Behavioral Economics: Insights for the Unbanked and the Underbanked

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Standard Economics

- Assumes rational choices based on stable preferences, and complete knowledge to maximize satisfaction

Behavioral Economics

- Uses concepts from psychology to investigate how social, cognitive, and emotional factors affect our choices
Why Study Behavior?

- Describe what people *actually* do, and why
- Recommend what individuals *ought* to do
- Recommend what society *ought* to do
Standard Model... how things ought to be

- We are able to carefully weight costs and benefits
- We are able to consider all relevant information
- We plan for the lifetime
- We are kind of selfish
Behavior Economics... what people actually do

- We fail to consider costs and benefits
- We can’t process all information available
- We are present-oriented
- We kind of care about others... we make comparisons
The BIG Reveal:
People are not always Rational!
First Research Question:
Is the economic choice of being unbanked or underbanked a rational one?
Evidence from 2013 FDIC National Survey of Unbanked and Underbanked

More Banking

More education

More income

Older

More employment

Whites and Asians
## Unbanked Adults Demographics

<table>
<thead>
<tr>
<th>Unbanked Adults</th>
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<tbody>
<tr>
<td><strong>Overall – US adult population</strong></td>
<td>7.6%</td>
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<tr>
<td>African-American</td>
<td>32%</td>
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<tr>
<td>Hispanic</td>
<td>24%</td>
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<tr>
<td>Native American/Alaska Native</td>
<td>29%</td>
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<tr>
<td>Single female parent household</td>
<td>20%</td>
</tr>
<tr>
<td>Single male parent household</td>
<td>15%</td>
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<tr>
<td>Household income less than $30,000</td>
<td>20%</td>
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<tr>
<td>Less than a high school diploma</td>
<td>25%</td>
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Source: FDIC 2009 Survey of Unbanked and Underbanked Households
2013 FDIC National Survey of Unbanked and Underbanked

Reasons for Being Unbanked

- Not enough money
- Don’t like dealing with or don’t trust banks
- Account fees are too high/unpredictable
  (previous banked households more likely to pick this one)
- ID/Credit/Bank history problems
- Privacy

- Banks do not offer needed products or services
  (only 1.2% picked this as the main reason... payday lending)
Why do we care about the unbanked/underbanked?

• Banked households have more assets
• More small business owners amongst banked households
• Externalities:
  – Employers: payroll
  – Retailers: more access to credit, payment methods
• For banks/credit unions, more business
Some Households might be better off not being banked

Most Households might be better off being banked

We just don’t know the split
Account at a formal financial institution (% age 15+)

Source: 2013 A Cross-Country Analysis of Unbanked Within the OECD
Unbanked/Underbanked: Possible Issues

Bounded Rationality

- Processing information is costly
- Our perception is biased: overconfidence, use of rules of thumb, status quo bias

Bounded Willpower (self-control)

- We put off doing things we don’t like...
- We don’t do what is good for us
- Procrastinate even the good stuff

Bounded Selfishness

- We care about others feelings and opinions
- We display altruism/warm glow, use clues from others
Strategies: Bounded Rationality

- Relevant information: brief and easy to understand (graphics and pictures work!)
- Benefits of banking/costs of AFS
- When there is ambiguity, people clink to the *status quo*
Conflict and the status quo

Proliferation of Choice

Shoppers in upscale grocery store encounter tasting booths for jams:

6 jams: (40% stopped); 30% bought

vs.

24 jams: (60% stopped); 3% bought

(Iyengar & Lepper, 2000; B. Schwarz, 2000)

401(k) options: For every 10-option increase, individuals’ participation probability declines by ~ 2%

(Iyengar & Jiang, 2005)
Strategies: Bounded Willpower

- Easy to open account: smartphones {can we scan ID barcodes?}
- Commitment Devices: free checking if transfer X every month to a savings
- “Now” Incentives: immediate gratification
Tying Odysseus to the Mast

- People demand commitment devices to help them save
- They prefer limited access to their money - a locked piggy bank, banker has the key
Strategies: Bounded Selfishness

- Social media/social feedback
- Use of peer groups
- “Family” options
- Nudge people towards the desirable behavior/social norm
  - Instead of 7.7% of people are unbanked
  - 92.3% of American households are banked!
Thank You!

If you have any questions, contact me at: nilton_porto@uri.edu or 401-874-7135