment. However, most participants tended to choose a low default savings rate (2 to 3%) and conservative investment plan (e.g., 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

plans, rollovers into new pension accounts of low-balance accounts for terminated workers, and employer matches can all increase participation and contribution rates (Choi et al., 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 & Benartzi 2003).

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 40 percent gets only two percent of any tax benefit (Summers, ; U.S. Department of the Treasury Chart,). 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 & Greenstein, 2004). 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 anti-discrimination 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 (IDAs) have been introduced and are becoming more widespread. Most states have some type of IDA policy, and in addition to the American Dream Demonstration, the federal government enacted the Assets for Independence Act in 1998. Despite this policy activity, IDA programs to today are small and community-based. The next step is to connect IDA programs and principles with large policy

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and more conservative plans, there was only a slight positive overall company-wide 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 & 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). *See also* PROFIT SHARING/401(K) COUNCIL OF AMERICA (2001); FIDELITY INVESTMENTS (2001); VANGUARD CENTER FOR RETIREMENT RESEARCH (2001). 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. Rul. 2000-33, and Rev. Rul. 2000-35 (2000); Summers (2000); Economic Growth and Tax Relief Reconciliation Act (2001).

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,[47] 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.[48] 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, non-profit focused efforts to a large-scale, financial-institution driven financial product that meets the longer-term savings needs of low-income families.[49] As with bank accounts for low-income persons, technology will need to play a central role in driving down the costs of IDA provision.[50]

Directions for a Universal, Inclusive Saving Policy

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. The role of public policy may be even more pronounced in the case of broad, inclusive policy. To that end there are active policy discussions, for example by (Freidman and Boshara, forthcoming), who look at policy principles and pathways; Orszag and Greenstein (forthcoming), who examine and make proposals regarding employer-based pensions; Rideout (forthcoming), who looks at the federal Thrift Saving Plan as a model for large-scale policy; Goldberg (forthcoming), who makes recommendations for a universal children's saving account. So that this discussion of large-scale policy does not seem entirely speculative, we turn next to a

[47] A version of the legislation passed the Senate as Title V of the CARE Act of 2003 on April 9, 2003, see S. 476, 108th Cong. (Sen. Grassley).
[48] *Id.*; *see also* Senate Rpt. 108-011-Care Act of 2003 (Feb. 27, 2003). The administration had earlier proposed a somewhat larger scale program (U.S. Department of the Treasury, 2002) (900,000 accounts eligible at a cost of $1.7 billion).
[49] 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).
[50] 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.

proposal for a large, inclusive saving plan in the United States, and a universal, progressive child saving policy in the United Kingdom.

Proposal for Universal Saving Accounts in the United States

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, though differently structure proposal, saying:

> Tens of millions of Americans live from paycheck to paycheck. As hard as they work, they still don't 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.[51]

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 per 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 the President Bush saving initiatives 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 non-poor, and nothing to the poor.

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[51] Barr participated in policy development on USAs and RSAs at the Treasury Department. Prior 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.

Child Trust Fund in the United Kingdom

A serious discussion of asset-based policy began in the United Kingdom in 2000 (Kelly and Lissaur, 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.[52] Blair (2001) said, "As a Government, we are committed to extending power, wealth, and opportunity to the many, not just the few." He offered a vision of inclusion:

> 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….

The Child Trust Fund would be based on the principle of progressive universalism, wherein every baby would receive an endowment, but those in families on lower incomes 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 of 300 to 500 pounds (approximately $430 to $720). In addition, three additional deposits, ranging from 50 to 100 pounds, would be made as the child grows up. Additional contributions could be made by parents, relatives, or friends. A limited number of investment options would be available (H.M. Treasury, 2001a). By the time the child reaches 18 years of age, the Child Trust Fund could be in the range of $7,000 to $10,000.[53]

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

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[52] The Institute for Public Policy Research (IPPR) has led asset-based policy work in the UK (e.g., Kelly and Lissauer, 2000; IPPR, 2001). Sherraden consulted with the UK government on the impetus for and design of the policies. *See, e.g.,* Sherraden remarks (2002).
[53] Nissan and Le Grand (2000) were influential in the Child Trust Fund proposal.

may signal a new direction in policy. As David Blunkett (2000), when he was Secretary of State for Education and Employment, observed: "We are on the cusp of a different way of looking at the welfare state – one which focuses on capital and assets." The Trust Fund would provide progressive contributions to the child's account, and life-long accumulation, rather than one large lump sum at birth or at the age of 18 or 21.[54]

Conclusion

Perhaps the rudimentary institutional theory of saving outlined in this paper 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 paper 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 20th 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.[55] If the same level of policy commitment and commercial creativity were applied to the goal of extending saving, it is 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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[54] Those who have raised children through the teenage years might have reason to wonder if a large, lump sum, unrestricted payment to all 18 year olds would be a wise national policy. For better versions of this idea, see Tobin (1968), Haveman (1988), and Sawhill (1989).

[55] 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.

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