

Savings Policy and Decisionmaking in Low-Income Households

Sendhil Mullainathan and Eldar Shafir

Theories about poverty, held both by social scientists and by regular folks, typically fall into one of two camps: those who regard the behaviors of the economically disadvantaged as calculated adaptations to prevailing circumstances, and those who view these behaviors as emanating from a unique “culture of poverty” that is rife with deviant values. The first view presumes that people are highly rational, hold coherent, well-informed, and justified beliefs, and pursue their goals effectively, with little systematic error and no need for help. The second view attributes to the poor a variety of psychological and attitudinal shortcomings, presumed to be endemic, that render the views of the poor misguided and ill informed, their behaviors impulsive and lacking, and their choices fallible, and that leave them in need of paternalistic guidance.

Both camps are likely to capture some important elements some of the time. There are, no doubt, important circumstances in which people—the poor included—are methodical and calculating, and other circumstances in which they are fallible or misguided. But both camps fail to explain important phenomena. We propose an alternative perspective, one largely informed by recent behavioral research. According to this perspective, the behavioral patterns of the poor may be neither perfectly calculating nor especially deviant. Rather, the poor may exhibit fundamental attitudes and natural proclivities, including weaknesses and biases, that are similar to those of people from other walks of life. One important difference, however, is that in poverty the margins for error are narrow, so that behaviors shared by all often manifest themselves in the poor in more pronounced ways and can lead to worse outcomes (see Bertrand, Mullainathan, and Shafir 2004, 2006).

Whereas the “rational” view assumes that the poor are doing as well as they can and ought to be left to their own devices, the “culture of poverty” perspective is motivated by the impulse to change how the poor function. In contrast, the central gist of the “behavioral” perspective is that much of the time the poor are not functioning optimally, nor are they any more in need of behavioral change than everyone else. Instead, it is the interaction of fundamental behavioral proclivities with the

context in which they function that produces the particularly destructive circumstances in which the poor often find themselves. According to this behavioral view, people who live in poverty are susceptible to many of the same impulses and idiosyncrasies as those who live in comfort, but whereas people who are better off function in the midst of a system—composed of consultants, reminders, cooperative employers, “no-fee” options, incentive awards, and automatic deposit—that is increasingly designed to facilitate their decisions and improve their outcomes, people who are less well off typically find themselves without easy recourse to such “aids” and often are confronted by obstacles—institutional, social, and psychological—that render their economic choices all the more overwhelming and their economic conduct all the more fallible.

In what follows, we explore some insights provided by a behaviorally more realistic analysis of the economic conditions of the poor. Our perspective draws on empirical research on judgment and decisionmaking and is supplemented by lessons from social and cognitive psychology. We first review the psychological insights and then consider their implications for a variety of financial products and services that feature prominently in the financial context of the American poor. Of course, insights generated by experimental research and empirical observation need to be carefully tested and evaluated before they can be relied on to shape policy. Even when an intervention succeeds in shaping some intended outcomes, there is always the possibility that other, unforeseen patterns will emerge. Bearing that in mind, we propose some guidelines for thinking about the future design and regulation of financial services.

THE BEHAVIORAL PERSPECTIVE

The Importance of Context

Human behavior proves to be heavily context-dependent, that is, a function of both the person and the situation. One of the major lessons of modern psychological research is that situation exerts impressive power; we have a persistent tendency to underestimate that power relative to the presumed influence of personality traits. Various studies have documented the stunning capacity of situational factors to influence behaviors that are typically seen as reflective of deep personal dispositions. In his now-classic obedience studies, for example, Stanley Milgram (1974) showed how decidedly mild situational pressures sufficed to generate persistent willingness on the part of regular people to administer what they believed to be grave levels of electric shock to innocent subjects. Along similar lines, John Darley and Daniel Batson (1973) recruited seminary students to deliver a practice sermon on the parable of the Good Samaritan. While half the seminarians were told that they were ahead of schedule, others were led to believe that they were running late. On their way to give the talk, all participants passed an ostensibly injured man slumped in a doorway, coughing and groaning. Whereas the majority of those with time to spare stopped to help, a mere 10 percent of those who were running late

stopped; the remaining 90 percent stepped over the victim and rushed along. In contrast with these participants' ethical training and biblical scholarship, the contextual nuance of a minor time constraint proved decisive in the decision to stop and help a suffering man.

The Role of Construal

A simple but fundamental tension between classical economic analyses and modern psychological research is captured by the role of "construal." Agents in classical economic analyses are presumed to choose between options in the world, objectively represented. People do not respond directly, however, to objective circumstances; rather, stimuli are mentally construed, interpreted, understood (or misunderstood), and then acted upon. Behavior is directed not toward actual states of the world but toward our mental representation of those states; moreover, mental representations do not bear a one-to-one relationship to the thing they represent, nor do they necessarily constitute faithful renditions of actual circumstances. As a result, many well-intentioned interventions can fail because of the way in which they are construed by the targeted group—for example, "as an insulting and stigmatizing exercise in co-option and paternalism" (Ross and Nisbett 1991) or as an indication of what the desired or expected behavior might be, or of what it might be worth. Thus, people who are rewarded for a behavior they find interesting and enjoyable can come to attribute their interest in the behavior to the reward and consequently to view the behavior as less attractive (Lepper, Greene, and Nisbett 1973). In one classic study, for example, children who were offered a "good player award" to play with magic markers, which they had previously done with great relish in the absence of extrinsic rewards, subsequently showed little interest in the markers when these were introduced as an unawarded classroom activity—in contrast with children who had not received an award and showed no decrease in interest.

Mental Accounting and Finances

One domain that is of great relevance to our present topic and where construal can prove of great consequence is that of mental accounting. Mental accounting research documents the variety of ways in which the assumption of the fungibility of money fails, leading people to view cash, credit, and debit differently depending on the "mental account" in which the money is perceived to be. People's representation of money systematically departs from what is commonly assumed in economics. According to the fungibility assumption, which plays a central role in theories of consumption and savings, "money has no labels"; all components of a person's wealth can be collapsed into a single sum. Contrary to this assumption, people appear to compartmentalize wealth and spending into distinct budget categories, such as savings, rent, and entertainment, and into separate mental accounts,

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such as current income, assets, and future income (Thaler 1985, 1992). These mental accounting schemes lead to differential marginal propensities to consume (MPC) from one's current income (where MPC is high), current assets (where MPC is intermediate), and future income (where MPC is low). Consumption functions thus end up being overly dependent on current income, and people find themselves willing to save and borrow (at a higher interest rate) at the same time (Ausubel 1991).

A variety of other experimental findings are relevant to a better understanding of financial behaviors, but a full summary of those findings is beyond the purview of the present brief exposition. To list just a few, people are loss-averse—the loss of utility associated with giving up a good is greater than the utility associated with obtaining it (Tversky and Kahneman 1991)—and loss aversion yields “endowment effects,” wherein the mere possession of a good can lead to higher valuation of it than if it were not in one's possession (Kahneman, Knetsch, and Thaler 1990). This, in turn, leads to a general reluctance to depart from the status quo, because the disadvantages of departing from it tend to loom larger than the advantages of the alternatives (Knetsch 1989; Samuelson and Zeckhauser 1988). People often also fail to ignore sunk costs (Arkes and Blumer 1985), fail appropriately to consider opportunity costs (Camerer et al. 1997), and show money illusion, wherein the nominal worth of money interferes with a representation of its real worth (Shafir, Diamond, and Tversky 1997). Furthermore, people often prove weak at predicting their future tastes or at learning from past experience (Kahneman 1994), and their intertemporal choices exhibit poor planning (Buehler, Griffin, and Ross 1994) and high discount rates for future as opposed to present outcomes, yielding dynamically inconsistent preferences (Loewenstein and Prelec 1992; Loewenstein and Thaler 1989).

An understanding of such proclivities may be further harnessed to help make sense of behaviors that might otherwise appear perplexing, and this understanding may also help produce more desirable behaviors and outcomes. For example, numerous studies of middle-class savings show that, as a consequence of faulty planning and procrastination, saving works best as a default. Thus, participation in 401(k) plans is significantly higher when employers offer automatic enrollment (Madrian and Shea 2001), and because participants tend to retain the default contribution rates, savings can be increased as a result of agreeing to increased default deductions from future raises (Benartzi and Thaler 2004). As we discuss later, the poor tend to have little recourse to just this kind of default savings and saving programs, but the general notion that context can be designed so as to ameliorate outcomes is a central and important one.

Channel Factors

As it turns out, the pressures exerted by apparently trivial situational factors can create restraining forces that are hard to overcome, or they can promote inducing forces that can be harnessed to great effect. What is particularly impressive is the fluidity with which construal occurs and the sweeping picture it imposes.

Alongside the remarkably powerful impact of context is a profound underappreciation of the effects of construal. When interpreting others' behavior, we tend to exhibit the "fundamental attribution error": we overweight the influence of internal, personal attributes and underappreciate the influence of external, situational forces. As explained by Lee Ross and Richard Nisbett (1991), where standard intuition would hold that the primary cause of a problem, or the particular weakness of a group of individuals, is human frailty, the social psychologist would often look to situational barriers and to ways to overcome them.

The behavioral perspective, with its emphasis on context and construal, suggests that in opposition to major interventions that prove ineffectual, seemingly minor situational changes can have a large impact. Kurt Lewin, in the middle of the last century, coined the term "channel factors." Certain behaviors, Lewin (1952) suggested, can be facilitated by the opening up of a channel (such as an a priori commitment or a small, even if reluctant, first step), whereas other behaviors can be blocked by the closing of a channel (such as the inability to communicate easily or the failure to formulate a simple plan). A well-known example of a channel factor was documented by Howard Leventhal, Robert Singer, and Susan Jones (1965), whose subjects received persuasive communications about the risks of tetanus and the value of inoculation and were told where they could go for a tetanus shot. Follow-up surveys showed that the communication was effective in changing beliefs and attitudes. Nonetheless, only 3 percent actually took the step of getting themselves inoculated, compared with 28 percent of those who received the same communication but were then also given a map of the campus with the infirmary circled and urged to decide on a particular time and route to get there. Related findings have been reported in studies of the utilization of public health services: a variety of attitudinal and individual differences rarely predict who will show up at a clinic, whereas the mere distance of individuals from a clinic proves to be a strong predictor (Van Dort and Moos 1976.) Consistent with this interpretation, Derek Koehler and Connie Poon (2006) argue that people's predictions of their future behavior outweigh the strength of their current intentions relative to situational or contextual factors. As it turns out, seemingly inconsequential contextual features can have a profound influence on the likelihood that intentions will be translated into action. (It is worth noting the complicating implications of these and related findings for standard assumptions of revealed preference: Did the students in the study conducted by Leventhal and his colleagues "want" to get the inoculation? And which observed preference is the "right" one—the 3 percent observed in the control condition or the 30 percent observed when handed a map?)

Individual psyches can be understood as "tension systems" (Lewin 1951), composed of coexisting proclivities and impulses, in which incentives, if they run against substantial opposing forces, will have little influence, whereas other interventions, when the system is finely balanced, can have a profound impact. In other words, big interventions can sometimes have negligible effects, whereas apparently small manipulations can make a big difference.

The basic insights outlined here have important corollaries for our present concerns. For one, they suggest that the same tendencies and weaknesses express

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themselves differentially in diverse circumstances. For example, the tendency to avoid action and resort to the status quo leads to inferior outcomes when context is structured so that the most beneficial outcomes require action, and this tendency leads to more desirable outcomes whenever the default is set naturally to produce them. Similarly, the same tendencies and weaknesses have different repercussions in different circumstances. A person who is well off but fails to formulate a farsighted plan may have a more modest though still comfortable nest egg upon retirement, whereas a poor person who exhibits similar failures may end up with too little cash to pay a phone bill, accrue large fines for reconnection, become increasingly unable to pay bills, and descend further into poverty.

In this chapter, we examine the specific implications of the behavioral perspective for the financial lives of the poor at three different levels. At the individual level, how does this perspective affect their choices about savings and borrowing? At the institutional level, what does this perspective say about how financial services ought to be designed? And at the regulatory level, what are the implications of this perspective for how financial services ought to be regulated?

Individual psychology is relevant at each of these levels. It directly affects the choices and actions that compound to generate a pattern of saving and borrowing. It affects how individuals respond to various features of a financial product, from its pricing to the transaction costs in acquiring it to its intertemporal consequences. It also gives us a different perspective on the channels by which financial services can affect behavior. All of these insights generate implications for design. Finally, since individual psychology generates deviations from the traditional economic model, it also provides different rationales and guidance for regulation, and not always in the direction of traditional consumer protection. Interestingly, by helping to elucidate specific psychological mechanisms, individual psychology undercuts some of the previous motivations for consumer protection.

INSTITUTIONAL FINANCIAL ACCESS FOR THE POOR

The Role of Financial Access

Financial services may provide an important pathway out of poverty. Such services facilitate savings to mitigate against shocks and promote asset development, and they facilitate borrowing to purchase durables or help weather tough times. In short, financial services allow individuals to smooth consumption and invest (for more on the financial instruments used by low-income Americans, see Barr 2004, this volume). Improvement of financial services, then, provides two key advantages. First, for individuals who already have access to these services, improvement would lower the costs they pay. For example, improved financial services may enable them to use a credit card rather than the more expensive payday lender. Second, individuals who have not had access to financial services would get the direct benefits of access, such as the ability to borrow to smooth shocks (such as health shocks).

Some Features of Financial Access

Our perspective highlights the importance of contextual nuance and consequently the emergence of circumstances in which benefits and costs emanate from the interaction between behavioral tendencies and contextual structure. We briefly consider some simple contextual features that are pertinent to financial access.

INSTITUTIONS SHAPE DEFAULTS It is well established that defaults can have a profound influence on the outcomes of individual choices. Data available on decisions ranging from retirement savings and portfolio choices to the decision to be a willing organ donor illustrate the substantial increase in market share of default options (Johnson and Goldstein 2003; Johnson et al. 1993). This is likely to prove of great importance for the design of financial services, which often shape default financial behaviors.

Consider, for example, two individuals with no access to credit cards: one has her paycheck directly deposited into a savings account, and the other does not. Whereas cash is not readily available to the first person, who needs to take active steps to withdraw it, cash is immediately available to the second, who must take active measures to save it. The greater tendency to spend cash in the wallet compared to funds deposited in the bank (Thaler 1999) suggests that the first, banked person will spend less on impulse and save more easily than the person who is unbanked. Holding risk- and savings-related propensities constant, the first person is likely to end up a more active and efficient saver than the second.

INSTITUTIONS SHAPE BEHAVIOR Many low-income families are in fact savers, whether or not they resort to banks (Berry 2004). Without the help of a financial institution, however, their savings are at greater risk (from theft, impulse spending, access by household members), will grow more slowly, and may not be readily available to support access to reasonably priced credit in times of need. Institutions provide safety and control. In this sense, institutional context may be even more critical for the poor than for the comfortable. In circumstances of dearth, temptation, distraction, and difficult management and control, those savers who are unbanked are likely to find it all the more difficult to succeed on the path to long-term prosperity.

In fact, a recent survey conducted by the American Payroll Association (2002) shows that “American employees are gaining confidence in direct deposit as a reliable method of payment that gives them greater control over their finances, and that employers are recognizing direct deposit as a low-cost employee benefit that can also save payroll processing time and money.” The employers of the poor, in contrast, often neither require nor propose electronic salary payments. Instead, they prefer not to offer direct deposit to hourly or non-exempt employees, temporary or seasonal employees, part-timers, union employees, and employees in remote locations—categories which often correlate with being low-paid. The most frequently stated reasons for not offering direct deposit to these employees

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include lack of processing time to meet standard industry (“Automatic Clearing House”) requirements, high turnover, and union contract restrictions. All these factors create a clearly missed opportunity to offer favorable defaults to needy individuals whose de facto default procedure for pocketing the money they have earned is to take a check, often after hours, to a place, often inconvenient, where it can be cashed for a hefty fee.

INSTITUTIONS PROVIDE IMPLICIT PLANNING As it turns out, a variety of institutions provide implicit planning, often in ways that address potential behavioral weaknesses. Credit card companies send customers timely reminders of due payments, and clients can elect to have their utility bills automatically charged, allowing them to avoid late fees if occasionally they do not get around to paying in time. By contrast, the low-income buyer who has no credit card, no automatic billing, and no Web-based reminders risks missed payments, (high) late fees, disconnected utilities (accompanied by high reconnection charges), and so on.

Interestingly, context can also be detrimental by providing debt too easily. Temporal discounting in general and present bias in particular can be exploited to make cash more attractive in the present than the future costs appear menacing. Whenever this happens, the increased availability of debt could especially lower the well-being of the poor, since overspending by the poor may entail subsequent cutbacks in far more essential consumption than overspending by the rich.

One fundamental lesson of such a behavioral analysis is a new appreciation for the impact and responsibilities of financial institutions. These should not simply be viewed from a financial cost-saving point of view but instead should be understood to affect the lives of people by easing their planning, facilitating their desired actions, and enabling their resistance to temptation. Such effects, furthermore, may have substantially different implications for those who are wealthier, who get professional help, and who, at the same time, can afford to err or be tempted than they do for the poor, who resort to fewer professionals and may pay dearly even for infrequent temptations or minor mistakes.

These considerations form part of a more general view of why financial institutions can be so important in the lives of the poor. Access to financial institutions allows people to improve their planning by keeping money out of temptation’s way. In some cases (such as direct deposit and automatic deductions), one may not even notice the moment the money “arrived” in the savings account or was invested in the long term. The recourse to financial institutions provides the opportunity to make infrequent, carefully considered financial accounting decisions that can prove resistant to intuitive error or to momentary mental accounting impulses. In this sense, improving financial institutions can have a disproportionate impact on the lives of the poor. Moving from a payday lender and check-casher to a bank with direct deposit and payroll deduction can have benefits that far exceed the transactional costs saved (for further discussion and more examples of savings instruments aligned with behavioral principles, see Tufano and Schneider, this volume).

SOME NON-INSTITUTIONAL ASPECTS OF THE FINANCIAL LIVES OF THE POOR

Aided by these insights, we aim to further understand the interactions of the poor with specific financial institutions. To begin, we discuss three stylized facts about the financial lives of the poor that are non-institutional but that we think are especially important to the behavioral perspective. These stylized facts are not necessarily psychological. (Two of them have very straightforward economic interpretations.) Rather, they are facts that may render the impact of the relevant psychology particularly interesting and consequential.

Lack of Financial Slack

Though it is hard to define precisely in an economic model, the notion of “economic slack” is central to the lives of the poor. We define slack as the ease with which one can cut back consumption to satisfy an unexpected need. Under this definition, the poor appear to have less economic slack than the rich. Whereas a rich person can often cut back on (by their own admission) more frivolous spending, a poor person faced with a financially demanding situation is forced to cut back on essential expenses. There are two ways to understand this mechanism. The first, more traditional vehicle is via diminishing returns: if a rich person and a poor person face equivalent shocks and cut back on consumption by the same amount, the rich person will be cutting back on lower marginal utility consumption. The second, more psychological vehicle concerns temptations: if the incidence of temptation spending is increasing in income, the rich will be cutting back on precisely those goods that are less valuable from the point of view of past or future selves.

This analysis abstracts from the role of savings. We could argue that the poor, exactly because they face a more volatile environment, would put aside enough buffer-stock savings to handle that excess volatility. This in turn would mean that the same size shock is less likely to result in a poor person running out of savings. While plausible, we ignore this factor in the following conceptualization because a large amount of data show that poorer families tend to have negligible liquid savings. The lack of buffer-stock savings is, we feel, one of the more interesting puzzles to understand in the financial lives of the poor; we return to this issue briefly later in the chapter.

A lack of financial slack is particularly consequential when we consider the type of expenditures the poor might be forced to cut back on. One common finding in the literature is that late payments, some resulting in phone and gas disconnections (and ensuing costly reconnections), are frequent in the lives of the poor. Kathryn Edin and Laura Lein (1997) estimate that 5 percent of annual income is spent on the costs of reconnection. Many financial services impose fees for late payments. This ranges from the expected (on credit card bills) to the unexpected (the penalty for a late payment imposed by rent-to-own stores of repossessing the

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item, thereby forcing a loss of all previously made payments). Landlords can impose late fees, and all sorts of bills, from utility to medical bills, usually have steep fees for late payments. The key observation about fees is that they are usually disproportionate. For example, a 5 percent late fee for a monthly bill is effectively a 100 percent APR on a loan. In other words, if the poor cut back by skipping a bill payment, they are effectively borrowing at very high rates.

High-interest borrowing, however, may be the *least* costly consequence of late payments. In fact, what makes the lack of financial slack particularly onerous are the indirect but linked consequences. Consider a household that has had its phone disconnected. The members of this household now face several difficult consequences. First, they need to make a large lump-sum payment to get the phone reconnected. Acquiring this large lump sum poses extra difficulties to an already stretched budget. Second, and more importantly, the lack of a phone could have other consequences for their lives. For example, if they happen to be unemployed (not unlikely for a household that was unable to pay its phone bills), they are now far less effective job-searchers. Even if they are employed, the employer may not be able to reach the home in case shifts change and they are needed at work, making them a less valuable employee. In other words, one action—paying the phone bill late—can have dynamic consequences, amplifying the initial cost and further depressing income. Low-income households struggling with the chronic lack of slack that comes with being low-income are thus always at risk of becoming ever more destitute.

There are profound consequences to being on the edge of further destitution. The first is that any failures to plan well can have quite severe consequences. A rich person who fails to plan, or who plans poorly, may simply cut back on frivolous expenditures. A poorer individual may face a domino effect of consequences that can amplify an otherwise small misplanning step. The lack of slack makes the poor walk a planning tightrope: they must in effect be super-planners, in less conducive and less helpful surroundings, lest they slip deeper into poverty.

A second consequence is empirically easier to identify. The individual who is facing the prospect of having his phone shut off, paying a hefty late fee to have it turned on again, and dealing with the assorted difficulties that arise from a lack of phone service may well be willing to borrow at high rates to keep this sequence of events from happening—or to get the phone reconnected if it has already happened. In fact, not only are low-income individuals sometimes willing to borrow at very high rates, it may be rational for them to do so. The desire to borrow at high rates is interesting: it can easily be confused with myopia, but in some contexts it can constitute a perfectly rational, even if undesirable, response to financial difficulty. This is also relevant to payday loans, an issue we return to later in the chapter.

Small to Big Transformations

One of the fundamental services that financial institutions provide is to allow for the gradual transformation of small amounts of cash, which are easier to come by, into larger lump sums, which can be hard to attain. As Stuart Rutherford (1999)

explains, individuals often need to transform small cash amounts into “usably large” amounts. Such transformation is particularly needed by the poor because of the nature of their cash inflows and needs. The urban poor typically deal with cash inflows in relatively small amounts, receiving weekly or biweekly paychecks. Net of the “necessary” rent, utility, and other bills, they are typically left with only small amounts of cash on hand. Many of the durables they may wish to purchase—washing machines, cars, televisions—require more than what they have left at any point in time. Consequently, the poor need to transform small amounts into usably large sums.

According to traditional economic theory, such transformation is straightforward: individuals simply save the cash they come by until they have accumulated enough. Alternatively, if credit is available, individuals borrow against future income streams to finance the transformation. Whether debt or savings are used depends on the flow value of the durable to be purchased, relative to the interest rate on debt. Of course, because the poor often do not have access to credit, they would need to save their way up.

The psychology of planning and self-control suggests that such savings may be more difficult than traditional theory is prone to assume. An individual saving to buy a durable over a long period of time would have large amounts of cash continuously accessible. And accessible cash can be extremely tempting and thus easy to spend on things that are mostly valued at the moment of spending. As such, temporal inconsistency and self-control problems make savings a weak vehicle on which to rely for small-to-big cash transformations. These factors turn savings accounts into highly leaky budgets.

Many institutions that are popular among the poor and that may otherwise look like less than perfectly rational solutions can be understood as alternative methods for making small-to-big transformation more feasible in a world of imperfect planning and limited control. First, consider the purchase of lottery tickets, which, as many have noted, the poor are especially likely to engage in (Blalock, Just, and Simon 2007; Kearny 2005). What is particularly interesting is the type of lottery ticket the poor typically buy—tickets with maximum payoffs of \$200 to \$500. If the poor are “buying dreams” through lottery tickets, these are quite modest dreams. Such small maximum payoffs are more consistent with lottery tickets as a vehicle for small-to-big conversion. An individual who struggles to save up to buy a \$400 item, for example, would find it easy to buy a lottery ticket periodically. The recurring ticket costs are the “deposits,” which eventually lead to a win and the ability to buy the expensive item with the winnings. Notice the dominance of this method of “saving” over the typical savings account. There is no money accumulating and providing recurring temptation to dip into it to satisfy one’s own needs or those of family and friends. The individual loses his outlay until he (effectively) wins the desired item, the lottery ticket essentially serving as a commitment device, albeit an expensive one.

Notice that this explanation is very similar to a self-control explanation for the prevalence of ROSCAs in developing countries (Basu 2008). In a typical ROSCA, each participant contributes a fixed amount each week or month, with one participant taking the entire pot. The winner is determined by lottery or by bidding,

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with each participant eligible to win once throughout the ROSCA. This is much like a lottery ticket except that one is guaranteed to win once in a given number of times. Both these institutions reinforce the view that a bigger lump of money is worth more to the poor than many small amounts.

Perhaps most telling is the prevalence of layaway plans. In a typical layaway program, an individual picks a particular durable he would like—for example, a washing machine. He then opens a layaway account, to which he deposits money on a payment schedule that depends on the particular store. Once the client has accumulated enough, he is given the durable. This is quite similar to the SEED commitment savings product offered to clients of a Philippine bank (Ashraf, Karlan, and Yin 2006). Some stores offer a price lock-in feature so that prospective buyers are guaranteed the initial posted price, but many others do not. Individuals who do not save enough to buy the item often forfeit their cash. It appears that the primary benefit of the layaway account is its illiquidity.

The popularity of layaways emphasizes the difficulty that simple myopia models face in explaining the behavior of the poor. In resorting to such arrangements, the poor are showing remarkable farsightedness. They are opting to save, without interest, in order to purchase a durable good, which they do not even get to enjoy as they save up to buy it. As with other examples in this section, there is apparently a willingness among the poor to pay large costs to transform small amounts of cash into larger sums.

Of course, the need to make such transformations is not unique to the poor. And surely some of the phenomena we discuss here may also appear among the middle class. We conjecture, however, that in the United States they are much more common among the poor. With access to a variety of institutions intended to facilitate such transformations—from store credit for durable purchases to automatic savings deductions—the well-off are less likely to resort to more exotic, and costly, institutions.

No Buffer-Stock Savings Despite High Volatility

One of the fundamental observations of behavioral research is the exceedingly “local” nature of everyday decisions. More global perspectives and considerations about the long term are often discounted in favor of issues salient at the moment. Thus, even when long-term decisions are made, they tend to be influenced by minor contextual nuances at the moment of decision that often have little relevance for the long run. Furthermore, long-term forecasts and predictions often fail to take into account the relevance and impact of foreseeable future developments. Along with mental accounting, this tendency typically yields consumption patterns that are overly dependent on current income.

The narrow focusing that emerges has clear implications for planning. Great energy can be spent on decisions of the moment—where to go for dinner or what brand to buy—with relatively little attention allocated to arguably more important decisions that are less immediate, such as how to invest one’s retirement savings,

or whether to save at all. And the failure to plan can be exacerbated when circumstances are highly uncertain and the future less clear, as is often the case in the lives of the poor. With this month's rent proving of great concern, saving for the children's education or for retirement is naturally left until some better point in the future that may arrive. The tendency to leave financial planning for a more appropriate moment is particularly common among low-income individuals, whose finances afford little slack with which to do much planning. An outcome of this highly volatile struggle with the moment is a lack of buffer-stock savings even, or especially, among these people who, in some ways, need it most.

FROM A BEHAVIORAL PERSPECTIVE

The Unbanked

A little over 10 percent of American households are unbanked and have to rely on alternative financial institutions, such as check-cashers, to cash or process their checks (see also Scholz and Sheshadri, this volume). These alternative financial institutions usually charge high fees, and the households that use them typically have no recourse to formal borrowing instruments. Instead, they may resort to high-interest loans, borrow from friends and relatives to make ends meet or to cover emergency spending, or, in the worst case, simply live without access to credit even during tough times.

This pricey nonparticipation in banking could be the result of a rational choice based on cost-benefit analysis. If households have little to save, then the benefits of being banked may simply be outweighed by the financial costs of maintaining an account, such as the minimum balance fees required by most banks. Alternatively, the decision to remain unbanked could be due to sheer hassle; for example, since few banks have branches in disadvantaged neighborhoods, too much travel time may be involved in using a bank account. Low participation rates may also reflect various cultural factors. Some have attributed to the poor a persistent culture of distrust of financial institutions, or they argue that the poor have not internalized a culture of savings and simply prefer living one day at a time, doing little planning for the future. What is common to these arguments is a tendency to explain a "big" problem (millions of unbanked households) through appeal to "big" factors, such as the dearth of attractive banking options or a deep mistrust combined with a culture of living from day to day.

In contrast, a behavioral perspective suggests that even in the context of big problems, small factors may sometimes play a decisive role. From a normative perspective, defaults are seen as largely irrelevant and easily alterable, but it turns out that, descriptively speaking, the status quo, bolstered by loss aversion, indecision, procrastination, or even a simple lack of attention, has a force of its own (Samuelson and Zeckhauser 1988). Thus, the mere perception that banks are mostly intended for people of greater wealth may reinforce the impression that

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banking is not meant for, and ought not appeal to, those of lesser means. Indeed, decisions that involve being subjected to scrutiny, interviews, requests, and applications are all likely to have a nontrivial affective component. And those who are most vulnerable are likely to feel the weight of such sentiments even more than the rest. As a number of ethnographic studies suggest (DeParle 2004; LeBlanc 2004), the poor often are painfully aware of society's norms and of their own inability to abide by them. A single mother who, without access to child care, needs to present herself at a bank in the company of her small children may be aware of the fact that, ideally, children are not brought into a bank. Along with a severely limited understanding of financial instruments, a poor client may feel reluctance, even shame, and a general sense that she can never be a valued bank customer.

Of course, that perception may not be terribly distant from the truth. There is, after all, a built-in asymmetry in banks' incentives between credit and savings for the poor and the rich. Regarding poorer clients, banks have a greater incentive to promote debt (which can be lucrative, delayed, and compounded) rather than savings (which are bound to remain modest), as opposed to the treatment of the wealthy, whose debt is likely to be repaid with little penalty and whose savings promise to be large and valuable.

In fact, when it comes to bank accounts, the default option is often different for the poor than it is for those who are better off. Consider, for example, the simple option of direct deposit. As mentioned earlier, the employers of the poor often do not make electronic salary payments, giving their employees one less important reason to pursue the default option of maintaining a checking account. Given the well-established power of default options, even among the comfortable, it seems safe to assume that such defaults would have at least as substantial an impact on the poor, whose options are inherently inferior and who may be less informed about available alternatives.

From a public-sector perspective, the government could play an important role by further encouraging the automatic transfer of tax (including the Earned Income Tax Credit) refunds to bank accounts. This would also provide a way to facilitate the opening of bank accounts. Some evidence from the First Account program in Chicago provides cautious optimism on this front. For many years, the Center for Economic Progress has been providing free tax preparation services for those eligible for EITC refund. Over the last couple of years, the center has been trying to combine this tax preparation service with the First Account program. Specifically, the center has been singling out individuals who are eligible for a refund but lack a bank account. These individuals are informed that they could get their refund much sooner if they were to open a bank account to which their refund would be directly deposited. Data obtained from the bank handling the First Account program suggest that those individuals who opened an account in this "quick refund carrot" context were not less likely to still be using their account compared with those individuals (more positively self-selected) who opened an account following a financial education workshop (further, related findings are reported later in the chapter).

In light of this discussion, it is clear that a behavioral view would predict positive effects on saving from the opening of bank accounts. Such accounts should generate a “good” savings default to replace the “bad” money-on-hand situation. In addition, the transfer of cash from, say, checking to savings could trigger a propensity to save more. In fact, bank accounts could be designed specifically to conform to people’s mental accounting schemes (Thaler 1999). People might choose to label one account their housing account, another their education account, and yet another their car account. The labeling of accounts, while nonsensical from the perspective of standard fungibility assumptions, could provide a salient reminder and help with the allocation of specific funds. Such labeling is reminiscent of other, already existing schemes such as education funds, Christmas clubs, and even layaways, and indirect evidence suggests that it may have real consequences. For example, increased child allowance payments in Sweden were found to have disproportionate effects on how the recipients spent on children (discussed in Thaler 1990).

It is fair to note at this juncture that, despite preliminary empirical support, these proposals would need to be tentatively implemented and seriously evaluated before their full consequences could be fully understood. Behavioral outcomes, after all, tend to be multifaceted and complex. Thus, for example, although the appropriate default arrangements may indeed increase savings, it is possible that people with newly automated savings might only come to feel more empowered to take on greater debts, presumably to be covered by the new savings. The dynamic and malleable nature of behavior often necessitates a pilot testing and evaluation prior to full implementation before the construal and ultimate impact of new instruments can be fully understood.

To summarize thus far, being unbanked typically means that whatever little cash is available is readily available. The storage mechanisms that the poor have access to are highly fungible. Keeping money in cash rather than in the bank increases the ability and temptation to spend immediately, making it difficult to achieve any asset accumulation. Furthermore, even among the non-poor, small amounts, as compared to large amounts, are more likely to be spent than saved, and since the poor typically deal with small amounts, savings is thereby further discouraged. In contrast with classical analyses, which impute substantial planning and control, numerous studies of middle-class savings suggest that saving works best as a default (Benartzi and Thaler 2004; Madrian and Shea 2001). Thus, 401(k)s seem to be effective because the cash is automatically deposited into savings. Yet the poor typically have little recourse to “good” savings defaults. And with good defaults less available to those without bank accounts, the poor have to revert to alternative and typically expensive commitment schemes to try to save toward big purchases. We can view participation in programs such as rent-to-own or layaway schemes as such alternative commitment devices, and some have argued that the purchase of actuarially unattractive lottery tickets may serve as a saving mechanism because they occasionally leave purchasers in possession of larger amounts than they would be able to save otherwise.

Payday Loans

Payday loans are a commonly used financial vehicle among lower- and middle-income households (for an analysis, see Skiba and Tobacman 2007; Stegman 2007). The typical payday loan involves receiving an advance on one's paycheck for a week or two, but this advance comes at a steep price, an effective interest rate that can be more than 7,000 percent APR. Such loans are highly contentious from a policy point of view and are often implicitly used to point out the myopia of the poor. We make two basic observations about this widespread institution.

First, as noted earlier, the highly credit-constrained sometimes find themselves at the edge of poverty. In these circumstances, there may be no myopia in taking out a payday loan. Instead, the local cost-benefit calculus, however painful, may be sound. Lack of cash at crucial times can result in disastrous and mounting consequences—such as having one's telephone service cut off. In these circumstances, even (especially!) the farsighted would take out a loan at high interest rates. The "error" happened earlier, through a sequence of actions that left the individual without a buffer stock to deal with shocks. In this view, therefore, there will be circumstances in which the question is not why the poor take out payday loans but why they find themselves in situations where they need them.

This perspective poses an interesting challenge to policymakers, who should want borrowers to have access to loans *at the time of borrowing*. Suppose payday loans are taken by people in severe need, and that the need they face is real, and that failure to meet it will have even more severe consequences. Put in this light, payday loans may be a lesser evil compared with policies that use interest-rate caps (or other vehicles) to drive out payday lenders, which could make the poor *worse off*.¹ Interestingly, unless interest-rate caps are accompanied by policies that solve the fundamental lack of a buffer stock among the poor, such principled arguments against payday loans are, once again, predicated, even if only implicitly, on the expectation that the poor ought to act more "rationally," and they could render the poor only more vulnerable to the various shocks they face. Note that a counter to this argument would be that perhaps the unavailability of payday loans would somehow make those who resort to them into better planners. While this is a priori possible, it seems unlikely, and it should certainly at least not be straightforwardly assumed. If, despite facing huge consequences, individuals still fail to plan, why would the addition of yet another cost have the desired effect?

To further understand the relative lack of reluctance to resort to such loans, we should ask: in what sense are payday loans so very costly? What we refer to here is not the question of whether such fees reflect marginal costs or monopoly profits. Instead, we are asking: what is the psychologically accurate way to view such costs? Do they really reflect an individual making a net present value calculation at such high (more than 7,000 percent APR) rates? Or is the behaviorally most compelling perspective one that suggests more bearable debts? As much research on mental accounting and related behavioral proclivities has shown, magnitudes are often evaluated in a narrow context. People may be willing to travel thirty minutes to save \$10 on a \$30 purchase, but not to save \$20 on a \$500 purchase. Just as we

should not impute a low value of time (less than \$20 per hour) from the first behavior or a high value of time (more than \$40 per hour) from the second, we should not necessarily impute discount rates to the intertemporal trade-offs implicit in specific payday loans.

Consider someone who is thinking about paying \$20 to get a one-week advance on his \$200 paycheck. Such a transaction could be psychologically coded in nominal levels: \$20 for a one-week, highly beneficial advance. Viewed in these terms, it may not seem like such a bad transaction. (After all, when the wealthy individual pays \$2 to withdraw \$100 from an ATM machine out of town, she is really stating a willingness to pay \$2, not a general proneness to pay 2 percent to withdraw her own cash.) Of course, when put into annual rates, this payday loan implies an APR of over 14,000 percent! The disjunction between the absolute amount and its APR is the result of compounding. But, of course, the individual is not actually making this decision over a year: he typically makes this decision a few times a year, and each for a short period, so the actual compounding is more of a technical than an experienced cost. In short, while the pricing of payday loans may raise economic as well as ethical questions about competition (supply-side issues), psychology can shed light on why individuals would be willing to pay such high rates, without necessarily suggesting immense if not stunning discount rates. Especially for short-horizon loans, computed APRs may not appropriately capture how individuals naturally frame the intertemporal trade-off.

Check-Cashing

Like many other services provided to the poor, check-cashing is a costly option that provides a service the well-to-do get for less. In a survey of households living in low- and moderate-income census tracts in Chicago, Los Angeles, and Washington, D.C., Christopher Berry (2004) found that people often have a fairly accurate understanding of the relative costs of products provided by banks and check-cashers. Nonetheless, for many individuals who would be unable to adhere to banks' minimum requirements, costly check-cashing arrangements may prove to be the lower-cost option.

The willingness to engage in costly arrangements may be further facilitated by some of the behavioral proclivities reviewed here. Loss aversion is likely to increase the attractiveness even of fairly costly ways to delay or altogether avoid permanent losses. And the high costs of financial services may be aggregated with the perceived gains to which they would contribute in the short run, thus leading to an accounting that at least locally may prove more attractive.

While alternatives to costly check-cashing often exist, they may be less familiar, less common, and less readily available, especially to low-income individuals. A behavioral analysis suggests that it is not that the mere existence of good alternatives makes the greatest difference, but that, in addition, what is often required is the design of effective channels, perhaps combined with directed marketing. For example, in a recent intervention intended to increase elderly

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Americans' enrollment in Medicare Part D prescription drug coverage, Jeffrey Kling and his colleagues (2008) documented significantly higher enrollment rates, with an average of at least \$230 savings, among participants who were mailed personalized information regarding their current plan and costs, as compared to a control group who were provided with information regarding the official website where comparable information could be obtained.

For another illustration, credit unions and check-cashers in New York have pioneered the use of the point-of-banking machine to facilitate deposits for credit union members at check-cashing stores, providing immediate liquidity of funds and greater convenience for consumers (Stuhldreher and Tescher 2005). Although such arrangements can prove highly beneficial, other partnerships between banks and nonbanks to facilitate payday loans have at times had negative consequences for consumers. Taking the implications of behavioral research seriously, regulators need to focus on promoting partnerships between banks and nonbanks that provide a more responsive and beneficial range of services to unbanked and under-banked consumers.

AN ILLUSTRATION OF A CHANNEL FACTOR

In the attempt to increase take-up of bank accounts among the poor, the behavioral discussion suggests that more attention should be devoted to making the task of "meeting with the bank" an easier and more appealing one and, if possible, perhaps one that does not feel like a "decision" at all. This suggests a variety of small, low-cost interventions that could have first-order effects on the take-up of bank accounts among the poor.

An illustration of the potential impact of small channel factors comes from a brief study of the First Account program implemented by the Center for Economic Progress in the Chicago area. As described earlier, the goal of this program was to entice an unbanked, lower-income population that was mostly dependent on check-cashers to open low-fee accounts at a local bank. To evaluate this program, we first conducted, in collaboration with Marianne Bertrand, a phone survey of a random sample of individuals who had participated in the financial education workshops organized by the Center for Economic Progress. In the workshops, participants took part in a lecture and discussion covering the mechanics of opening a bank account, basic banking products, personal budgeting, and goal-setting. They were also introduced to the First Account program and told that, if interested, they could obtain a referral letter to take to the bank to start the process of opening a First Account. In the survey, we hoped to glean a better understanding of why some participants decided to open First Accounts and others did not.

A promising illustration of small channel factors emerged from our analysis. First, while roughly 50 percent of respondents reported having opened a First Account following the workshop, close to 90 percent reported *thinking* they would do so. We asked those who had planned to open an account but had not done so why they had not. Among those who responded, a large fraction reported some form of time mismanage-

ment as the main cause (missing the deadline, too busy to complete the take-up process, and so on). Taken at face value, these responses suggest that take-up could have been higher had small hurdles to take-up been removed.

More direct evidence came from comparing take-up and usage of the First Accounts across two types of workshops. As mentioned, in the standard workshop participants interested in opening an account received a referral letter they could take to the bank to complete the take-up process. In an experimental subset of workshops, we gave participants interested in opening an account the opportunity to complete most of the paperwork at the workshop location with an available bank representative before heading to the bank to complete the process. From an economic perspective, the mere presence of a bank representative should have little effect on take-up, as it does not alter the cost-benefit analysis at the core of the First Account decision. From a behavioral perspective, however, this small change in implementation could have a large effect on take-up, as it would increase participants' perceived dedication to the program and reduces the likelihood that they would be derailed by procrastination or forget the initial intention.

In fact, we found a large positive effect on take-up associated with the presence of a bank representative on site. Of course, a higher take-up may not have the intended effects if people who open an account end up not using it (or rapidly closing it). As it turns out, we found that having the bank representative at the workshop was associated with a higher likelihood of having an account open at the time of the survey. In addition, a bank representative on site was positively correlated with usage of the complementary services offered by the bank, such as electronic fund transfer, direct deposits, and ATM cards. Contrary to the notion that the unbanked are plagued by "cultural norms" or a general distrust of banks, those who attended a workshop with a bank representative on site were more likely to open an account and to use it.

BEHAVIORALLY INFORMED REGULATION

The behavioral perspective has regulatory consequences, which must be handled with care for three reasons. First, the psychology underlying specific phenomena can be more involved than lay intuition allows. For example, suppose payday loans are in fact the result of individuals "overborrowing." If excess expenditures—spending "too much" on discretionary items (by the person's own admission)—occur throughout the week, then the payday loan is merely a symptom, not the source of the problem. In such circumstances, regulation of payday loans, if it has no impact on excess expenditures early in the week, could make the problem worse. When payday loans are used to deal with rent or phone bills, regulating them may generate problems of late fees or eviction.

Second, as we argue at greater length elsewhere (Barr, Mullainathan, and Shafir 2008a, 2008b), this thinking needs to be embedded in the logic of markets, through a framework that takes into account firm incentives and responses to behaviorally motivated regulation. Outcomes are an equilibrium interaction between individuals'

psychology and firms' responses to that psychology. Such interactions may or may not produce outcomes that are socially optimal, and they may even produce real harms. Depending on the bias and the context, the biases of individuals can either help or hurt the firms with which they interact. Hence, the interests of firms and of publicly minded regulators are sometimes aligned and other times are not. Consider, for example, a consumer who does not understand the profound effects of the compounding of interest and is thus led both to undersave and to overborrow. In one context—savings—investment firms have an incentive to correct the bias, since they can generate fees from the investment. In another context—borrowing—lenders have an incentive to exaggerate that bias, since they can generate revenues from the loan (we abstract here from fee structures and collection costs). A notable example of such positive interactions is the finding that firms are happy to help boost participation in 401(k) retirement plans. The Truth in Lending Act (TILA) of 1968, in contrast, attempts to force disclosure of hidden and complicated prices of credit in contexts where lenders have strong incentives to avoid such thorough disclosure.

Finally, regulation must recognize that firms “move last”: they can respond to regulation by subtly altering the context (see Barr, Mullainathan, and Shafir 2008a, 2008b). For example, consider the power of defaults. In one context—401(k) choices—the setting of defaults appears to have large effects, compounded by the compliance of firms, if not their active participation. In other contexts—for example, car rentals—firms have greatly facilitated getting rid of mandated “defaults,” to the point where placing one’s initials in specially provided boxes on the form indicates the waiver of “defaults” and could be argued to have become the new default. This reinforces an earlier observation: When firms have incentives to take advantage of or even exacerbate a bias, they will explore ways to circumvent regulations intended to avoid the problem. And regulators, of course, do not have sole access to behavioral insight. In fact, the firm, often in a position to deal directly with customers and operating after regulations have been set, is well situated to circumvent regulatory intent.

CONCLUDING COMMENTS ON THE DESIGN AND REGULATION OF FINANCIAL SERVICES

Assuming a context where no further redistribution is about to take place, our perspective suggests some potential alterations to the way financial institutions for the poor are designed. These institutions could include for-profit banks attempting to gain footholds in a lucrative market, nonprofits providing financial and other services, and government service providers. We think several principles are relevant to the design of financial access. What is particularly important about these principles is that they often stand in contrast to classical economic assumptions, and to common intuition.

One such principle, underappreciated by program designers, is that information provided does not necessarily constitute knowledge attained. Individuals often do not fully process data put before them. Either they do not attend to it or they do not fully understand it. This, combined with the curse of knowledge—the tendency of

those who know something to overestimate the probability that others know it—can result in underinvestment in outreach programs that serve to educate individuals about financial services and costs.

Another principle concerns the relevance of people's construal processes. As discussed at the outset, individuals' internal representations of stimuli are, by necessity, interpretations of the "objective" reality. As a consequence, how information is framed systematically alters how it is construed. In an earlier paper (Bertrand, Mullainathan, and Shafir 2006), we focused on the role that marketing plays in the construal of contexts in which decisionmakers find themselves. On the one hand, marketing has been used profusely and effectively by for-profit firms and contributed, at least on occasion, to making the lives of the poor even poorer. Aggressive marketing campaigns have targeted the poor on products ranging from fast food, cigarettes, and alcohol to predatory mortgages, high-interest credit cards, payday loans, rent-to-own plans, and various other fringe-banking schemes (see, for example, Caskey 1996; Mendel 2005). On the other hand, significantly less has been done by marketing firms to promote more positive options aggressively, such as healthful diets, various not-for-profit services, union banks, prime-rate lenders, and so on.

Existence need not imply availability. Whereas most programs focus on the options that are available, a large behavioral literature emphasizes the importance of channel factors and small costs. Specifically, take-up of a program can be importantly influenced by the perceived nature of these small costs. Thus, an otherwise beneficial program with small "channel blockages" may de facto be a program that is not "available." Related to this principle is another touched on earlier: the existence of more options may not entail their availability. As options proliferate in what becomes a difficult choice, people may avail themselves of those options less rather than more.

This, in fact, is an area where recent trends have moved in a direction opposite to that suggested by behavioral analyses. In contrast with the economic truism that having more options is always good, behavioral research suggests that a greater number of alternatives can increase decisional conflict and overload decisionmakers, leading to deferral, procrastination, or inferior choices (see, for example, Bertrand, Mullainathan, and Shafir 2006; Kling et al. 2008 for further discussion). Consider, for example, the case of shopping for mortgages discussed earlier. To the extent that decisions are multi-attribute and complex and need to be simplified, the required monthly payment is probably the best attribute to rely on, since the affordability of payments is a good way to assess risk of foreclosure. If a client has to pick a simplifying heuristic in a sea of complicated alternatives, this would be it. Of course, apart from the ability to pay on a month-by-month basis, monthly payment conveys little information about the price of the loan. Consequently, shopping based on monthly payment might have worked adequately when home loans (say, thirty-year, fully amortizing) were roughly comparable products. But as the number and type of loans available quickly increases, sellers of loans can take advantage of this simplifying heuristic to extract substantially larger profits from borrowers (Willis 2006).

Related to the notion of channel factors is another important issue, that of the distinction between intention and action. In particular, problems of self-control, poor planning, forgetfulness, distraction, and habit can often intercede to produce observable actions that do not match underlying intentions. This tension may help produce a variety of “counterintuitive” venues intended to help people commit to their “better” intentions, such as a demand for financial services that provide illiquidity as a form of “commitment device.” As in other contexts, such questionable venues, with their mixed benefits, are more likely to arise in the context of poverty, where superior institutional arrangements are often less immediately available. In addition, interventions that focus heavily on altering intentions, such as financial planning or education, may prove unsuccessful whenever context leads to actions that are in tension with these newly formed, even if genuine, intentions. Context-sensitive behavior, in other words, may run counter to people’s true intentions. As a result, revealed preference fails.

A fundamental implication emanates from the present perspective that has direct consequences for issues of regulation and design: whereas the classical perspective assumes that people are rational and doing as well as should be expected, the “culture of poverty” perspective is motivated by the perception that people need to be changed. The central gist of the behavioral perspective is that the poor are neither irrational nor in need of change (not any more, that is, than the rest of humanity). Instead, it is the context in which people function—ranging from financial institutions, benefits programs, and the design of default structures to the availability of child care and transportation and the complexity of application forms—that merits careful attention and constructive work. Such a perspective is likely both to enrich and to complicate our views of the role of institutions and of regulation. As long as these are founded on a better understanding of decision-makers and generate novel policies intended to help them, it clearly seems worth trying.

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NOTE

1. Of course, if one believes that payday lenders are local monopolists, interest-rate caps could have other positive benefits. We are focusing here on the reduction in payday lending that would accompany caps in a competitive situation.

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