The Provisioning of Inequality

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Abstract

Lower income groups make much heavier use of costly financial services such as payday loans, check cashing services, auto title loans, and many more. These services are crafted for, targeted to, and distributed through outlets in lower-income neighborhoods. In other words, there are extensive provisioning systems designed specifically to deliver such products and services to lower income households. Such marketing aimed at lower-income groups reduces their wealth and welfare relative to upper and upper-middle groups.

> Anyone who has ever struggled with poverty knows how extremely expensive it is to be poor.
>
> ---James Baldwin

Introduction

Provisioning of the innumerable goods and services which make up a consumer society involves networks of supply to deliver these objects. Just as incomes and wealth are unequally distributed in society, the provisioning of goods and services to different income groups is also unequal. For instance, higher income groups have access to credit on the most favorable terms while lower income groups are often exposed to onerous terms. Whereas many studies of inequality focus on macro-level issues such as wage trends, the present paper deals with micro-level issues, particularly with consumption and the provisioning thereof. We argue that marketing and distribution practices not only reflect income differences but, in fact, contribute to the widening of inequality.

The focus here is with the sorts of product and (mainly) services which are frequently used by low and lower-middle income groups but less frequently used by upper-middle and upper income groups. These come in many varieties and a given individual may use one, or may use a dozen. An infrequent use of a service discussed here is unlikely to be seriously detrimental. However, a typical user is subject to multiple instances of disadvantage, which are correlated and accumulate to significant disadvantage (Saatcioglu and Corus 2014). These products and services can cost a low-income household thousands of dollars a year. When taken across millions of households, the effect is to materially increase inequality in society.

The provisioning of these products and services is neither inadvertent nor haphazard. The enterprises that furnish such services do what they can to increase usage and boost profits. In keeping with good business practices, these organizations research high-potential customers, design offerings specifically for them, locate outlets in areas convenient to them, conduct promotional activities, and reward frequent customers. Using the standard marketing tools of market segmentation and product differentiation, some offerings are suited to the working poor, while others are tailored for the unemployed; some are aimed at homeowners, others at renters; some are targeted to military personnel or public sector employees, and others to retirees.

The paper next outlines three examples of the provisioning of inequality. The examples include financial services (specifically, payday loans), wishful thinking (gambling), and well-intentioned but ill-directed efforts (education). It should be noted that in the latter two cases governments, as well as private enterprises, are involved. Implications for consumer choice and widening inequality are then discussed; conclusions follow.

Provisioning of Inequality

In the following examples, attention is paid not only to the services themselves but also to the associated marketing and distribution efforts. It is not the mere existence of the services that is problematic but the extensive targeting of low and lower-middle class clients.

Payday Loans

Payday loans are classified as an "alternative" financial service, one of many types of small-scale financial innovations (Redmond 2014). They are alternative in the sense of falling outside the traditional banking system. A typical payday loan transaction involves amounts of $100 to $400 for a period of 7-30 days and an interest charge of $15-20 per $100 borrowed. These provide a useful service to those in need, but often in an exploitative manner (Fligert 2013). On an annualized (APR) basis, the fees amount to a rates of 400-1000%.

The first stand-alone payday loan operation appeared in 1993, and the number of storefront operations subsequently peaked in 2006 at about 24,000 store locations (Rivlin 2010). Although further growth was indicted by strong customer demand, 16 states and DC either restricted or banned payday loan operations (Wann and Wann 2012). In reaction, internet operations were developed in order to make loans in states which banned payday stores, so their reach now extends to anyone with internet access. The estimated volume of payday loans in

2012 was over $29 billion from storefront operations, plus another $14 billion from internet operations (*Economist* 2013).

As behooves them, payday loan companies understand customer characteristics and spending habits well, adjusting their marketing strategies accordingly. The companies heavily target neighborhoods with incomes in the $20,000-40,000 income range (Stegman 2007). They specifically target individuals with jobs but low incomes and those with poor credit histories (Wann and Wann 2012). Larger firms deploy advertising campaigns through a variety of media including TV, direct mail, yellow pages and billboards (Stegman 2007). Lenders incentivize employees to promote repeat borrowing (Stegman 2007).

As is the case with many other businesses, erstwhile competitors find ample grounds for cooperation. For instance the Financial Services Centers of America, a trade association, is composed largely of firms in the payday loan and check cashing businesses, and its primary function is to lobby governments at state and federal levels. Members of this association account for over 13,000 locations in the US, generating $106 billion in revenues from an estimated 30 million customers (FiSCA 2014). Also payday lenders, like most traditional businesses, need a source of funds in order to operate. They obtain funding from large, well-known banks such as Deutsche Bank or Citigroup (Morgenson 2013). Indeed, payday lenders and others would be unable to operate in the absence of such funding; hence the big banks are an essential cog in the provisioning of inequality.

Gambling

A second example of the provisioning of inequality is gambling, in both its governmental and private forms. Governments are involved in state-sponsored lotteries, which are differentially patronized by low and lower-middle class consumers and act as a sort of tax on heavy users (Han, Lee and Suk 2012). Indeed this would be regarded as a highly regressive form of taxation (Blalock, Just and Simon 2007; Freund and Morris 2005). Income from state sponsored lotteries has become an important component in many states' education budgets (Borg and Stranahan 2005). Profits garnered from state lotteries are currently around $35-40 billion per year.

Here again, the provisioning process involves targeted marketing efforts and the use of standard marketing techniques (Clotfelter , Cook, Edell and Moore 1999). Product development includes providing a range of options such as periodic drawings, daily numbers and instant scratch-off cards, all offered in a wide range of dollar amounts. Advertising targets individuals through radio, TV and billboards (Borg and Stranahan 2005). As with other types of products, point-of-purchase displays serve to stimulate impulse buying.

Lower income consumers tend to regard the lottery as a convenient and accessible means of possibly changing their lifestyle in a significant way (Blalock, Just and Simon 2007). Convenient and accessible it most certainly is: lottery tickets are distributed in over 240,000 gas stations, convenience marts and neighborhood stores, according to the North American State and Provincial Lotteries association (NASPL 2014). The resultant gambling losses are held to be a strong contributing factor to inequality (Freund and Morris 2005).

The private sector is increasingly able to participate in the gambling business. Several states have authorized new casinos, often in reaction to gambling money flowing out to nearby states. Studies find that ready access is an important determinant of casino gambling (Thalheimer and Ali 2003). Slot machines are a popular form of casino gambling and are widely available: there are said to be more slot machines in the US than ATM machines (Perfetto and Woodside 2009). As the number of urban casinos has grown, gambling participation among lower-income groups has also grown. For example, around 40% of frequent casino gamblers in Detroit had annual incomes under $20,000 (Martin, Lichtenberg and Templin 2011).

Gambling is known to have addictive properties for some individuals (Freund and Morris 2005). Living within 10 miles of a casino has been found to more than double the rate of gambling-related problems (Whitehead 2014). Thus, urban centers provide a large base of potential customers among low and lower-middle income groups. Not only does proximity affect gambling, casino operators also make use of customer loyalty cards and other marketing programs to increase the frequency and lengthen the duration of visits.

Education

The third example involves education, which also occurs in both public and private manifestations. Striving for education is unquestionably a laudable undertaking, and a huge network of educational institutions undertakes the provisioning of education in the US. The issue here is whether the low and lower-middle groups are less well served by educational systems. Many studies indicate that performance ratings of local school systems are negatively correlated with the percentage of low-income students.

Students from higher income homes have better access to a range of education-related opportunities ranging from after-school programs to tutoring to test coaching. Parents in wealthier neighborhoods are also adept at fund-raising for schools, generating many times the funds achieved in lower income districts (Rich 2014). SAT scores show a steady income gradient, from 1326 for students from households in the bottom 10% of incomes rising to 1714 in the top 10% (Balf 2014). Once admitted to college, the higher education system seems to reinforce class background rather than mitigate it. The six-year graduation rate for those born into the bottom half of household incomes is about 25%; the rate for those born into the top quartile is 90% (Tough 2015). In sum, public school systems serve lower-income students less effectively and leave them less well prepared for college.

A network of for-profit colleges provide degree granting options outside the traditional set of public and private institutions of higher learning. The target market of for-profits is primarily low-income individuals and military veterans (Mettler 2014). Several of the for-profits are quite considerable enterprises. Corinthian Colleges, for instance, had 75,000 students across 100 campuses before being wound down by the Department of Education for financial shortcomings (Morganson 2014). Despite the financial problems, top executives received compensation in the high six-figure range. This last point illustrates an important aspect in widening inequality: when lower-income individuals lose, someone else wins.

For-profit education became a growth business in recent years and financing is an integral and essential part of their business model. For-profit schools are adept at connecting students with loans, with the result that most students receive loans. At many for-profit schools students graduate with high debt loads and have difficulty finding jobs with sufficient incomes to pay the loans. There is also a high dropout rate, with the result that many former students fail to graduate but still have sizeable loans to deal with.

Other Provisioners

The above examples are meant to be illustrative, not exhaustive. Indeed, many other provisioning activities also serve to magnify inequality. High cost examples of financial services which are differentially used by lower-income households include check cashing services, credit card late charges, bank overdraft charges, rent-to-own stores, tax return anticipation loans, and auto title loans. More recent innovations include subprime mortgages, and pension advances. There is also a new subprime boom, this time involving automobiles. Not the same as auto title loans for previously purchased autos, this activity finances purchases of new or used cars. In parallel with subprime mortgages, underqualified buyers are given easy access to loans for cars at high interest rates and poor terms. These loans are then bundled and the resultant securities sold to institutional investors (NYT 2014).

Demand for high-cost services is not simply a function of income, but is intertwined with location. Since 2008, 93% of bank branch closings have been concentrated in areas where median income is below the national average (*Economist* 2014a). Individuals in these areas increasingly take recourse to check-cashing firms, payday lenders, auto lenders and others (Rivlin 2010). Lack of access has pushed an estimated one million people out of the formal banking system in the US (*Economist* 2014a). In such cases, the de-provisioning of traditional services contributes to the provisioning of inequality.

Discussion and Conclusion

Four aspects of the provisioning of inequality are of note. These involve consequences of frequent use of high cost and/or low quality products and services. They also involve situational characteristics of such consumption.

First, many offerings targeted to low and lower-middle income groups involve personal debt, a situation which results from both unforeseen expenses and from aspirational expenditures

(Rivlin 2010). Increasing income inequality results in a greater dependence on credit to maintain consumption expenditures (Brown 2008). As a result, the ratio of consumer debt to income has been increasing most at the bottom of the income scale and least at the top (Holt and Greenwood 2012). In 2004, households classified as poor had a mean debt load equal to 59% of income, while households at the median income level had a debt load of 23% (Pressman and Scott 2009). Around a third of payday loan customers spend 20%+ of their income to service their loans. Interest payments and various associated fees take a larger share of income at the lower end, effectively increasing inequality beyond that measured solely by income.

Second, the connection between inequality and education is a reinforcing and self-sustaining one. Income inequality is closely connected with disparities in educational attainment (Rajan 2010). Thus the products and services promoted to the low and lower-middle classes are inevitably aimed at those less well equipped to understand them or their financial implications. Lacking the education to more fully understand financial consequences, lower income individuals are more likely to make harmful choices. Falling into the "rollover trap" in payday loans is an illustration of this problem. As another example, lottery players focus more on the size of the payout, rather than the odds of winning. Blalock, Just and Simon (2005) observe that the poor appear to play lotteries because of a misplaced belief that participation will improve their financial well-being. Lower educational attainment can exacerbate a number of cognitive biases, thereby contributing to inequality.

Third, various elements of the provisioning of inequality are not independent of one another, but rather are correlated and interdependent. Low income, low education and locational factors combine to foster conditions of continuing disadvantage for many who find themselves on the bottom rungs of society. Saatcioglu and Corus (2014, 125) note: "Structural inequalities are linked to institutional, systemic factors that sustain marginalization of disadvantaged groups,". The effects extend well beyond the use of high cost services. For example, lower income populations are more exposed to health handicaps such as food deserts. For lower income households, energy costs take up a larger, and growing, portion of income (Chester 2014). Also, the prohibitive cost of legal representation has a limiting effect on access to the legal system (Oleinik 2014). Inequality is a multifaceted syndrome.

Lastly is the effect of provisioning on higher income groups. Money doesn't just disappear from the lower end---it goes somewhere. There are numerous benefits for the upper and upper-middle classes who sell and finance these products and services. Owners of the businesses that sell these services profit directly. Investors in stocks and bonds of these businesses profit. The banks that finance them and the investors in high-interest instruments, such as securitized credit card loans, also profit. Indeed the avenues of participation are so numerous and subtle that many investors in mutual funds are typically unaware of their own participation. Income from dividends, interest, rents and so forth has been found to be a significant contributor to income inequality (Frabdorf, Grabka and Schwarze 2011). Thus, the provisioning of inequality is not just a case of making the less well-off even worse off---their money moves up the ladder, widening inequality.

Conclusion

The costs outlined above, in addition to many more, fall differentially heavily on the lower and lower-middle classes. Policies to remediate exploitative situations include individual-oriented efforts such as financial education, but also extend to institutional concerns such as community support and social networks (Figart 2013). However, well-intentioned efforts to mitigate the disadvantages often go awry. Laws designed to limit payday loans merely stimulated the online version. Legislation intended to limit debit-card fees has instead had the effect of increasing them: "They have resulted, by one calculation, in the transfer of between $1 billion and $3 billion annually from poor households to big retailers and their shareholders," (*Economist* 2014b). As is the case with other businesses, the provisioners of inequality are inventive and resourceful in their pursuit of self-interest. It is remunerative to be rich, as well as expensive to be poor.

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