RESEARCH BRIEFS

The Effects of Financial Education in the Workplace

The basics of personal financial management are simple—budget, save, and pay bills on time—yet many Americans continue to struggle with unmanageable debt and inadequate savings, particularly for retirement. Financial education is often suggested as a solution for improving financial decision making and programs have been created to target a variety of populations, including workplace programs for employees. But what are the benefits of workplace financial education and how effective are these programs?

Based on the results of a three year workplace financial education pilot program that began in 2006, Kelly Edmiston, Mary Gillet-Fisher and Molly McGrath find evidence of positive changes in personal financial behaviors. The program included both group education and one-on-one counseling components and the findings include evidence of increases in the usage of budgeting and paying off credit card balances every month and reductions in late bill payment. In addition, the researchers find that workplace-related financial outcomes also improved, such as decreased requests for 401(k) loans and pay advances, increased use of flexible spending accounts, and increased 401(k) participation and contributions. Employers provided anecdotal evidence that program participants exhibited better attitudes, higher levels of engagement, and less absenteeism, and all of the companies that participated in the pilot continue to offer the program today.

These findings demonstrate the effectiveness of a carefully designed workplace financial education program, suggesting that such efforts can be an effective means for influencing financial behaviors. In particular, the authors stress the importance of the one-on-one component of the financial education, saying it "is integral to [the program's] success."

Edmiston, Kelly, Mary Gillet-Fisher, and Molly McGrath. (2009). Weighing the Effects of Financial Education in the Workplace. Federal Reserve Bank of Kansas City Research Working Papers, RWP 09-01.

Payday Lending and Neighborhood Crime

It's widely recognized that "fringe" or alternative financial services, such as pawn shops, check cashers, and payday lenders, are concentrated in lower-income, urban neighborhoods. This pattern of geographic targeting is cause for concern as users of fringe financial services pay high fees and often fall into the "debt trap" of taking out a new loan in order to pay down an existing one. Thus, the lure of quick cash can often saddle the most financially vulnerable households with unmanageable debt. We know predatory lending imposes a cost at the individual level, but can it also have an effect at the neighborhood level?

Charis Kubrin, Gregory D. Squires, and Steven M. Graves find that a concentration of payday lending leads to higher crime rates, even after controlling for a range of factors traditionally associated with neighborhood crime, such as poverty, unemployment, race and educational attainment, as well as the crime rate from prior years. The researchers observe the number of licensed payday lenders and crime rates at the census tract level for the city of Seattle, WA. Using a variety of research models, they find that a concentration of payday lending appears to have a significant effect on the incidence of violent crime in a neighborhood.

These findings suggest that payday lending inflicts broader community costs on all neighborhood residents, whether or not they take out payday loans. The authors argue for greater access to responsible small dollar loan products and policy efforts, such as rate caps at 36 percent, to curb the practices of payday lenders.

Kubrin, Charis, Gregory D. Squires and Steven M. Graves. (2009). Does Fringe Banking Exacerbate Neighborhood Crime Rates? Social Disorganization and the Ecology of Payday Lending. Working Paper.

Loan Modifications and Redefault Risk

As the foreclosure crisis continues to impact communities across the country, various efforts have been made to provide direct aid to homeowners. Many borrowers have been seeking loan modifications in efforts to remain in their homes. However, an alarming proportion of modified loans fall back into delinquency. Why are some loan modifications successful, while others result in redefault?

Roberto Quercia, Lei Ding, and Janneke Ratcliffe examine a large sample of recently modified nonprime loans and find that the type of modification matters when trying to prevent redefault. Specifically, the study finds that the most important factor for making a loan modification more sustainable in the short run is that mortgage payments are reduced enough to become affordable by the borrower. These reductions typically occur through an extension of the loan term, reduction in the interest rate or principal forgiveness. However, most loan modifications add the delinquent payment to the unpaid principal, increasing the amount of debt and often resulting in higher monthly payments, which can lead to redefault. The authors suggest that among the different types of modifications, the principal forgiveness modification has the lowest redefault rate. They also find that the timing of the loan modification matters—early intervention works best as it is associated with lower redefault risks.

These findings suggest that loan modifications can vary dramatically in practice and lead to very different outcomes for borrowers. Efforts to promote sustainable and affordable modifications should take these structural differences into account and focus on increasing mortgage affordability.

Quercia, Roberto, Lei Ding, and Janneke Ratcliffe. (2009). Loan Modifications and Redefault Risk: An Examination of Short-term Impacts. Working Paper, Center for Community Capital.

Tax Education and the EITC

The earned income tax credit (EITC) is a cash transfer program designed to increase labor supply and earnings among low-income working households. While many have heard about the EITC, few eligible filers understand the marginal incentive structure (EITC amounts increase, plateau, and then phase out as earnings increase). As a result, filers may not understand how additional work activities affect their credit amount. But could basic tax education and guidance have an effect on eligible filers' labor supply decisions?

To answer this question, Raj Chetty and Emmanuel Saez worked with H&R Block offices to provide simple information about the EITC to eligible tax filers. Half of the clients were randomly selected to receive a brief explanation from their tax professional on how the EITC works, including tailored advice on the implications of working more, given the individual's location on the EITC earnings schedule. The researchers found that tax professionals gave different types of guidance, resulting in different levels of client earnings. Tax professionals that tended to have clients with relatively higher incomes induced eligible filers to select an earnings level closer to the peak of the EITC schedule—they increased their EITC amounts and were less likely to have very low incomes. In contrast, the other group of tax professionals gave advice that did not lead to significant changes in EITC amounts—the authors speculate that this group encouraged clients to aim for a higher income level rather than maximizing EITC amounts.

This study suggests that information provision can lead to real labor supply responses and that the impacts of tax policies depend on the way in which individuals are taught about the tax system.

Chetty, Raj and Emmanuel Saez. (2009). Teaching the Tax Code: Earnings Responses to an Experiment with EITC Recipients. NBER Working Paper Series, Working Paper 14836.