The Financial Lives of Economically Vulnerable Families

North American Collections Agency Regulators Association

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University of Wisconsin - Madison

• Founded in 1848
  • 43,389 Students
  • Over $1 billion in externally-funded research
• Charles Van Hise (1904):
  • "I shall never be content until the beneficent influence of the University reaches every home in the state."
  • …The Wisconsin Idea.
• Shaped formation of Social Security programs
• Institute for Research on Poverty
The Center for Financial Security

Applied cross-disciplinary research center on Household Finance

- Developing and evaluating programs
- Testing financial products
- Engaging policymakers in dialogue
A FRAGILE BALANCE

EMERGENCY SAVINGS AND LIQUID RESOURCES FOR LOW-INCOME CONSUMERS

EDITED BY J. MICHAEL COLLINS
Basic Trends

• Income is more volatile – more ups and downs
  • Scheduling
  • Payment timing more granular

• Expense shocks combined with income variations
  • Still employed but income drops / Expenses increase
  • Making ends meet

• About $\frac{1}{3}$ of households report large swings in income in last 12 months
  • Half of households report unexpected or large expenses
Annual Income Volatility by Education

- No HS
- HS
- College

Year:
- 1970
- 1975
- 1980
- 1985
- 1990
- 1995
- 2000
- 2005
- 2010
Income Spikes and Dips

2.6 Spikes

+ 25%

Average Income

2.5 Dips

- 25%

Mateo & Lucia earned $55,200 from June 2012 to May 2013, buoyed by Mateo’s stable job. Monthly income ranged from $3130 to $4720.
Amy Cox earned $28,700 from June 2012 to May 2013, with spikes from an EITC and ed grants. Monthly income ranged from $900 to $12,000.
Last 12 Months: Had an Expense Shock

- Any of these: 60%
- Large Expense - other: 10%
- Pay Cut: 24%
- Medical emergency: 24%
- Divorce / Separation: 4%
- Car Repair: 30%
- Home Repair: 24%

Source: 2015 Pew Survey of American Family Finances
Did this Expense Shock Make it Harder to Make Ends Meet?

Source: 2015 Pew Survey of American Family Finances
Most Vulnerable?

- Low income
- Lower education levels
- Renters
- Non-White
- Single parents
- Young (under 30)
Struggling to Pay Bills
Role of Income & Credit

Source: Survey of Household Economics and Decisionmaking 2015, Federal Reserve Board
Spillover Effects

- Disrupts consumption
  - Cannot invest in long-run goals
- Potentially triggers credit spiral
- Mental and physical health effect
  - Negative impact on children’s development
- Challenges for long-term planning
Need for Savings “Liquidity”

Up to half of households experience ≥30% change in income month to month.

The average household doesn’t have enough of a financial buffer to weather one month of volatility.

Monthly financial buffer needed for a middle-income household: $4,800

Shortfall in liquid assets: $1,800

Typical liquid assets: $3,000

Weathering Volatility JP Morgan Chase Institute, May 2015
• Need for liquid assets to cope with the unexpected
  • Unexpected expenses or irregular income
  • ‘Cash in a pinch’
• Liquid asset poverty may cause larger problems
• Alternative sources of liquidity: credit, social networks
  • Liquidity may facilitate resilience; ability to respond to opportunities
  • Reduce material hardship; increase economic mobility
Why Focus on Liquidity?

- Missed payments—fees, penalties and/or sanctions
  - Material cutbacks
- As little as $1000 or one month’s housing payment or other key payment…
  - Car repair—otherwise could limit work
  - Lower use of health care or prescriptions
  - Refrigerator breakdown might limit food security
- But also lack of resource for positive opportunities for children or work outcomes
  - ‘Contingencies’
  - Even low level of *liquid* assets might soften blow of shocks
- Funds might be formal or informal
- Families ‘count’ on lumpy payments like tax refunds
- Often will simultaneously borrow and save
  - Borrowing and saving are complements
  - Reserve savings for times when cannot borrow or cash is required
Barriers

• Public programs have constraints
  • Asset limits in public programs
  • Savings programs tend to be for restricted uses
  • Tax credits exacerbate volatility
  • Safety net and social insurance programs fail to address

• Behavioral biases
  • Access restrictions (money guards)
  • Peer pressure
  • Commitment devices

• Legal issues
  • Fees accumulated; account access; garnishments
Barriers, Con’t

Employment:
- Low wages / variable hours (43%)
- Technology for just-in-time scheduling

Liquidity Vehicles:
- Savings:
  - Lack of products – market failures
- Credit:
  - Cost and problems of “debt spiral”
- Insurance:
  - Lack quality policies to cover expenses or income shocks
Planning Ahead for Ups and Downs

Known (predictable):
- Five-Friday months – income changes
- Many variable expenses

Unknown (unpredictable)
- Unpredictable schedules
- Contracted positions / changes in work

Family Shocks (semi-predictable)
- Second earner issues
- Death, divorce, disability
Goal: Financial Capability

- Develop stronger financial confidence
- Ability to adapt to new economic contexts
- Focus on self-control & follow-through
- More focused attention and reduced inattention
- Support planned, goal-driven financial behaviors
Building Financial Capability

Goal is to develop capability to solve problems on their own

- People are creative and resourceful
- We want to improve our performance
- We need a structure to develop our own solutions

Barriers:

- Focus of attention
- Exercising self-control
- Rapid changes in marketplace
New Approaches Needed

Financial Literacy vs. Coaching
Looking Ahead

Unrestricted savings
• Encourage (and not discourage) emergency or contingency funds

Credit – Insurance Innovations
• Small dollar loans
• Micro-insurance

Smoothing Tools
• FinTech & ThinTech

Policy Change
• Emergency resources
• Savings incentives
• Managing Volatility is Central Task for Households
  • Income
  • Expenses

• Poverty and Lack of Resources Are Critical, but, stability is important too
  • Planning – time horizon
  • Stress – mental health / physical health

• Liquidity is the issue
  • Short term (sometimes very short)
  • Credit and savings as complements

• Too often overlooked as policy issue
  • How households plan and manage liquidity
  • How safety net and private markets support (or hinder)
For More Information: cfs.wisc.edu

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