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FEDERAL RESERVE BANK OF DALLAS

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A Case Study

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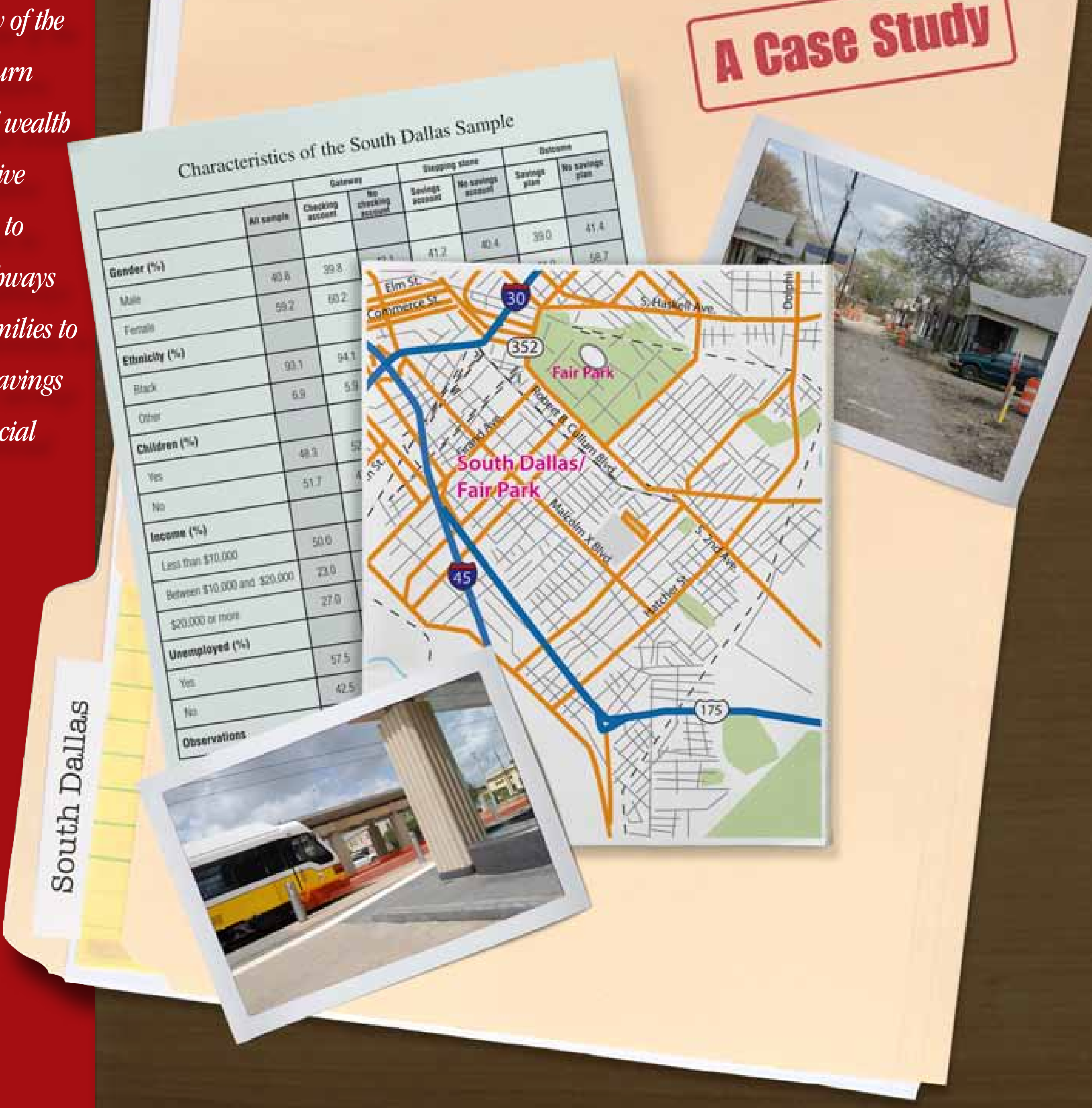

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This publication and our webzine, *e-Perspectives*, are available on the Dallas Fed website, **www.dallasfed.org**.

The recent Great Recession has adversely affected the financial situations of millions of American households and raised awareness of the importance of building assets through savings and long-term relationships with mainstream financial institutions. Lower-cost financial products, savings and asset-building programs inspired by behavioral insights, and consumer-friendly regulatory changes have been rapidly developed to help low- and moderate-income families attain their financial objectives.

This issue of Banking and Community Perspectives *summarizes some of the findings of a research project conducted in a South Dallas neighborhood that has lagged behind economically. We empirically test how gateways—basic transaction products and services and expanded financial knowledge—and stepping stones—the more-sophisticated financial practices that foster asset building—can put households on a path to financial security.*

The findings suggest that connections exist between these gateways and stepping stones and beneficial financial outcomes, providing insights for policies that seek to improve access to safe, low-cost financial products and services and help low-income households build relationships within the financial mainstream.

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Pathways to Financial Advancement: A Case Study

By Wenhua Di, Tammy Leonard and Emily Ryder

More than two years have passed since the end of the Great Recession in mid-2009. The economy has yet to recover, with unemployment hovering above 8 percent at the national level. The housing market is just starting to gradually improve. Mortgage underwriting criteria remain stringent, and potential homebuyers have become more cautious about their investment. Despite some signs of moderate production and consumption growth, income has remained largely stagnant.

According to official poverty estimates by the Census Bureau, the Great Recession raised the poverty rate of U.S. households to 15.1 percent in 2010 from 12.5 percent in 2007. Household wealth plummeted as home equity shrank by more than half from its 2006 level.[1]

Wealth disparities among households have persisted. The Pew Research Center recently examined net worth among race and ethnic groups with the Survey of Income and Program Participation, which provides asset information before and after the recession.[2] It found that the recession eroded all progress made in narrowing the wealth gap between white households and households of color. In fact, the ratio of median wealth of white households to that of Hispanic or black households has reached nearly 20 to 1. This gap is the largest in 25 years of data collection.

Financial Opportunities for All

In view of the economic downturn and the enlarged wealth gap, it is imperative for policymakers to examine the pathways for American families to build sufficient savings to mitigate financial shocks. For many who struggle to make ends meet or are unemployed, it becomes even more critical to preserve limited income and assets by using safe and affordable financial products and services.

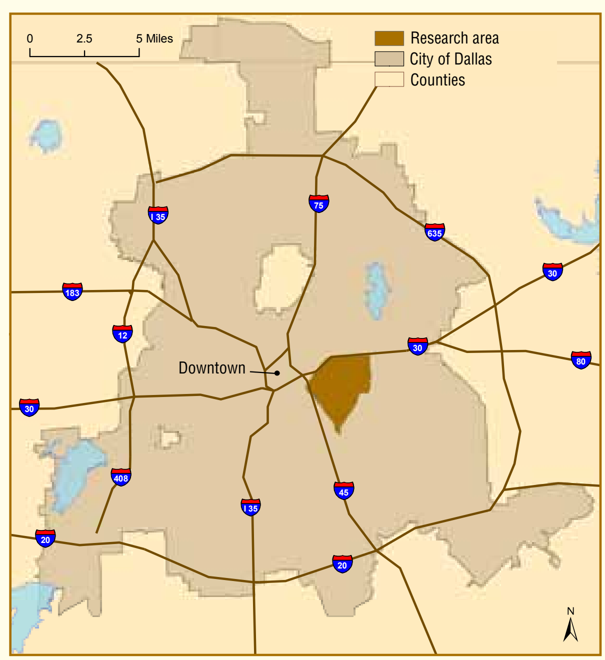
The ability to access transaction accounts at mainstream financial institutions enables low-income households to make payments and deposits, cash checks and send remittances for relatively low cost. Transaction-account owners can use other products and services, including savings accounts and long-term investment products for education and retirement, at the same financial institutions. Empirical studies find that households with transaction accounts are 43 percent more likely to have positive net worth than those without, even when controlling for income and other factors.[3]

Another commonly considered entryway to saving and asset building is through financial training and education. Conceptually, increases in financial comprehension could lead to adoption of and success with advanced financial products. Many financial education programs—private, public and nonprofit—have been created and funded to encourage this relationship. However, evaluations of these programs are scarce, and the existing few have shown limited and often ambiguous effectiveness in increasing financial stability.[4]

While some studies find that financial skills are positively related to financial outcomes, others observe that they have no impact on knowledge and behavior. Many more evaluations are compromised by data constraints and measurement issues. What is clear from the literature is that financial knowledge alone is by no means a panacea for economic stagnation and inequality. Only when it is combined with access, opportunity and policy can it be transformed into financial capability. In other words, financial knowledge can be effective when coupled with opportunities to use such knowledge.

When making financial decisions, households have various objectives and

South Dallas Research Area



Lower-income households may be subject to more financial and behavioral constraints than higher-income households and have less access to financial tools.

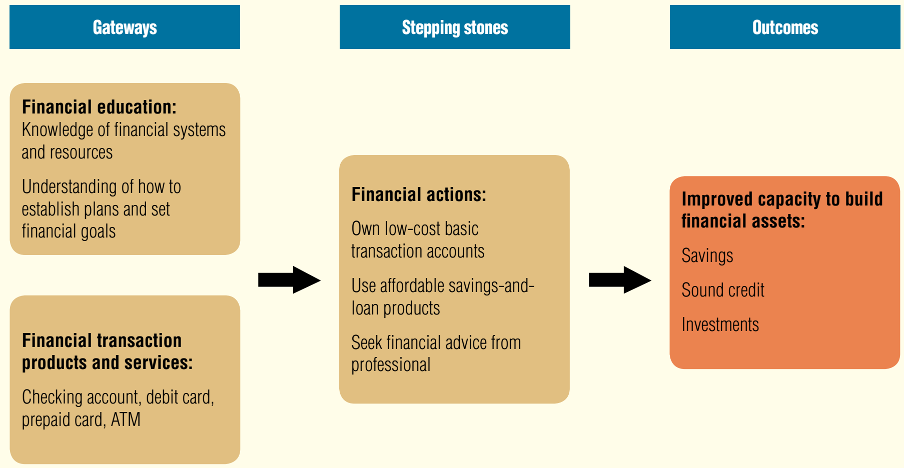
savings horizons and are subject to different constraints. The framework for studying household decisions has expanded in recent decades to recognize differences among households in time and risk preference, trust, social identity, cognitive ability, etc. Observed household behavior may deviate from optimal decisions based on assumptions of rationality. In particular, lower-income households may be subject to more financial and behavioral constraints than higher-income households and have less access to financial tools; therefore, their decisions may appear suboptimal if their unique circumstances are not adequately considered.

South Dallas Residents: A Case Study

In an effort to examine the effectiveness of potential pathways for lower-income households to escape poverty and build financial assets, we create a conceptual model depicting "gateways" and "stepping stones" to better financial outcomes (*Figure 1*).

Checking accounts and their linked financial tools (ATMs, debit cards, direct-deposit access, etc.) can be a first step to basic financial transactions, saving accounts, mortgages and other loan products, as well as to the ability and willingness to seek professional financial advice. The model suggests these products and services will in turn enable households to be more financially sophisticated, make long-term saving plans and use other investment tools to reach asset-building goals. Financial knowledge equips households with money-management skills and helps them become familiar with financial products that suit their needs.

Figure 1
Conceptual Framework for Financial Advancement



Project Overview

As a component of a larger study of the impact of public investment on the well-being of residents in a South Dallas neighborhood, we empirically test how financial outcomes are related to the gateways and stepping stones in the conceptual framework.[5] The South Dallas Fair Park neighborhood is two miles southeast of downtown Dallas and is home to more than 15,300 residents. It is one of the poorest areas in Dallas County. Over the last decade, the Fair Park area has received public investment from various sources, including funding for the construction of a new light rail line, a city bond for development around the rail station, funding for a Tax Increment Financing District that provides private investors a mechanism to recover infrastructure investments, and a HOPE VI award for housing development.[6]

Participants, preferentially families with children, were recruited by community-based field researchers to complete the data collection. The information on financial behavior and product usage collected provides measures of the three components in our conceptual model. We use participants' knowledge of financial systems and whether they own a checking account to describe gateways. We use four indicators to determine household engagement in activities that can be stepping stones: 1) willingness to seek professional financial advice, 2) savings account ownership, 3) mortgage possession and 4) paycheck cashing through direct deposit or at a bank.

The financial outcomes are measured by whether the families save for emergencies and whether they report having a consistent savings plan. In addition, the families were asked if they would advise a friend who has received monetary gifts to invest in a financial institution. The question does not ask about participants' own choices but assesses the likelihood of a participant recommending that others invest in mainstream financial institutions.[7] This survey method seeks to mitigate bias in self-reported behavior.[8] The definitions of the variables used in the analysis are presented in Table 1.

The "financial knowledge" variable is based on answers to a five-question test about financial systems and represents the percentage of questions answered correctly.[9] On average, participants answered 63 percent of the financial knowledge questions correctly. Other summary statistics are as follows: Sixty-nine percent of participants own a checking account, while 54 percent have a savings account and 55 percent cash paychecks through direct deposit or at a bank. About 17 percent seek professional financial advice, and 17 percent have a mortgage. About 38 percent save for emergencies, and 84 percent would advise a friend who received a large monetary gift to invest it in a financial institution. About 76 percent of the households

Table 1
Variable Descriptions in the South Dallas Project

Variable	Description
Gateways	
Checking account	Participant has a checking account
Financial knowledge	Participant's score on test of knowledge of financial systems
Stepping stones	
Professional advice	Participant seeks the advice of a professional financial adviser or financial counseling organization when making major financial decisions
Savings account	Participant has a savings account
Mortgage	Participant has a mortgage
Cash paychecks at bank	Participant cashes paycheck through direct deposit or at a bank
Outcomes	
Save for emergencies	Participant saves for emergencies
Savings plan	Measures the rigor of participant's savings plan: 1=participant does not save; 2=participant saves but no set plan; 3=participant has consistent savings plan
Advise friend to invest in financial institution	Participant would advise a friend to invest a monetary gift in a U.S. savings bond, checking account, savings account or stocks
Sociodemographic characteristics	
Gender	Participant is male or female
Age	Participant's age at time of survey
Married	Participant is married or living with a partner
Kids	Participant has one or more household member under 18 years of age
Black	Participant is black
High school dropout	Participant attended some high school, but did not receive a diploma
High school diploma	Participant's highest educational attainment is a high school diploma or GED
Some college but no degree	Participant attended some college but did not complete a degree
College degree	Participant's highest educational attainment is a college degree or more
Income categories	Household income is less than $10,000, between $10,000 and $20,000, or $20,000 or more
Unemployed	Participant has been unemployed in the past 12 months
Behavioral measures	
Savings horizon	Time period participant considers when making savings decisions, ranging from 1 (next few months) to 5 (longer than 10 years)
Trust in banks	Participant's trust in banks, ranging from 1 (complete trust) to 4 (no trust)

Table 2
Characteristics of the South Dallas Sample

		Gateway		Stepping stone		Outcome	
	All sample	Checking account	No checking account	Savings account	No savings account	Savings plan	No savings plan
Gender (%)							
Male	40.8	39.8	43.1	41.2	40.4	39.0	41.4
Female	59.2	60.2	56.9	58.8	59.6	61.0	58.7
Ethnicity (%)							
Black	93.1	94.1	90.8	95.7	90.1	91.5	93.6
Other	6.9	5.9	9.2	4.3	9.9	8.5	6.4
Children (%)							
Yes	48.3	52.7	38.5	51.3	44.7	47.6	48.5
No	51.7	47.3	61.5	48.7	55.3	52.4	51.5
Income (%)							
Less than $10,000	50.0	41.8	67.9	35.8	66.5	42.7	52.3
Between $10,000 and $20,000	23.0	25.9	16.5	26.7	18.6	25.6	22.2
$20,000 or more	27.0	32.3	15.6	37.5	14.9	31.7	25.5
Unemployed (%)							
Yes	57.5	57.3	57.8	57.2	57.8	36.6	63.9
No	42.5	42.7	42.2	42.8	42.2	63.4	36.1
Observations	348	239	109	187	161	82	266

report that they save, but only 24 percent save with a set plan.

The demographic characteristics of the residents include their gender, age, marital status, race, family composition, education, income and employment status. We use two behavioral measures: survey participants' self-reported time horizon for saving and level of trust in banks. Specifically, participants were asked to identify the most important time period for planning their savings and finances, ranging from "the next few months" to "more than 10 years." They were also asked to rate their level of trust in banks on a scale from 1 to 4 in which 1 is completely trusting and 4 is not at all trusting. While 12 percent of respondents report that they're completely trusting of banks, about a third indicate a relative distrust of banks.

Table 2 shows summary statistics for one "gateway" measure, one "stepping stone" measure and one "outcome" measure for South Dallas residents by several sociodemographic characteristics. These examples suggest that bank account ownership does not vary substantially by gender, race and employment status but is more likely when residents have higher incomes or children. Further, when residents are employed or have relatively higher incomes, they are more likely to have a set savings plan.

Using multivariate regression methods, we further examine the correlations among all elements of the conceptual framework while controlling for the sociodemographic characteristics, time preferences and trust level of the respondents.[10]

From Gateways to Stepping Stones

We first estimate the relationship between the gateway and stepping-stone measures, controlling for sociodemographic characteristics and behavioral measures of the families. The preliminary results suggest that owning a checking account is positively related to owning a savings account, having a mortgage and cashing paychecks through direct deposit or at a bank. When other factors are held constant, individuals with a checking account are 4.6 times as likely to have a savings account and 2.3 times as likely to have a mortgage or cash their paychecks through direct deposit or at a

The preliminary results suggest that owning a checking account is positively related to owning a savings account, having a mortgage and cashing paychecks through direct deposit or at a bank.

bank. However, knowledge of financial systems does not have a statistically significant relationship to any of the stepping-stone measures.

From Stepping Stones to Financial Outcomes

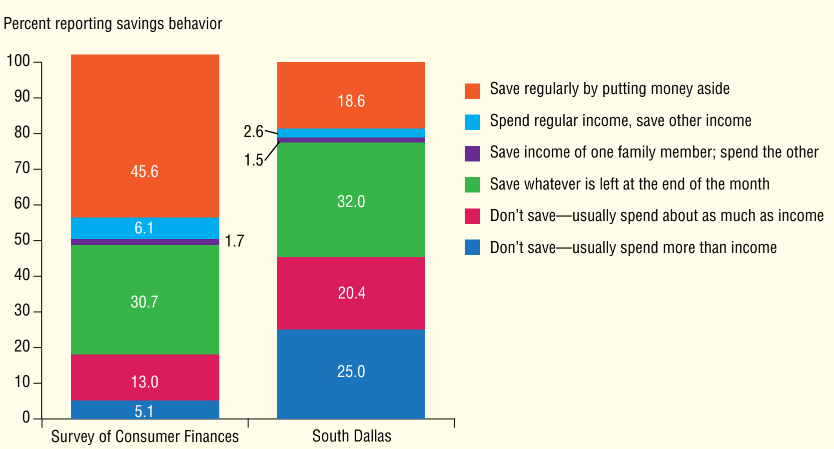
We also examine how the outcome measures are related to stepping-stone measures, holding other factors constant. We find that many of the stepping-stone measures are related to the outcome measures. Individuals who report that they would seek professional financial advice are more likely to save with a plan and also more likely to advise friends to invest in a financial institution. Participants with a savings account are more likely to save. Also, participants who cash their paychecks through direct deposit or at a bank are more likely to save for emergencies.

From Gateways to Financial Outcomes

One of our gateway measures in the South Dallas survey—having a checking account—is not statistically related to any of the outcome variables, but the other gateway measure—knowledge of financial systems—is positively associated with all of the outcome measures. Participants who got just one additional question correct in the financial knowledge assessment were 5 percent more likely to save for emergencies, 15 percent more likely to advise a friend to invest in a financial institution and 8.5 percent more likely to report some savings behavior.

Figure 2

Distribution of Savings Behavior Between Samples



SOURCE: Federal Reserve Board 2007 Survey of Consumer Finances; University of Texas at Dallas South Dallas Survey.

Financial Decisions by Demographic Characteristic

Financial decisions of the South Dallas residents vary by demographic characteristic. Older individuals are more likely than younger ones to have a mortgage or cash their paychecks through direct deposit or at a bank. Younger respondents are more likely to save for emergencies but less likely to have a rigorous savings plan. Black respondents are less likely than others to seek professional advice but more likely to have a savings account. Higher incomes are related to an increased likelihood of seeking professional advice or owning a savings account. Respondents living in households with children are more likely to save for emergencies. Households headed by a married couple or cohabitating partners also tend to save. Having a college degree is strongly associated with an increased likelihood of saving for emergencies, while respondents unemployed in the past year are less likely to have a set savings plan than those with jobs.

Behavioral Influences

As expected, individuals who do not trust banks are less likely than those who do to seek professional advice. However, the savings horizon is not correlated with any of the stepping-stone measures when other factors are controlled for, indicating no discernible difference in the use of these products or services for short-term savers versus long-term ones. Neither the trust in banks nor the savings horizon is significantly correlated with the outcome measures.

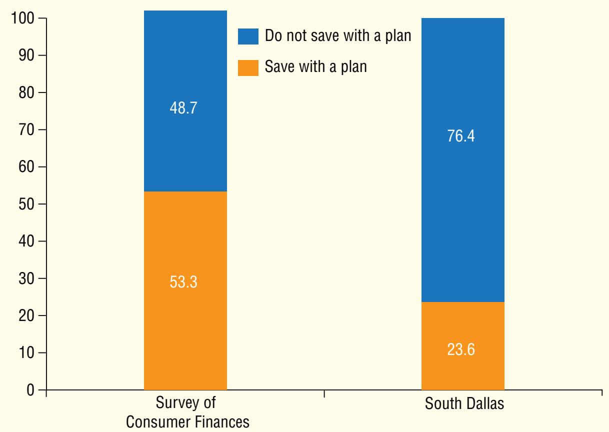
South Dallas Residents and the Rest of the Population

South Dallas' Fair Park area significantly differs from national demographics in various ways. Nearly half of households in our sample have incomes below $10,000, compared with 7 percent nationally, census data show. More than 93 percent of those in our sample

Figure 3

Fewer South Dallas Respondents Save with a Plan

Percent of survey respondents indicating savings practice



SOURCE: Federal Reserve Board 2007 Survey of Consumer Finances; University of Texas at Dallas South Dallas Survey.

identify themselves as black. According to the Census Bureau's American Community Survey, 13.6 percent of the U.S. population is black.

The South Dallas survey incorporated questions that are identical to the nationally representative Federal Reserve Board Survey of Consumer Finances (SCF). This allows comparisons of respondent data.

Figure 2 shows the distribution of savings behaviors for the 2007 SCF and for South Dallas. The South Dallas sample shows 2.5 times the proportion of respondents who report having no savings at all. Only 18.6 percent of South Dallas respondents save regularly and consistently, compared with nearly half of the SCF respondents.

Over 53 percent of respondents to the nationally representative SCF say they have some type of savings plan, while fewer than 24 percent of South Dallas residents report the same (*Figure 3*).

As Figure 4 shows, South Dallas residents have very different savings horizons than the SCF respondents. They are much more likely to report planning for the next few months, while more SCF respondents are saving for a longer term, particularly the next five to 10 years. This discrepancy may indicate a sense of urgency in the South Dallas community for fulfilling immediate needs that overrides long-term financial planning.

The South Dallas neighborhood examined represents a specific demographic profile, as Figures 2 to 4 indicate. Significantly, it contains a key sociodemographic group for which asset building and financial-access policies are particularly relevant—low-income black households. The study of the financial behavior of these South Dallas residents can provide insights for other low-income neighborhoods with similar demographics.

Enhance Lower-Income Households' Financial Capacity

The study suggests that checking account ownership and financial knowledge—as well as the use of low-cost transaction accounts, savings accounts, mortgages and professional financial advice—are associated with improved financial decisions. The findings are evidence of the relationship among the gateways and stepping-stone products and services depicted in the conceptual framework.

However, the results are not sufficient for causal interpretations. Conceivably, greater access to safe and lower-cost transaction accounts should enable households to establish relationships with financial institutions and avoid the exploitation that can occur with high-cost alternative products and services. Moreover, greater use of safe and affordable loan products should help households build credit, and more exposure to mainstream products and services should help them become more familiar with the financial system, learn financial planning and management skills and access options to obtain higher returns on assets. Future research is needed to examine the mechanism behind these correlations.

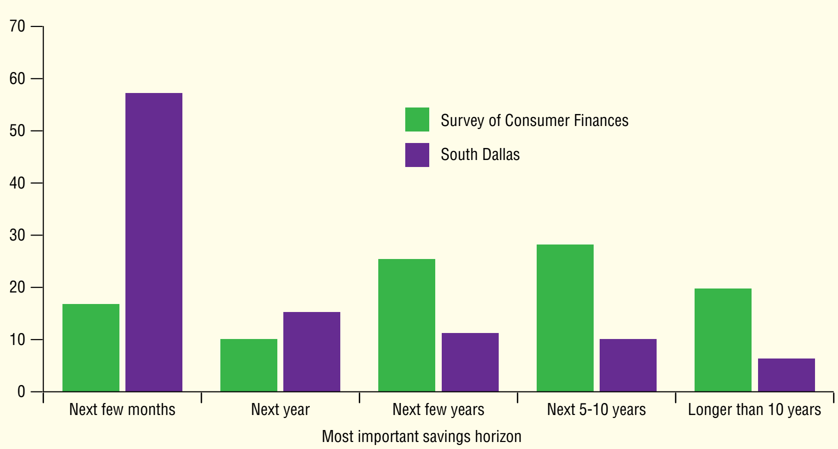
The South Dallas study is an initial step toward empirically exploring these links. With additional evidence-driven programs, practitioners and policymakers have an opportunity to improve the financial access, knowledge and capability of many lower-income households and communities.

(*Continued on back page*)

Figure 4

South Dallas Savings Horizon Tends to Be Short

Percent of sample reporting savings behavior



SOURCE: Federal Reserve Board 2007 Survey of Consumer Finances; University of Texas at Dallas South Dallas Survey.

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(*Continued from page 7*)

Notes

[1] In aggregate, from the Federal Reserve Board's Flow of Funds Accounts. More than $7 trillion in home equity has been lost since 2006.

[2] For more information, see "Twenty-to-One: Wealth Gaps Rise to Record Highs Between Whites, Blacks and Hispanics," by Paul Taylor, Rakesh Kochhar, Richard Fry, Gabriel Velasco and Seth Motel, Pew Research Center, July 2011, www.pewsocialtrends.org/files/2011/07/SDT-Wealth-Report_7-26-11_FINAL.pdf.

[3] See "Asset Accumulation Among Low-Income Households," by Stacie Carney and William G. Gale, The Brookings Institution, November 1999 (revised February 2000).

[4] See "Defining and Measuring Financial Literacy," by Angela A. Hung, Andrew M. Parker and Joanne K. Yoong, RAND Working Paper no. WR-708, 2009, www.rand.org/pubs/working_papers/WR708.html.

[5] The larger study is the University of Texas at Dallas' Fair Park Neighborhood Study. It seeks to examine how investments in neighborhood structural and physical conditions affect the well-being of residents, with a focus on children's educational outcomes as well as residents' employment and health outcomes. For more information, see www.utdallas.edu/ncri/the-fair-park-neighborhood-study/.

[6] This study used the second cross-sectional wave data, collected between October 2009 and February 2010. For a detailed description of the study, see the website in note 5.

[7] The score is derived from a hypothetical question in which new parents receive money as a baby gift and wish to save it for the child's education. The survey prompts the participant to select an option that best fits what he/she would suggest the couple do with the money.

[8] This technique is similar to indirect questioning, in which researchers ask subjects to respond to a question from the perspective of another person or group. For more information, see "Social Desirability Bias and the Validity of Indirect Questioning," by Robert J. Fisher, *Journal of Consumer Research*, vol. 20, no. 2, 1993, pp. 303–15.

[9] The variable "financial knowledge" is a numerical score given to each participant based on his/her response to a five-question test on financial systems. The variable differs from other measures of financial literacy because it specifically captures a respondent's understanding of the ways in which mainstream financial institutions function. The questions test knowledge of: 1) how credit history is shared and considered in approving or rejecting a loan application, 2) the ability to access one's credit record, 3) the services consumer credit counselors provide, 4) the differences between fixed- and adjustable-rate mortgages and 5) what happens to a customer's money when a bank fails.

[10] We use a logit model if we want to examine a decision between two financial choices, such as having or not having a checking account. We use a multinomial model if the decision involves more than two choices.