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Choice and Scarcity: A Systematic and Simultaneous Approach

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EXECUTIVE SUMMARY

US welfare policy fails to alleviate poverty because it doesn't consider the role institutions play in preventing financial instability. New research suggests that policy solutions should address multiple simultaneous problems through holistic approaches that focus on alleviating systematic and simultaneous factors that individuals face.

Current welfare policy can be viewed as two main theoretical frameworks: (1) the *resource limited* approach, which suggests poverty is a matter of income alone and (2) the *agent heterogeneity* approach, which assumes that poverty is a failure of individual. Both frameworks fail to acknowledge all of the necessary considerations needed for low-income individuals to reach financial stability over time. These frameworks seek to fill a gap with income rather than treat underlying systematic and simultaneous problems.

Individuals who are facing a self-reinforcing system of perverse intuitions need to have a holistic approach to escape persistent poverty. A holistic approach is an approach that considers both the systematic and simultaneous problems associated with poverty. It does this by addressing the underlying institutions of poverty, including the effects of bad neighborhoods and any present-oriented bias.

This paper argues that the income approach should be replaced with an asset approach that focuses on institutional changes that allow individuals to escape poverty in the long-run. Focusing on assets instead of income is important because as soon as someone has enough income to no longer qualify for poverty programs they are at risk to financial shocks, like unexpected medical bills.

Community-based financial education programs are viewed as examples that address poverty in a holistic manner. The institutions of these programs promote asset accumulation and extend time horizons in the decision making of individuals in poverty who deal with the present-oriented bias of financial stress, and ultimately help mitigate poverty in a sustaining way.

I. INTRODUCTION

Current US welfare policy reflects a concept of poverty alleviation that treats poverty as a temporary problem without taking account of the role institutions play in either perpetuating or preventing financial instability. This means welfare programs have focused too much on income assistance and not enough on increasing the agency of those who the programs seek to help. Opposition to welfare programs has largely been focused on the failures of welfare and the assumption that recipients are a drain on public resources.

New research takes the question of poverty not as an isolated incidence of income flows, but as a comprehensive set of circumstances faced by an individual. For example, "place-based interventions" take geographic regions and try to understand the special conditions that residents face (Kline and Moretti 2014). Another view takes into account psychology of those individuals stuck in poverty, including the systematic problem of stress (Haushofer and Fehr 2014). Poverty alleviation also requires addressing multiple simultaneous problems that individuals face in overcoming patterns of present-biased decision-making under financial stress (Carvalho, Meier, and Wang 2016).

Helping low income individuals overcome financial stress involves addressing these simultaneous factors. Financial education is less successful as it would be if participants were not facing high levels of stress. Poverty fighting organizations are adopting a holistic approach that is founded on a deep understanding of basic human nature (Carmen and Zamarro 2016). In this paper, we look at one program designed with a holistic approach. The Financial Success Program at Creighton University focuses on breaking down barriers to financial stability by addressing the factors of poverty systematically and simultaneously.

In section II, the current approaches to welfare are discussed in terms of a resource limited approach or an agent heterogeneity approach. Then the asset approach is given as an alternative framework for thinking about financial success. In section III, the main focus of poverty alleviation is discussed through the lens of those institutions that would extend time horizons to make individuals less present-oriented. In Section IV, community-based financial education programs are given as an example that addresses poverty as a problem of systematic and simultaneous factors. Section V concludes with a summary of the approaches discussed and suggests further inquiry.

II. THE INCOME APPROACH

This paper classifies current welfare policy into two main theoretical frameworks: (1) the *resource limited* approach, which suggests poverty is a matter of income alone and (2) the *agent heterogeneity* approach, which assumes that poverty is a failure of individual (Bailey, 2010). Both frameworks fail to acknowledge all of the necessary considerations needed for low-income individuals to reach financial stability over time. Both frameworks focus on individuals without referencing the impact of community on systematic and simultaneous problems. These frameworks seek to fill a gap with income rather than treating underlying problems. As a result, those that escape nominal poverty might experience episodic poverty due to systematic and simultaneous problems associated with financial insecurity and fluctuations in income (Morduch and Siwicki 2017). While income is essential for navigating various life crises and temporary shortfalls, it is just one of the many resources necessary for financial stability.

The Financial Success Program, by contrast, supplements the need for income with social structures necessary for asset accumulation that ultimately provide financial stability.

II.a. A Critique of the Resource Limited Approach

If poverty is seen as a problem with income, the answer might be to increase the generosity of income transfers. In the last two decades discussion of the universal basic income is one example of such an improvement in resources for those in poverty (Wispelaere and Noguera 2012). Income approaches seek to provide impoverished individuals with resources that will replace the benefits of economic participation. This type of welfare assistance sees gaps in work as temporary and is structured to last only a short period of time. By distinguishing between cyclical and structural unemployment, policymakers can design different strategies for those that are in in temporary poverty due to an economic recession or chronic poverty due to a change in the skills required in a changing economy (Mocan 1999).

Despite its humanitarian basis, extending income assistance to those that are structurally unemployed can hurt many whom it is trying to help by undermining the incentive structure necessary for gaining new skills. By confusing cyclical and structural unemployment, individuals might wait longer before seeking skills training in industries where jobs that are more plentiful. There is even reason to believe that welfare discourages work motivation, family stability and further marginalizes recipients from the rest of society (Ellwood, 1988). Building skills and gaining occupational experience are essential for economic advancement. Lack of employment stability, job skills, and occupation-specific experience impedes welfare recipients' abilities to obtain a “good job” or to transition into one from a “bad job.” (Johnson and Corcoran, 2003).

Economic participation is more than just a source of income, it is also an important part of forming individual agency. Having a job also gives a person a sense of place and identity in a community. Economic participation is more than just income alone. Instead, longer term solutions require thinking of the individual as forming the skills they need to be a productive participant in their community.

II.b. A Critique of the Agent Heterogeneity Approach

Public policy includes many types of transfer payments, which have been framed as temporary assistance because they rely on a belief that once assistance is given individuals can recover quickly from adverse circumstances. The reform of US welfare programs in 1996 sought to limit free-riding of otherwise employable people on generous welfare programs. For those that do not quickly recover the stigma associated with chronic poverty can intensify the systematic and simultaneous problems of poverty. In many cases, chronic poverty has been treated as a chronic illness and evidence of mental disability (Hansen, Bourgouis, and Drucker 2014). Treating those in poverty as different is to ignore the causes of this difference. To treat all individuals as similar in terms of employable skills is to apply a homogeneity standard that does not reflect differences in skills, experience, and social capital. Instead, it is important to model individuals as confronting heterogeneous institutions, which allows for analysis of the role that institutional reform can play in increasing skills, experience, and social capital for those that are currently structurally unemployed. Meaningful process can be made by treating the complex bundle of conditions of poverty instead of drawing a dichotomy between those with the skills necessary and those without.

II.c. The Asset Approach as an Alternative

In the book, *Rethinking Poverty*, Bailey (2010) calls for a change in thinking about poverty assistance. He states that the income approach should be replaced with an asset approach. In his view the 1996 welfare reform did not work because it didn't consider poverty as the result of a longer-term problem, the problem of assets (Bailey 2010, p. 13). His "asset approach" focuses on one major institutional change that can be responsible for escaping poverty. A primary example of why assets matter is that as soon as someone has enough income to no longer qualify for poverty programs they are at risk to financial shocks, like unexpected medical bills (McKay 2013). An unexpected financial shock will put a person with no assets back into poverty. Having assets, like the equity in homes that so many middle-class people have, or a savings account, means that you can survive unexpected financial shocks. Avoiding the slip back into poverty and dependency comes from thinking of assets as a way to create independence where mere income replacement does not do.

The focus on assets is one important way that institutions can be used to extend time horizons for those that are in poverty. The major feature of the assets-based approach is the elimination of the present-oriented bias for individuals in poverty. Assets can help to endure financial shocks and recover from unanticipated expenses. The assets-based approach naturally alleviates some of the same systematic and simultaneous problems that other welfare programs face.

III. INSTITUTIONAL RESPONSE: BULDING ASSETS AND EXTENDING TIME HORIZONS

Individuals who are facing a self-reinforcing system of internal and external factors need to have a holistic approach to escape persistent poverty. A holistic approach is an approach that considers both the systematic and simultaneous problems associated with poverty. It does this by addressing the underlying institutions of poverty, including the effects of the neighborhood and community (Ellen and Turner 2010) and present-oriented bias (Carvalho, Meier, and Wang, 2016). The holistic approach uses a wide variety of approaches to address these factors simultaneously.

III.a. Institutions

Neighborhoods can either be encouraged to help connect people and reinforce good institutions, or they can continue to be plagued by a persistent bundle of perverse institutions. It is clearly understood that distressed neighborhoods "have greater criminal involvement and fare worse on educational, economic, and health outcomes than do those living in less distressed areas" (Ludwig et al. 2012, p. 1505). Low-income individuals have higher rates of alcohol abuse and higher risk of disease and mortality (Turner et al. 2014).

An important factor in one's ability to make sound financial decisions is an individual's stress (Haushofer and Fehr 2014). Results of stress on otherwise healthy people lead to short-term thinking, making poverty a chronic condition for those in distressed environments. Recognizing the importance of institutions relies on agent homogeneity, meaning that the differences in individual actors matter less than the differences in the institutions that are responsible for the context of choice. Institutions that support asset building promote long-

term thinking. Building a longer-run focus, primarily by the use of community building, will mitigate the tendency to engage in short-run thinking.

III.b. Stress

A stressful atmosphere reduces the number and quality of choices considered by individual decision makers. Evans (2016) points to the effect of stress in low-income neighborhoods on adult formation of short-term spatial memory. Thinking under stress reduces one's ability to frame their decisions in the long-term and rewards thinking in the short-term. Gennetian and Shafir (2015, p. 905) argue that psychological stress results from financial instability and turns temporary financial crises into "long-lasting poverty traps". Poverty, stress, and present-oriented behavior can lead to higher obesity rates (Kwarteng et al. 2017). The cognitive and health effects of resource scarcity go much further than just a propensity for learned helplessness (Evans and Cassells 2014).

There is a cognitive toll that stress places on those in low-income. Children who are raised in persistent poverty demonstrated 20 percentile ranks lower than those that had never experienced poverty (Dickerson and Popli 201). Pepper and Nettle (2017) suggest that present-oriented behaviors are a contextually appropriate response to structural and ecological factors. The brain's evolutionary response to focus harder on the problem at hand, as the stress of scarcity emphasizes its importance. Mani et al. (2013) focus on temporary stress and the reduction of cognitive performance. The extra effort spent on adapting to uncertain financial circumstances does not come without opportunity cost. Effort spent adapting to uncertain financial and other effects associated with poverty comes at the cost of longer-term thinking. If cognitive capacity is related to the institutional constraints that individuals face, institutions become much more important for solving problems than the incentives faced by individual decision makers.

Not only does scarcity diminish cognitive capacity in the form of stress and present-orientation bias, but it weakens executive control as well. Executive Control underlies the ability to manage cognitive activities such as attention, impulse control, and initiating/inhibiting actions (Spears 2011, p. 3). In addition to lowering the amount and quality of perceived choices, scarcity also inhibits the agent's ability to act effectively after making a decision. The loss of executive control increases the effect of stress leading to an amplification of other cognitive biases (Spears, p. 34). Increased cortisol levels, a stress hormone, coincide with contemporaneous stress as well as other conditions of poverty (Haushofer and Fehr 2014). Empowering individuals with executive control can reduce some part of this stress hormone.

Reducing stress as a way of increasing the ability of individual actors to make financial decisions is an important part of reforming our approach to financial education. The link between financial stress, cortisol levels, and health outcomes is also an important benefit of addressing stress (Choi 2009, p. 121). This observation has led to a growth in financial education programs with mixed results, leading to questions about how to design effective programs (Zahn, Anderson, and Scott 2006, pp. 54-55). Packard et al. (2015) discuss the potential that by reducing stress as a primary objective contributes to the improvement of cardiovascular risk, and financial outcomes for participants and their children. By focusing on stress, the likelihood of success with financial education and other closely related outcomes improves.

IV. COMMUNITY-BASED FINANCIAL EDUCATION PROGRAMS

Community-based financial education programs are comprehensive financial literacy programs founded on a holistic approach to behavioral change that aims not only to educate participants but also empower them to take active control of their finances. By building communities, the program is more effective at addressing the systematic and simultaneous problems of poverty.

The ultimate goal is to train low-income individuals to proactively pursue financial goals. It is Programs that consist of financial training classes, a money management system, and ongoing financial coaching allow participants to become engaged in a process that reinforces a longer-term time horizon, empowering executive control and managing stress.

Community-based financial education programs hold classes at local community centers in neighborhoods where many participants live, as transportation is a barrier for low-income individuals. Course material is comprehensive and deviates from other financial literacy programs in its embodiment of the holistic approach. It aims not only to provide basic financial knowledge, but to do so in an intuitive and approachable way that is conducive to implementation and execution. The focus on accessibility is reflective of the overall challenge at hand. It is not just a few key differences that separate individuals socioeconomically, but the multitude of small resulting impediments that aggregate to establish economic immobility.

IV.a. Building Community to Reduce Stress and Promote Long-Term Thinking

The cathartic nature of community-based financial education classes is a powerful mechanism for eliciting change in participant thought and behavior. Participants are encouraged to share personal stories of struggle and triumph throughout the process. It is through a recognition of social homogeneity that participants can begin the essential process of introspection to help redefine their self-image.[1] Programs can integrate this technique into group exercises which serve both to increase financial self-awareness and reinforce social homogeneity.

Confidence is essential to establishing financial stability. In fact, confidence is actually more important than actual knowledge when making financial decisions (Walstad et al 2017). Recognizing the importance of confidence is a profound insight that is central to community-based financial education programs, which can be a key differentiator to other financial literacy programs. It is unsurprising that the establishment of a supportive peer group that one can easily identify with is a powerful catalyst for reconstructing self-image. Changing how participants view themselves is the first step in changing how they view their circumstances. From here, faith in the prospect of economic success can be pursued by reducing the sensitivity to temptation and bolstering the propensity for long-term cognitive time horizons.

An effective financial education process simultaneously breaks down a wide range of barriers, which allows participants to gain a perspective of long-term thinking consistent with asset building. Successful programs change how participants view their environment as well as themselves. This happens by building a sense of community, which reduces stress and instills a strong underlying sense of long-term consideration by maximizing perceptible choice options and optimizing decision making ability. The cognitive transition from short-term

1. Self Help Groups as Poverty Reduction Strategy in Enhancing the Socio-Economic Status of Rural Women.

thinking to long-term thinking results in a much higher likelihood of reaching financial stability. Addressing all barriers at once is much more effective than removing individual barriers separately.

IV.b. Unintended Consequences and Empowerment

Individuals who benefit from a reduction of stress and are provided an environment to promote long-term thinking improve other areas of their life. One piece of evidence involves the positive relationship between financial stress and obesity (Siahpush et al., 2013). Furthermore, there is an immense propensity for behavioral change in the context of social groups. The importance of peer groups for resisting temptation and manipulating self-image, fostered by an environment focused on long-term thinking, helps individuals make more empowered decisions. This is evidenced by analysis by Robinson and Thomas (2013) on eating norms and behavior, indicating the importance of perceived social norms and their effect on behavior.

V. CONCLUSION

Income assistance alone is not enough to ensure economic wellbeing for low-income individuals. The two main theoretical frameworks, the resource limited approach and the agent heterogeneity approach both fail to acknowledge all of the necessary considerations needed for low-income individuals to reach financial stability over time. These frameworks seek to fill a gap with income rather than treat underlying systematic and simultaneous problems.

The pursuit of financial stability requires important considerations to be made regarding the role institutions play in breaking down barriers to the wide range of tangible and intangible resources. To address the role of institutions, it is argued that an asset-based approach, instead of income-based approaches, would most effectively address the systematic effects of bad intuitions and help extend time horizons in individuals facing poverty. Due to the self-reinforcing nature of poverty, addressing the barriers to financial stability is most effective when done in a systematic and simultaneous manner.

Community-based financial education programs reach better outcomes than other financial literacy programs because of their adoption of the holistic approach, which provides an example of an effective process for breaking down barriers simultaneously to achieve financial stability. These programs provide participants with a clear path out of poverty by reducing stress while simultaneously equipping them with the knowledge, tools, and social support necessary actualize economic progress.

Further inquiry should be directed towards identifying specific policy implications, developing better processes for breaking down the web of barriers to financial stability, and adapting similar processes to other types of social groups.

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