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FINANCE & ECONOMICS

The poor

Smooth operators

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Even those with very little money have a sophisticated approach to finance

PAYING interest on your savings will strike most people as odd. Yet some poor people in the developing world do just that. In West Africa, for example, some people pay roving *susu* collectors a fee amounting to a -40% annual interest rate for looking after their deposits.

And the authors of a new book* about the financial lives of people who earn less than \$2 a day find that this sort of "pay-to-save" model is by no means unique to Africa. They encounter a similar phenomenon in India, where a female deposit collector called Jyothi looks after small savings for people in the slums of Vijayawada, at an effective yearly interest rate of -30%.

Some of Jyothi's customers are among the 250 families in South Africa, India and Bangladesh whose financial transactions over a year were recorded to study how very poor people manage their resources. Given that these are so meagre, this might seem to be an unpromising line of inquiry. But as many of the subjects emphasised, controlling the flow of cash becomes all the more critical when income is not just low, but also unpredictable and irregular.

These features are what economists like to call "consumption smoothing"—spreading spending out in a way that ensures that what you eat one day is not determined by what you have earned that day or the day before. The subjects used a combination of loans and savings to ensure that their lives were not, literally, hostage to fortune. Hardly anyone lived utterly hand-to-mouth.

The research provides evidence of the sophistication with which poor people think about their finances. They are acutely aware, for example, of the importance of some psychological phenomena whose effects behavioural economists have only recently begun to explore. For instance, they purposefully seek out commitments to help ensure that they meet their saving goals. Many of the South African women in the study joined several monthly "savings clubs" in spite of having bank accounts. They found that the extra discipline the clubs provided was valuable in itself, because it compelled them to save no matter what.

Some went further. The mother of a Bangladeshi man who found himself unable to stick to his monthly saving goal found she could make him save more by taking out a loan from a microfinance company. The shared obligation of having to pay the regular loan instalments meant he abandoned his spendthrift ways.

The unbanked do not have access to such luxuries as standing orders, which richer people use to overcome the temptation to spend whatever they earn. And they are forced to pay for things that are free for most—which enables women like Jyothi to earn a crust by offering a safe store for small savings. But with some ingenuity, they use unorthodox financial instruments to create a more stable life than their erratic incomes would otherwise allow.



A load on his mind

*"Portfolios of the Poor", by Daryl Collins, Jonathan Morduch, Stuart Rutherford and Orlanda Ruthven.

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