Introduction

Put aside common perceptions about poverty for a moment and consider this: Together, lower income households in this country are now collectively worth more than $650 billion in buying power every year.[1] That staggering sum is greater than the budgets of Canada and Mexico combined, and equal to more than 25 percent of the entire United States federal budget. To be sure, lower income families need nearly every penny of that total to get by—but not in the way you think. In fact, that $650 billion is potentially one of the most important sources of funding for anti-poverty initiatives today.

Last year, about 4.2 million lower income homeowners paid higher than average prices for their mortgages. About 4.5 million lower income households paid higher than average rates for auto loans. At least 1.6 million lower income adults paid too much for furniture, appliances, and electronics. And countless more paid higher prices for other necessities like basic financial services, food, and insurance than did their wealthier neighbors. Together, these high prices add up to hundreds, sometimes thousands, of dollars needlessly spent by lower income families every year.

But this problem—the evidence that lower income Americans pay more for necessities from groceries to car loans—is also a huge opportunity to push back against poverty. Reducing costs of living by just one percent would amount to over $6.5 billion in new spending for lower income families. What if we could cut these costs by 10 percent? That would add up to over $65 billion newly available for lower income families to save or invest in wealth-building assets from education to homes.

This is today's poverty opportunity: Reduce the higher cost of living that too many lower income families now must pay, and free up billions to help those families build real wealth. Through these savings, market dynamics can be put to work as an important asset, rather than just a liability, for lower income families.

We can accomplish this in three steps.

First, public and private leaders must take measures to bring down higher business costs that drive up prices for poor families. Second, new laws and more rigorous enforcement are needed to curb market abuses that gouge low-income workers. Third and most importantly, the public must invest in making lower income consumers the savviest shoppers in the marketplace, equipped with the know-how to spot and avoid bad deals and find the lowest possible prices. Together, these strategies will give lower income families a powerful tool to lift themselves out of poverty.

WHERE DID THIS OPPORTUNITY COME FROM?

Today's poverty opportunity is not a new one, but it is much greater in scope and importance today than at any time in the past.[2] There are two main reasons for this: demand among lower income consumers for many necessities has expanded dramatically over the last decade, while the supply of those necessities also has substantially changed.

Over the past decade, sweeping economic, market, and policy changes all interacted to create millions of new customers for many basic necessities. The roaring economy of the late 1990s helped contribute to income growth and the decline of concentrated poverty. Additionally, a major wave of new immigration to the U.S. also boosted demand for an array of goods. Those factors, along with sweeping policy reforms in programs that benefit lower income families, sent millions of lower income adults into the labor force in the 1990s.[3]

As demand increased for necessities like basic financial services, housing, cars, and insurance, the financial services market was transforming in ways that increased access to credit among lower income households. The most important of these changes was the burgeoning use of credit scores, which essentially allowed sellers of credit to index prices to reflect lending risks.[4] The advent of indexing helped open up numerous low-income credit markets once eschewed by businesses, and greatly increased lower income consumers' access to a host of credit products, from credit cards to mortgages. These market changes, in turn, expanded the purchasing power of lower income households.

At the same time, jobs were also spreading out in metropolitan areas, following, and sometimes leading, sprawling settlement patterns.[5] As jobs dispersed through metro areas and lower income workers found themselves spatially isolated from available jobs, car ownership among lower income households surged accordingly—from 67 percent in 1993 to 73 percent just ten years later.[6] This increase far outpaced the pace of car purchases among higher income households.[7]

Finally, in the background of all of these policy and market changes, the economy continued to flatten, as the globalization of supply and demand chains of the economy accelerated.[8] One important economic effect of globalization was that wages continued to stagnate, particularly among lower income workers.[9] In turn, this drove up demand among lower income consumers for a variety of short-term loans, along with creatively-priced products, such as mortgages with balloon payments.[10]

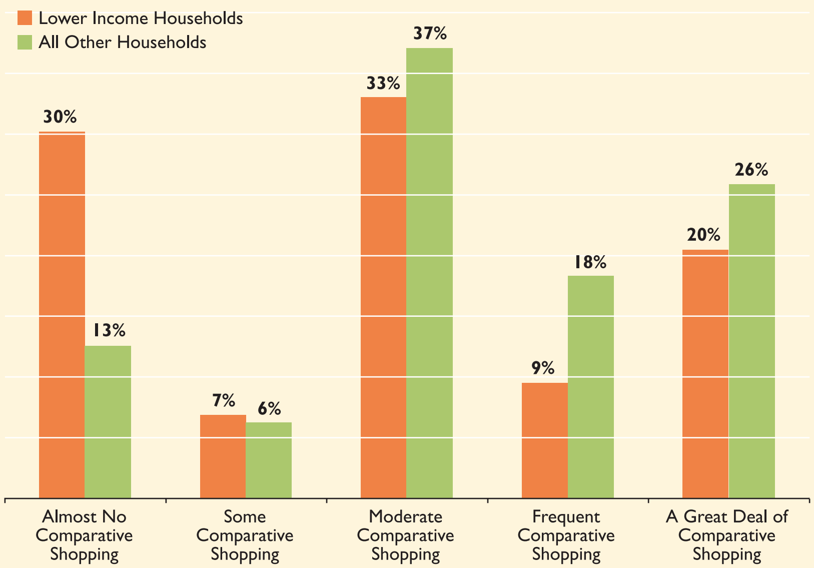
All of these changes worked to bring millions of new lower income consumers into the market for basic necessities.

The supply side of this market too underwent significant change, starting with innovative and entrepreneurial responses in the basic financial services market. Over the past decade, tens of thousands of high-priced, alternative financial services storefronts popped up around the country to meet surging demand in lower income households for check cashing, short-term loans, tax preparation, and money wiring services.[11] The mortgage market responded as well, creating new products for new lower income homebuyers who may have been ignored in the past.[12] Even the grocery market took steps to meet new patterns of demand, most visibly illustrated by Wal-Mart's recent efforts to move into underserved, lower income markets.[13]

For the most part, however, the rising market opportunities presented by lower income consumers went unnoticed. As mainstream

Being lower income is not just about having a lower income; too often, it is also about having to pay high prices for goods and necessities.

Lower income households do less comparative shopping for major credit and borrowing purchases than higher income households



Source: Author's analysis of the 2004 Survey of Consumer Finances

Note: Proportion of consumers in each income category that indicate the extent to which they comparatively shop when making major decisions about credit or borrowing.

businesses missed the moment, high-priced businesses moved to fill the void in the financial services and retail markets especially, leaving these new consumers vulnerable to exploitation.[14]

This vulnerability is not surprising: Survey evidence demonstrates conclusively that consumer savvy and financial literacy both increase with wealth.[15] In other words, low-income families have less understanding about financial services products and their value than do higher income households. This leaves lower income consumers more vulnerable to overcharging, unscrupulous businesses. Between 14 percent and 20 percent of all mortgage borrowers, for instance, are now estimated to pay higher interest rates and fees than indicated by their qualifications.[16]

Similarly, lower income consumers are much less likely than higher income households to shop around when making major decisions about credit or borrowing.[17]

In fact, nearly one in three low-income households reports that they do almost no shopping around; only about one in eight higher income households don't. One might hear such figures and respond, "caveat emptor," but the fact is that many of these consumers are new to many of these markets and may not fully understand their options. That problem has grown worse as many of these markets have become more complicated over the past decade: From insurance plans to mortgage policies, consumers are often beset with large numbers of choices, making it more difficult to make smart decisions.

This paper aims to demonstrate the higher costs lower income households pay for basic goods, costs that high-income households do not pay for what are substantially the same goods.

Overall, the items we examine—financial services, auto-related products, home financing and household goods, and groceries—account for at least 70 percent of a lower income household's budget. Put simply, the evidence is clear: For a wide range of goods and services, poor families pay more.

Thus, the opportunity beckons. Bringing down the costs for these items can create billions of dollars in potential savings, which can be put to work in investments like houses and educations, and in savings for families and retirements. Indeed, as we will describe below, a number of policy and market initiatives to lower prices for lower income families are already underway. Each of these initiatives represents a growing recognition among policymakers that it's time for them to take the other side of low-income families' ledgers more seriously. Being lower income is not just about having a lower income; too often, it is also about having to pay high prices for goods and necessities. As this report illustrates, that's a massive roadblock for working families—but avenues exist to take it down.

When we add up all of these higher prices, lower income households can end up paying hundreds, even thousands of dollars more every year to buy the exact same goods or services that higher income households consume.