



WISCONSIN
UNIVERSITY OF WISCONSIN-MADISON



The Financial Lives of Economically Vulnerable Families

North American Collections Agency
Regulators Association

October 12, 2016



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



EDITED BY J. MICHAEL COLLINS

A FRAGILE BALANCE

EMERGENCY SAVINGS AND LIQUID RESOURCES
FOR LOW-INCOME CONSUMERS



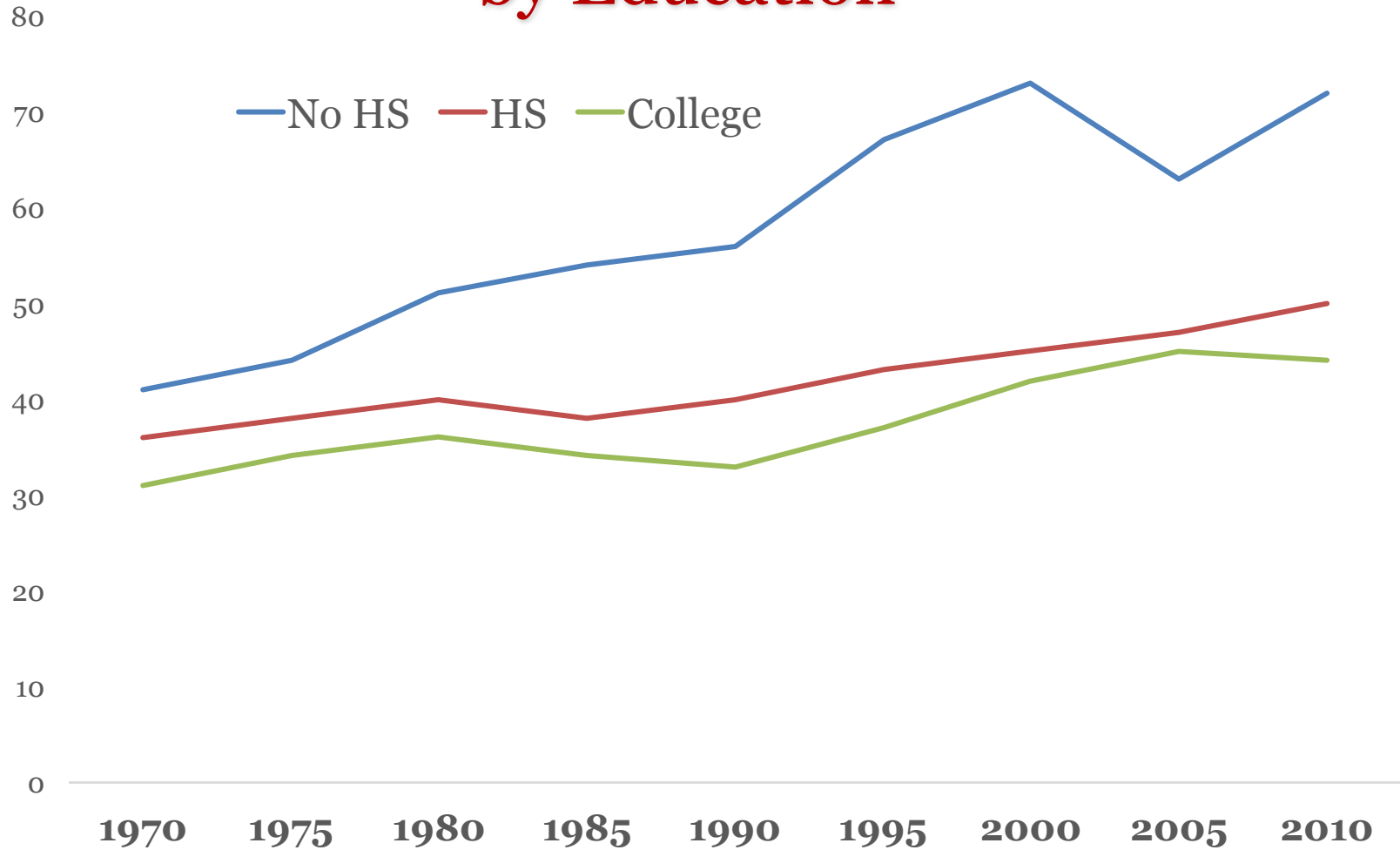


Basic Trends

- 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 1/3rd of households report large swings in income in last 12 months
 - Half of households report unexpected or large expenses



Annual Income Volatility by Education

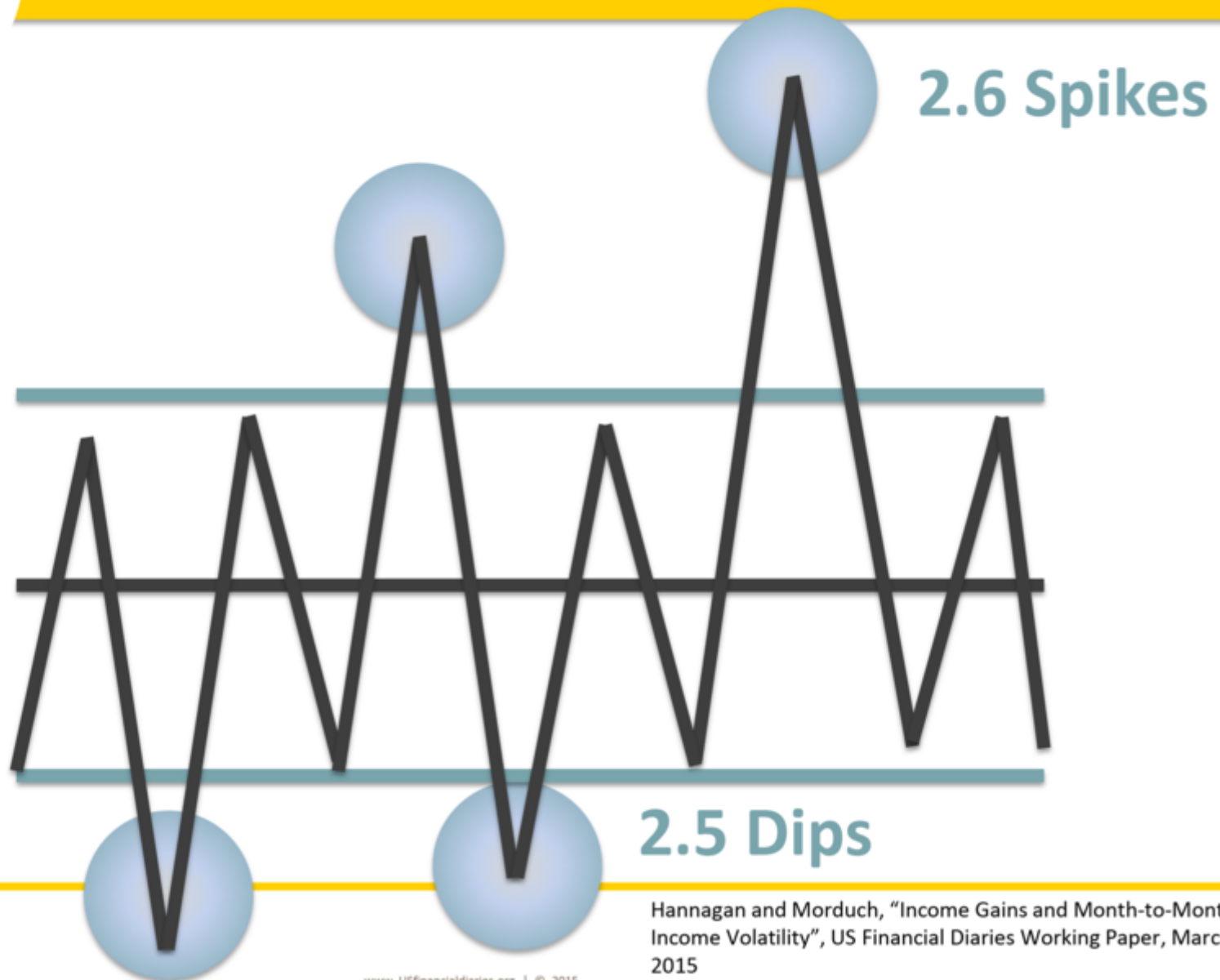


Income Spikes and Dips

+ 25%

Average
Income

- 25%



Hannagan and Morduch, "Income Gains and Month-to-Month Income Volatility", US Financial Diaries Working Paper, March 2015

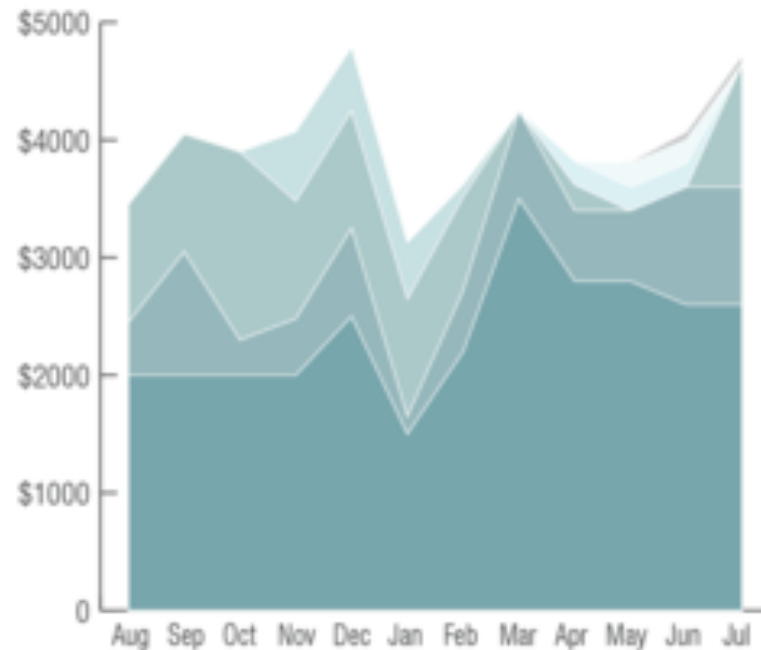


Mateo & Lucia earned

\$55,200

from June 2012 to May 2013,
bought by Mateo's stable job.
Monthly income ranged from

\$3130 to \$4720



- Mateo extra work
- Rental income
- Lucia seamstress
- Mateo body shop
- Free phone service
- Food stamps
- Lucia Ambal products

**U.S.
Financial
Diaries**

Amy Cox earned

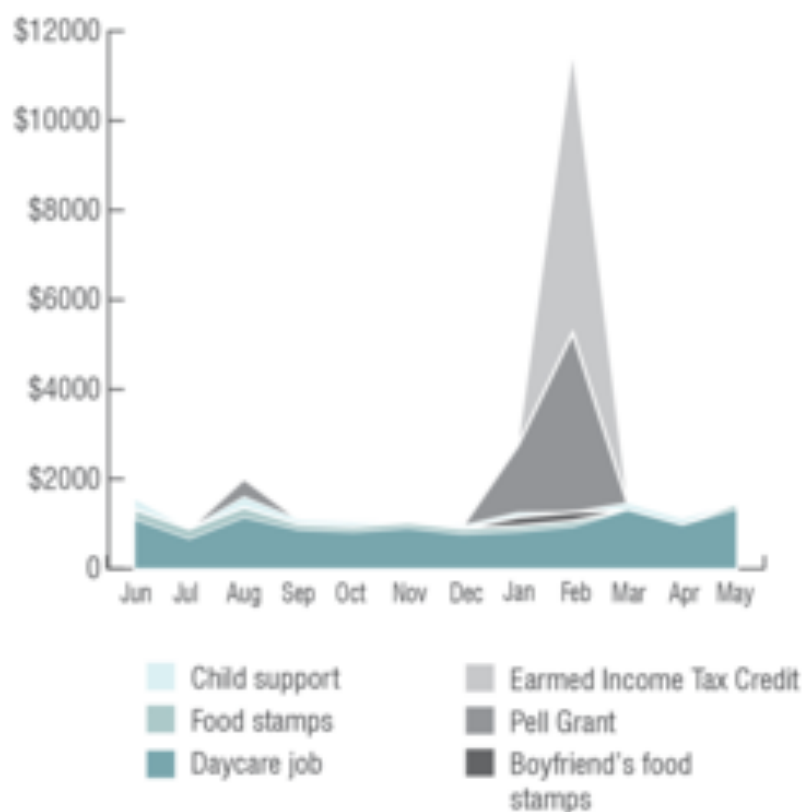
\$28,700

from June 2012 to May 2013,
with spikes from an EITC and ed grants.
Monthly income ranged from

\$900 to \$12,000

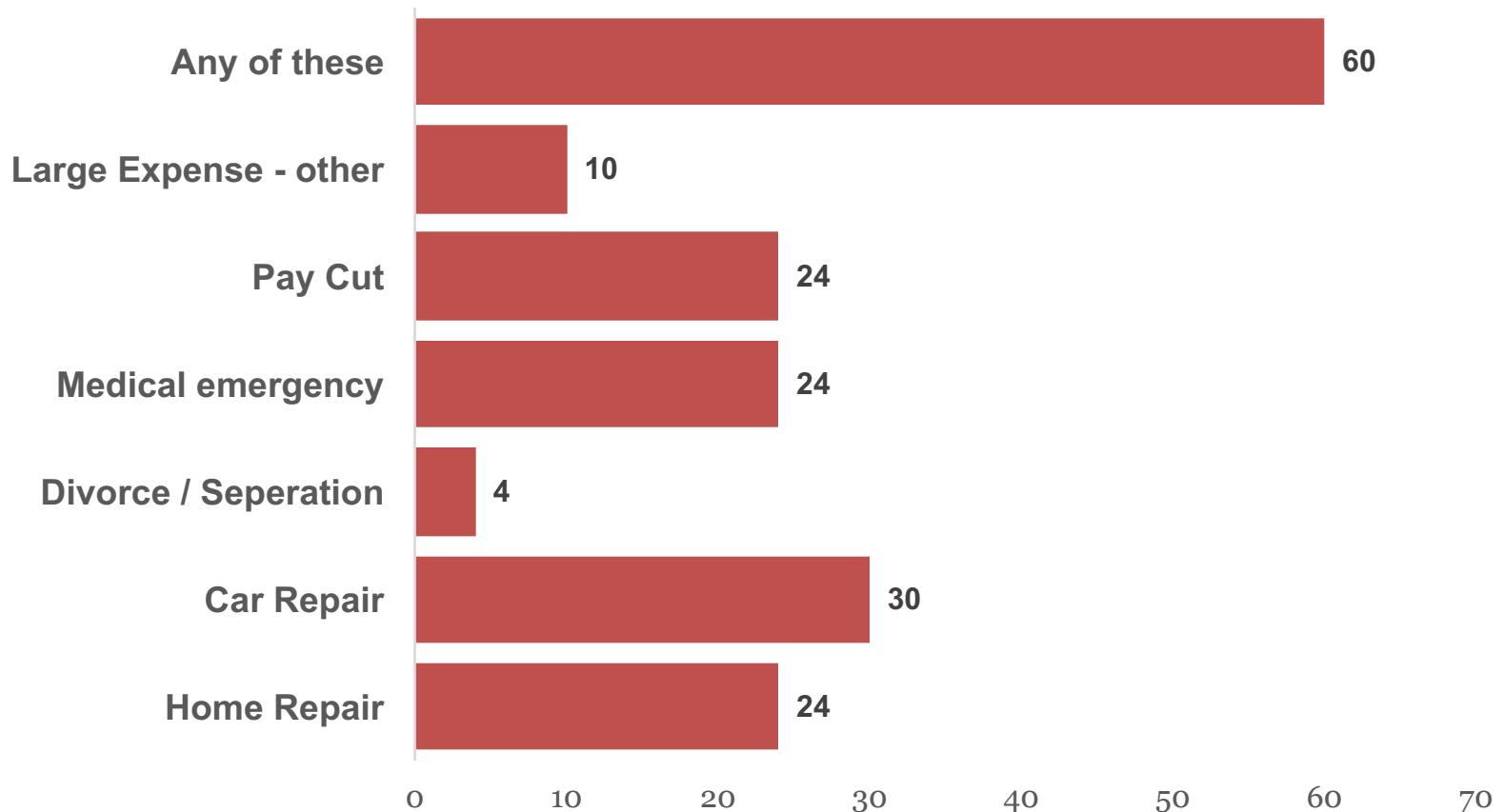


U.S.
Financial
Diaries





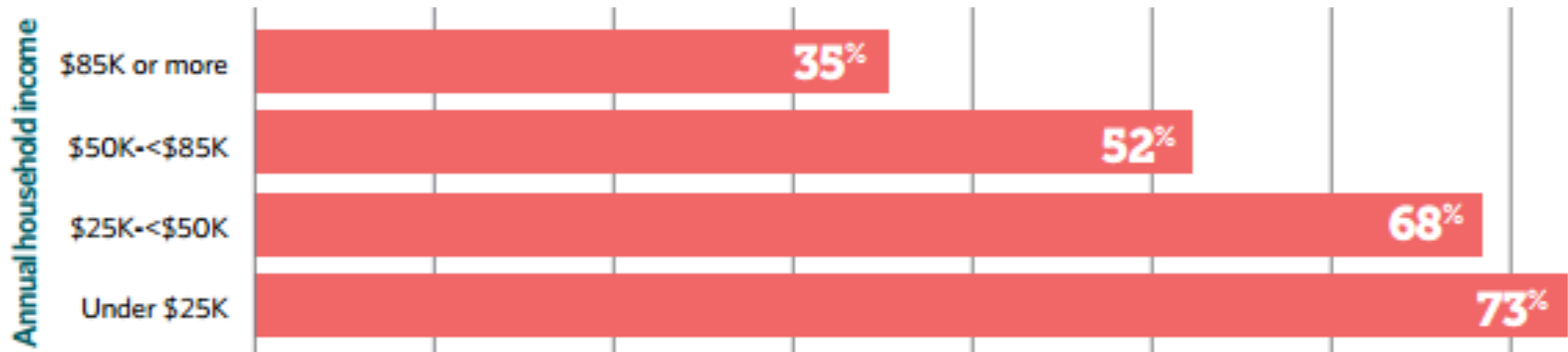
Last 12 Months: Had an Expense Shock



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



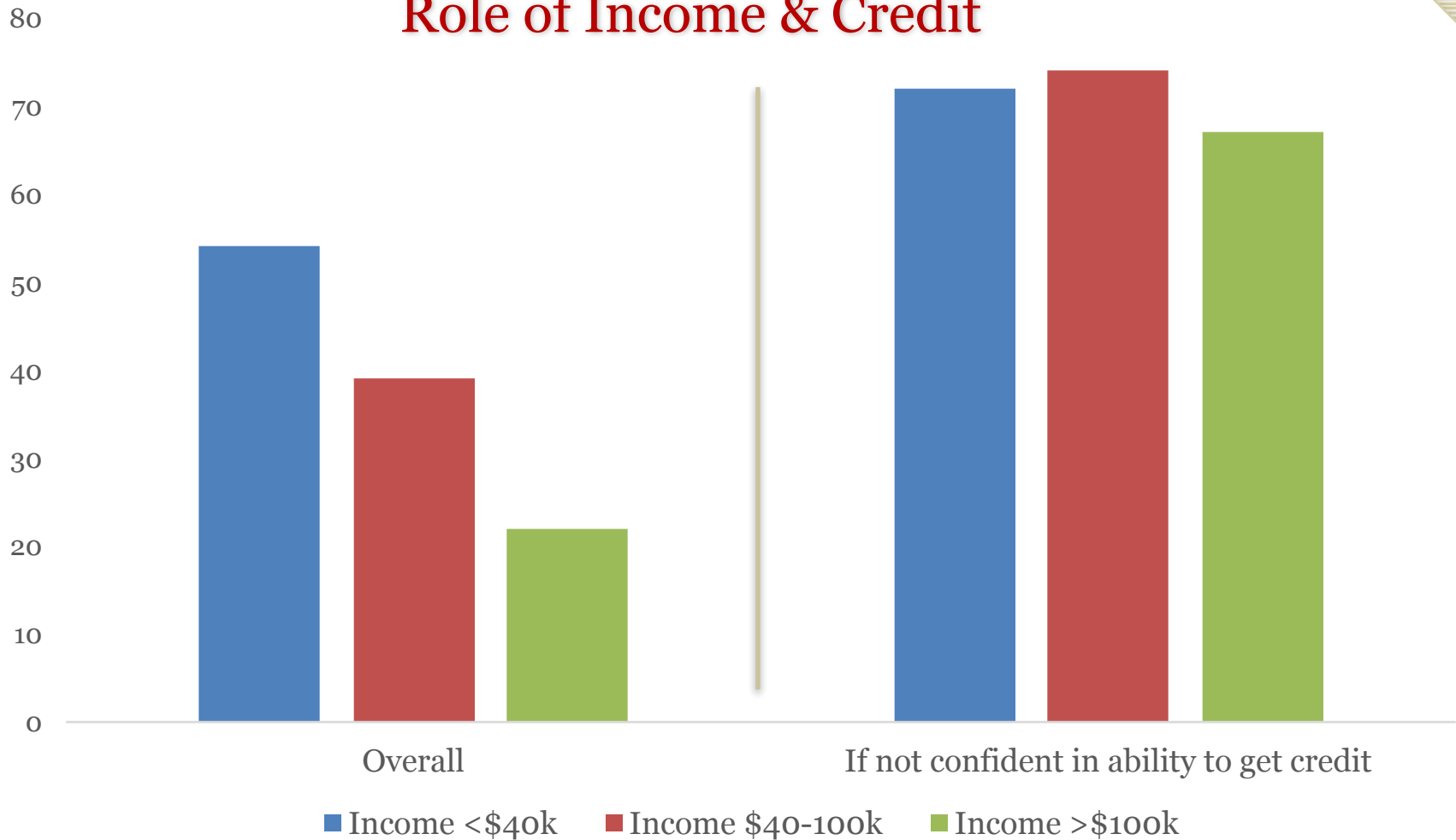
Most Vulnerable?

- 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



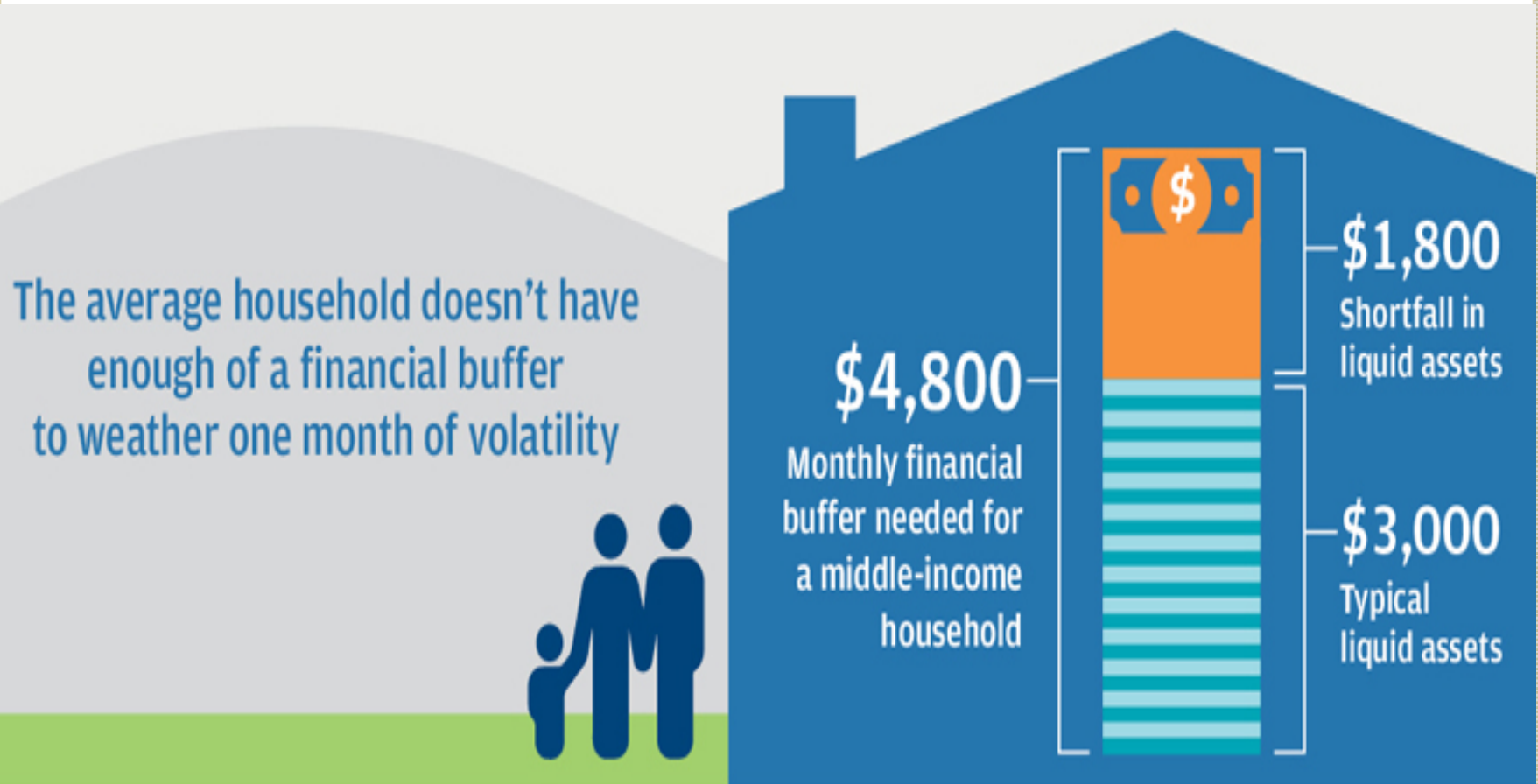
Spillover Effects

- 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 $\geq 30\%$ change in income month to month



Weathering Volatility JP Morgan Chase Institute, May 2015

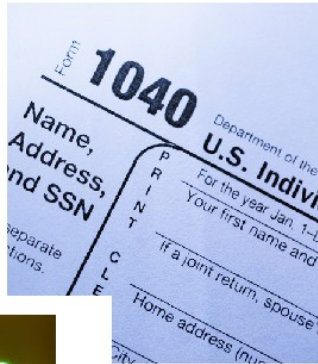


- Need for liquid assets to cope with the unexpected
 - Unexpected expenses or irregular income
 - 'Cash in a pinch'
- Liquid asset poverty may cause larger problems
- Alternative sources of liquidity: credit, social networks
 - Liquidity may facilitate resilience; ability to respond to opportunities
 - 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)



J. Michael Collins
Center for Financial Security
University of Wisconsin-Madison
jmcollins@wisc.edu
[@jmcollinswisc](https://twitter.com/jmcollinswisc)

For More Information: cfs.wisc.edu

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