Discussant's Comments
"A Financial Services Survey of Low-Income Households" and "Householder Response to the Earned Income Tax Credit: Path of Sustenance or Road to Asset Building"

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These two papers address three related questions. First, what financial services do low- and moderate-income (LMI) households use and why? Second, are there cost-effective policies that would help LMI households build financial savings? Third, are there cost-effective policies that would lead households without bank accounts (the "unbanked") to open accounts?

Obtaining answers to the first question is a prerequisite for thinking clearly about policies that could improve the delivery of financial services to LMI households. Answering the second question is important because households that maintain financial savings generally pay less for basic financial services than do those living from paycheck to paycheck. This is because the former households can meet banks' minimum balance requirements, are much less likely to write checks that bounce, and are more likely to pay their bills on time, giving them a higher credit score. But the benefits of maintaining financial savings go beyond simply lowering the cost of financial services. Individuals living paycheck to paycheck, if they are not currently in a financial crisis, know that they are only a small step from one. This is stressful and discourages long-term planning. Finally, people are interested in policies that encourage the unbanked to open bank accounts because having a bank account can lower the cost of payment services and might help people build savings.

The paper by Ellen Seidman, Moez Hababou, and Jennifer Kramer (SHK) presents the results from a high-quality survey of LMI households in three cities, focusing on their use of financial services. The survey results reinforce the findings from previous surveys, make a new point, and raise issues for future research.

The SHK paper reinforces five principal findings. First, the profile of households without bank accounts (the "unbanked") as being poorer, less educated, younger, and more likely to be black or Hispanic than are LMI households with bank accounts is consistent with findings from previous surveys. Second, the main barriers to more widespread ownership of bank accounts are a lack of financial savings among the unbanked and the cost of small-balance bank accounts. Inconvenient bank hours or locations are far less important. In other words, people lack *financial* access to banks, not *physical* access. Third, people who have bank accounts sometimes use nonbanks for financial services, and people without bank accounts sometimes cash checks at banks. Fourth, some LMI households save, and the propensity to save is highly correlated with income. Finally, people who save have more assets and indicators of household stability than do nonsavers.

The SHK paper also makes an interesting point that I do not recall appearing in previous studies. LMI households with checking accounts often pay their bills with cash or money orders because the payment recipients (frequently landlords) refuse to take personal checks. This may explain why many of the banked individuals in the survey said that they obtain some payment services at nonbanks. Banks typically charge much more for money orders than do nonbanks.

The SHK paper naturally leads to the question: Are there cost-effective means to encourage more LMI households to build financial savings? Typically, when one poses this question, researchers and policymakers think of individual development accounts (IDAs) or financial education initiatives. The American Dream Demonstration study of IDAs offered encouraging findings about the ability of LMI individuals to save when their savings are matched and when they are provided with significant encouragement and financial education (Schreiner et al., 2002). But since the findings did not come from an experimental design, we cannot be sure that they do not reflect selection biases. Moreover, the administrative costs (excluding the costs of the matching funds) of the IDA programs that were studied exceeded the total amount of savings generated, raising serious doubts about the cost-effectiveness of IDAs (Schreiner et al., 2004). It could be that a lower cost IDA program would induce people to save, but I am aware of no reliable evidence on this point.

One popular alternative to IDAs is educational initiatives that teach people how to develop budgets that would generate savings and teach behavioral tricks that can help them adhere to their budgets. While this may be a much lower cost approach than IDAs, as far as I am aware there are no experimental studies assessing the effectiveness of such initiatives. Clearly, there is a pressing need for such studies to provide reliable estimates of the cost effectiveness of educational initiatives seeking to build the savings of LMI households.

This brings me to the paper by Sherrie Rhine, Sabrina Su, Yazmin Osaki, and Steven Lee (RSOL). In recent years, several researchers have suggested that, with proper encouragement and institutional structure, unbanked households receiving tax refunds might use the refunds to open bank accounts and, perhaps, maintain savings. The RSOL paper is an early stage report on an initiative launched by the Community Food Resource Center (CFRC) in New York City that has that objective.

As reported in the paper, the CFRC prepared tax forms for 18,498 low-income individuals in early 2004. In a partnership with nine local depository institutions, the CFRC offered to open low-cost savings accounts for these individuals at the same time as they prepared the tax forms. Almost 40 percent of the tax preparation clients did not have deposit accounts prior to receiving this offer, and, among these, 90 percent were to receive a refund from the federal government. The average refund for unbanked individuals was $1,105. The CFRC emphasized to the clients that opening a bank account would enable them to receive their refunds by electronic deposit within just a few days.

The RSOL paper reports the results from this program. About 9 percent of the unbanked individuals opened bank accounts. Among those unbanked individuals due to receive refunds, 15 percent opened accounts. The larger the expected refund, the more likely an individual was to open an account. Among unbanked individuals, 9 percent said they planned to save the majority of their refund. Since there was no control group in this study and the researchers did not examine whether those opening accounts were able to maintain positive savings over time, we do not know the extent to which changes in behavior were due to this initiative, and we do not know whether individuals who had their refunds deposited into accounts were able to maintain savings over time. These are issues that the RSOL team plans to investigate in future research.

An alternative small scale study suggests that most of the unbanked households that opened accounts for their refunds quickly depleted those accounts. In early 2000 in Chicago, ShoreBank and the Center for Economic Progress teamed up to provide free tax preparation services to 446 lower income individuals (Beverly et al., 2001). At the same time, they offered to sign up these clients for a free no-minimum-balance savings account in which their tax refunds would be deposited. Funds in this account would earn a market rate of interest, and, as an extra savings incentive, participants would receive a 10 percent bonus on funds remaining in the account as of December 31, 2000 (with a maximum bonus of $100). Given this offer, 89 individuals chose to open the accounts, but only 58 were included in the subsequent study because it included only adults willing to complete a set of survey forms. The study found that most of the participants depleted their savings accounts fairly quickly. Within 30 days of receiving their refunds, the median ending account balance was only 13 percent of the typical refund. By 60 days, it was only 5 percent. After four months, the median account balance was $19, 2 percent of the typical refund.

I conclude by thanking the authors of these two papers. Both papers tackle important policy issues, are informative, and point to clear directions for future research.

REFERENCES

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