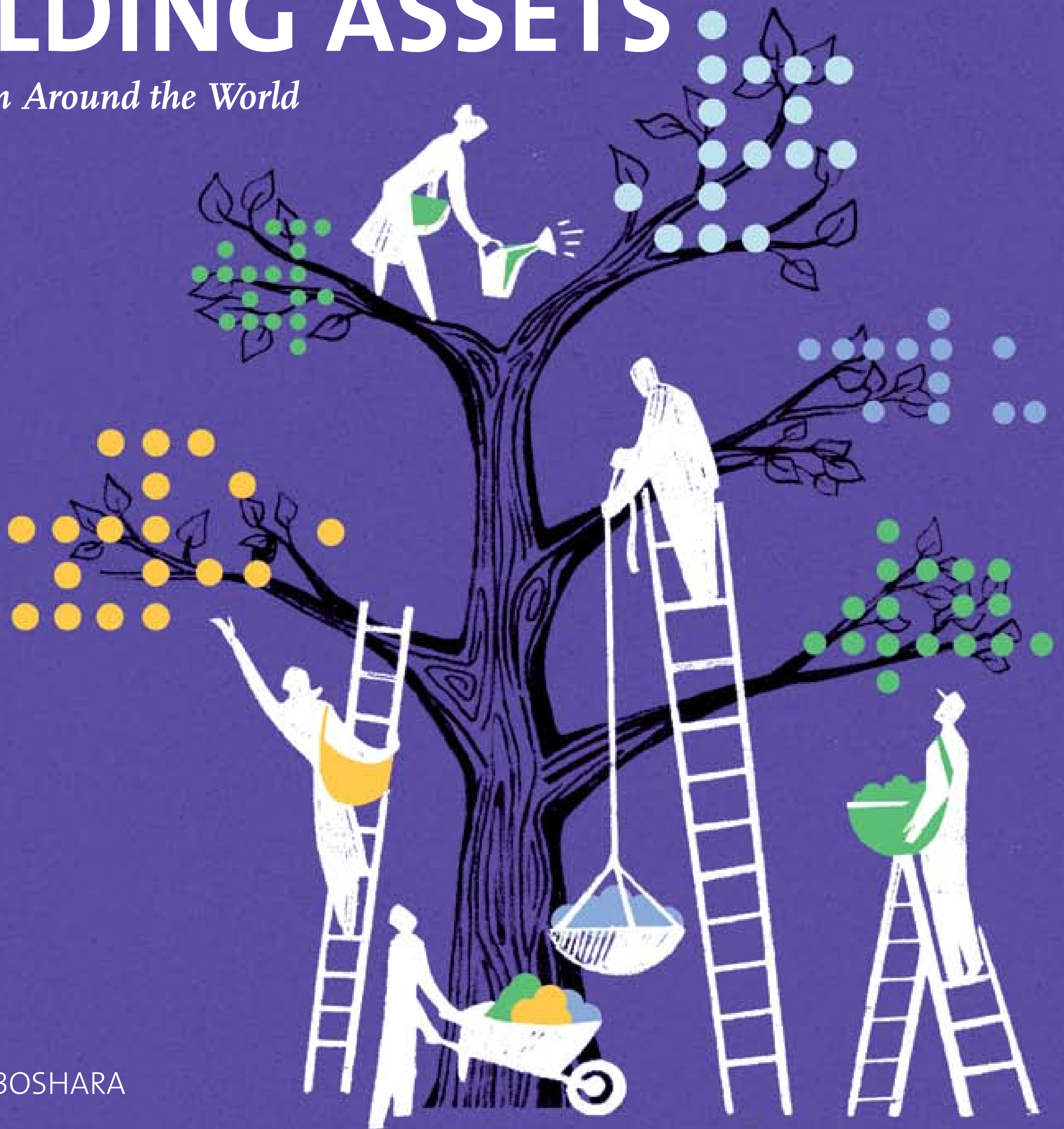
COMBATING POVERTY BY BUILDING ASSETS

Lessons from Around the World



BY RAY BOSHARA

A child in Uganda, orphaned when his parents died of AIDS, is off the streets and avoiding AIDS himself by saving money for secondary school with the support of the innovative Suubi project, which provides poor children with Child Development Accounts. In China's western Xinjiang region, a poor rural farmer sees his "dead," or untouchable, pension savings become "live," or usable income-producing assets, thanks to the work of a visionary local government bureaucrat.

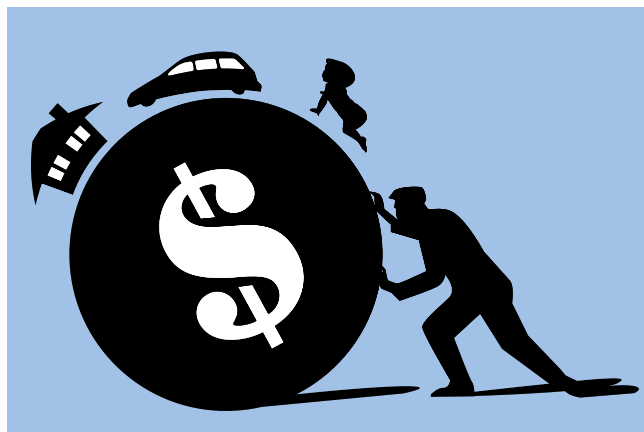
In Peru, a poor woman builds her small business by saving a portion of her "conditional cash transfer," a cash payment to encourage her to keep her kids in school and take them to the doctor. And in Britain, a new mother is pleased to learn that while she's buying a new stroller she can also set up her daughter's Child Trust Fund—a government-provided investment account that her baby can tap when she's 18, a "stakeholder" account now provided to each of the United Kingdom's 700,000 newborns every year.

What unites these widely-dispersed efforts is a novel approach to poverty alleviation birthed and tested in the United States but catching on even faster outside of it: asset development for the poor.

The Promise of Assets

Washington University scholar Michael Sherraden first proposed the modern concept of "asset building," as it is often called, in his 1991 book, *Assets and the Poor*. Sherraden argued that while income is necessary to escape poverty, it is not sufficient. Without assets—savings, a home, land, small business, education and skills, investments, a retirement account—it will be difficult, if not impossible, for the poor to permanently achieve financial security, especially across generations.

In addition, Sherraden argued that asset ownership—distinct from income flow—changes the way people think and behave and ultimately affects a range of social outcomes. Research now affirms this. Columbia University professor Fred Ssewamala's Suubi project has demonstrated that owning a Child Development Account instills a future orientation powerful enough to motivate orphans to avoid the risky behavior that can lead to AIDS. University of North Carolina–Chapel Hill's Gina Chowa, examining a number of studies in developing countries, reports that households with access to assets are better able to provide for their basic needs and make important investments in future generations through health care, education, and training, while those lacking assets are more vulnerable to poverty. John Bynner and Will Paxton, in a paper published by the British think tank IPPR, found that, regardless of income, holding assets at age 23 is associated with later positive outcomes such as better labor market experience, marriages, health, and political interest. Interestingly, this "asset effect" persists regardless of the amount of the asset: The simple presence of the asset seemed to matter most—research since corroborated by Trina R. Shanks of the University of Michigan. And Thomas M. Shapiro of Brandeis University reports that the presence of even small amounts of wealth at the right times can have a "transformative" effect on the life course. Even small amounts of assets can generate large stocks of hope.



The "income paradigm" of poverty alleviation reigned powerfully and largely unchallenged throughout the 20th century. Around the world, the most accepted poverty metrics are measures of income: If you live on less than a $1.25 a day (the new World Bank measure) in the developing world, or below $21,200 a year for a family of four in the United States, you are considered "poor." Framing the poverty problem in terms of income naturally leads to *solutions* centered on income, leaving assets out of the equation. But what if we also define poverty as lacking a certain level of assets for investment or long-term development? If we do, data show that poverty rates would double (at least in the United States and Africa, where research has been conducted), with potentially "game changing" implications for programming and public policy.

When asset building was first rolled out in the United States in the mid-1990s, the common response there and in other advanced economies was that the poor can't save, so why bother? Liberals and anti-poverty advocates were in fact the most doubtful, dismissive even, of encouraging the poor to save. Many of them assumed they knew best what the poor were capable of. Well, the poor knew better, and proved it—primarily though Individual Development Accounts, or IDAs. IDAs are matched savings accounts typically restricted to a first-home purchase, post-secondary education, or small-business development. Savings in IDA experiments were modest but meaningful, averaging $17 to $32 per month, leading to higher asset levels as compared with control groups. Success with IDAs then prompted additional demonstrations and even the development of national policies in the United Kingdom, Canada, South Korea, Kenya, Colombia, Taiwan, Indonesia, Kenya, Hungary, China, and elsewhere.

In developing countries in the 1970s, Muhammad Yunus and others generated buzz about the poor's "credit worthiness," or their ability to repay small loans. Since then, "microcredit" has evolved into a broader microfinance industry of small-dollar lending operations to the poor. Meanwhile, and out of the spotlight, the poor were always saving, whether in terms of livestock, village savings schemes, or credit unions; indeed, Stuart Rutherford, author of *The Poor and Their Money*, points out that the poor are too poor *not* to save and manage their money well. Nearly 3 billion poor people worldwide, however, lack

access to basic financial services as well as to safe, regulated, and sustainable financial institutions that make saving feasible on a much larger scale.

In the last few years, *savings* has become the new buzzword in the microfinance field, with growing demand and evidence to support it. A recent report from CGAP, a World Bank affiliate, states that "When savings accounts in financial institutions serving the poor outnumber microloan accounts seven to one, one thing is certain: microfinance clients want savings services." Elizabeth Littlefield, CGAP's CEO and Director, remarked that, "There is lots of evidence suggesting that poor people would rather save, turning small amounts into a lump sum, than borrow a lump sum and then pay it back." Indeed, the recent mortgage and financial meltdowns in the United States have generated some backlash against promoting indebtedness for all of the world's poor.

This momentum away from credit and toward saving raises an important question: How much of each should we emphasize in combating poverty? I'd argue that both are critical, but that the priority and sequencing should change. Building on Irish development finance thinker Garrett Wyse's formulation, I'd suggest that savings serve as the "base," the touchstone for meeting life-cycle needs and developing assets; insurance (or "micro-insurance," as it's known in the developing world) protects the base; and credit then expands the base, making further asset accumulation possible. That is, we should lead with savings, rather than with credit.

The CGAP numbers cited above suggest that the poor have already figured this out, and many if not most experts need to catch up. Indeed, microfinance scholar Dale W. Adams, in a forthcoming paper titled "Easing Poverty through Thrift," states, "Perhaps it's time to revisit traditional views about thrift and see if there is any wisdom there that might alleviate more poverty and create less risk than does the indebting fad that is currently in vogue." ACCIÓN's new "Lend to End Poverty" campaign perfectly demonstrates how fashionable debt-led strategies remain.

That applies to anti-poverty efforts in the United States as well. We've over-focused (but under-funded) income support, excluded and even penalized savings and asset ownership among the poor, and extended too much and the wrong kinds of credit—toxic sub-prime mortgages, deceptive credit cards, usurious pay-day and "refund anticipation" loans, etc.—to the very people who can least understand and afford them. Meanwhile, we massively and wastefully subsidized wealth accumulation in the United States—to the tune of $400 billion a year—for households in the upper half of the income scale, those who need it least and would accumulate wealth anyway. Should it be any surprise, then, that prior to the meltdowns in the housing and financial sectors and the onset of the recession, one in three American households had no more than $10,000 in net worth, and one in six had negative net worth? That wealth inequality dwarfs income inequality?

Accordingly, I'd recommend that U.S. policymakers learn from trends in the microfinance field and—while strengthening our nation's traditional safety net—emphasize thrift and savings-led strategies as the foundation of our development efforts. This includes making access to *good* credit available once a sufficient base of savings has been secured. And, just like in the developing world, policymakers will need to respond to what's already happening in households: The Federal Reserve recently reported that household debt fell for the first time ever recorded, falling 0.8 percent for the three-month period ending last September. Two-thirds of last year's stimulus checks were saved or used to pay down debts, with only one-third spent. Meanwhile, the personal savings rate has turned positive—reaching 2.9 percent in the last quarter of 2008—following a steep and steady decline that began in the early 1980s.

So how can policymakers specifically respond to the savings needs and behavior of

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most households in the United States? The neo-classical model of saving—in which it is presumed that people rationally choose to consume now (and thus not save) or consume later (and thus save) has lost credibility. Instead, we must, first and foremost, be guided by recent findings in behavioral economics—which stress irrational factors, such as inertia, that determine how we wind up managing our money. Richard H. Thaler and Cass R. Sunstein's important book, *Nudge: Improving Decisions About Health, Wealth and Happiness*, describes this new model.

The data are compelling: In IDA experiments, individual characteristics—age, gender, race, employment status, and even income—did not predict savings. In fact, the poorest of the poor—those at 50 percent of the poverty line or below—saved a greater percentage of their income than those at twice the poverty line, suggesting institutional and behavioral factors are at play. In another experiment, participation in 401(k)s grew from 35 to 85 percent for women, 19 to 75 percent for Hispanics, and 13 to 80 percent for low-income workers when the default setting was switched to being automatically in the 401(k) plan (you have to opt out) from being automatically out of the plan (you have to opt in). The United Kingdom's Child Trust Fund has nearly 100 percent participation because the government wisely opened up accounts automatically for the 25 percent of the population that didn't get around to redeeming their vouchers at a local financial institution or stroller store. And Hatton National Bank in Sri Lanka operates more than 700,000 child savings accounts because it enrolls families before they leave the hospital, in much the same way that infant formula companies in the United States hook new moms on their products.

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Asset Building through the Life Cycle

What, then, are the moments in our financial lives when these new insights could apply? I suggest making savings and asset accumulation automatic by getting everyone into savings systems at four key occasions: at birth, at the workplace, at tax time, and at the time when most Americans purchase their major asset, their home. Readers of *Pathways* (Summer, 2008) will see that my recommendations are in line with those offered by Dalton Conley, reflecting what I believe is a growing consensus toward a "soft paternalism" in savings policy.

At birth. Following the lead of the United Kingdom, Canada, South Korea, and Singapore, the United States should establish a lifelong savings account—an American Stakeholder Account—for every child born in America. It should fund those accounts progressively: $500 at birth for every child, and for children from low-income households another $500 at birth as well as the opportunity to earn $500 in annual matching funds on contributions from any source until age 18. Financial education would be provided with each account. Withdrawals, beginning at age 18, would be restricted to post-secondary education and training, first-home purchase, and retirement. The bipartisan ASPIRE Act reflects this idea—it's the boldest and most important measure we could take to rebuild a savings culture and expand economic opportunity for every generation in America.

At the workplace. Mandated employer and employee savings schemes—long embedded in Singapore's successful Central Provident Fund and, beginning in 2012, the law in the United Kingdom—should become part of the savings infrastructure in the United States as well. I suggest creating an American Savings Plan—modeled on the federal retirement Thrift Savings Plan for government workers—into which every new worker would be enrolled and provided with an American Stakeholder Account. Ideally, this system would be created at the same time accounts at birth are established so

that, eventually, every American would be in one system. Mandatory savings of 1 to 2 percent from both employers and employees would be required, with savings geared toward retirement security but with limited withdrawals permitted for emergencies and certain pre-retirement assets. For workers in the current employer-based system, which should be phased out once the American Savings Plan begins, automatic payroll deductions should be directed into IRAs, as proposed in the bipartisan Automatic IRA Act.

At tax time. We should do two things at tax time. First, to bank the unbanked and reduce reliance on pay-day lenders, taxpayers who do not choose direct deposit should automatically receive an electronic banking account that can receive tax refunds and payroll deposits, pay bills, and hold savings. Second, as outlined in the Savers Bonus Act, low-income savers who save automatically at tax time for college or retirement, in six-month or longer CDs, or buy Savings Bonds, would have their savings matched on a dollar-for-dollar basis up to $500 per year. All matching funds would be directly deposited into the account (or the value of their CDs or Savings Bonds would be increased). Savers would have a choice of savings products, while matching funds would be provided to low-income households without creating a new refundable tax credit—still a politically difficult thing to do.

When purchasing a home. Mortgage borrowers simply have too many choices. No one really understands the exotic subprime mortgage products that have led to the enormous and unexpected financial crisis in the United States and around the world. We must therefore get more Americans into safe, understandable, and appropriate mortgages. Accordingly, an "opt-out" mortgage, or Basic American Mortgage, should be the default mortgage—the first product offered to every American buying a home. This would be a 30-year fixed instrument that lenders would be required to offer to Americans with a decent credit rating, 10 percent down (the days of the zero down payment are gone), and a proven ability to make regular payments. Qualified buyers could opt out for other products, but the reporting and disclosure standards on these products would be significantly higher than today, earning approval from something like the Financial Product Safety Commission proposed by Harvard's Elizabeth Warren. Finally, the Basic American Mortgage would include an automatic savings feature so that when you make a payment you simultaneously build up the savings you might need to fix the roof or make payments should you lose your job.

A New Ownership Agenda for the United States

Stepping back for a moment, we must recognize that the most immediate measure we can take for the poor in the United States is to stimulate a massive economic recovery—led by government spending—that boosts U.S. productivity and competitiveness, creates jobs, raises wages, and moves us toward full employment. The recently enacted economic recovery package is designed, of course, to move us in that direction.

However, we must also recognize that our long-term economic growth and competitiveness, as well as the financial stability of households, depends on pools of savings for investment. We're finally seeing that there are limits on how much economic growth can be fueled by debt, consumption, and other nations' savings; that party is clearly over. Once we're through this recession, a new era of thrift—the conservation of financial, energy, and natural resources—will be on the horizon for households and the nation alike, just as thrift is gaining momentum in microfinance efforts abroad. Government should invest massively while enabling households to save automatically; we simply cannot expect low-income people to sacrifice their own economic security for the sake of the larger economy—and they won't, if experience is any guide.

The massive losses in home values, investments, retirement, and college savings accounts in the United States over the last year underscore the need for better regulation of financial markets, not the futility of building assets. We must affirm that assets remain essential to economic security and opportunity, that they are the essence of the now-fading American Dream. But how we achieve widespread asset ownership must change, especially the importance of accumulating savings and wealth in institutions with the right sets of defaults. We've certainly learned that expecting low-income people, indeed most people, to navigate an increasingly complex and often dangerous financial system on their own simply doesn't work.

Now, in short, is not the time to abandon savings and asset development for the poor, but to learn from its successes around the world, and redouble our efforts.

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