Journal of Financial Therapy

Volume 9 | Issue 1 Article 6

2018

Book Review: The Financial Diaries

Barbara O'Neill

Recommended Citation
O'Neill, B. (2018). Book Review: The Financial Diaries. *Journal of Financial Therapy, 9* (1) 6.
https://doi.org/10.4148/1944-9771.1180

Book Review

The Financial Diaries: How American Families Cope in a World of Uncertainty

Barbara O'Neill, Ph.D.

Morduch, J. & Schneider, R. (2017). *The financial diaries: How American families cope in a world of uncertainty.* 233 pp., $18.97, ISBN: 978-0691172989.

Researchers and practitioners will gain valuable insights into the financial insecurity experienced by many American families after reading this 233-page book by Jonathan Morduch and Rachel Schneider. Morduch is a professor at NYU and Schneider is senior vice president at the Center for Financial Services Innovation. The meticulously referenced book (46 pages are notes and a bibliography) describes a study of family finances "through a lens that extended beyond measuring yearly income, spending, and wealth" (p. 13).

The Financial Diaries describes a year-long study of 235 households in five states. It artfully combines stories about participating households with government and academic studies on income and wealth. From almost 300,000 cash flow records that were collected, a picture emerges of family financial instability that is difficult to see in studies that measure one-time income "snapshots." A major cause of financial instability is jobs with unpredictable pay and irregular hours. In fact, "the *instability* of families' incomes has risen faster than the *inequality* of families' incomes" (p. 10). A big issue for many families is coping with income dips. Difficult choices are often made as a result (e.g., paying bills late, partial payments, borrowing money from friends, depleting retirement accounts, and payday loans).

Families in the study completed interviews and surveys to record their income and expenses. An overriding theme was their desire for financial stability and the stress that accompanied income "peaks" and "valleys." One participant traded a job with uncertain hours and income for one with a longer commute and less total income but a guaranteed hourly wage and 40 hours of work per week. Income dips have many causes. A casino worker in Mississippi took a "hit" when a local college football team played away games, a NYC fruit vendor was hurt by Superstorm Sandy, and a trucker lost income when roads were too hot to drive on. Retail workers get sent home during slow times. People with volatile incomes don't have the luxury of developing long-term financial plans. Instead, their planning time horizons can best be described as "now, soon, and later."

ISSN: 1945-7774

The authors take issue with recommendations made by financial "gurus" Suze Orman and Dave Ramsey, not because their advice is technically wrong but because it simply cannot be acted upon by those experiencing financial instability. The reason is not a lack of knowledge, spending on nonessentials, or inability to resist temptation, but, rather, lack of an emergency savings/income smoothing buffer. Subjects in *The Financial Diaries* counted their financial planning time horizon in months, not decades, and advice given by Orman, Ramsey, and presumably some financial practitioners, is simply too ambitious.

Morduch and Schneider note that "volatility wreaks havoc with all the standard advice on how to manage finances. How do you create a realistic budget-and stick to it- if for half the year your income isn't close to average?" (p.44). An income dip can lead to delaying or forgoing medical care, missed bills, late fees, utility disconnections, evictions, and damaged credit. Another negative impact is that focus on coping with a volatile income saps time and attention (i.e., mental bandwith) from parenting, relationships, and community engagement. Quoting research by researchers Mullainathan and Shafir, attention is zero sum; i.e., people focused on managing irregular cash flow cannot devote attention to other things. There is also evidence that people with volatile incomes are risk averse and less likely to purchase investments.

Below are insights from *The Financial Diaries* for those who counsel people with volatile incomes:

- Income volatility affects eligibility for social service safety net programs. Families may qualify for food stamps, health insurance subsidies, and Medicaid at certain points in time but not at others. The later can cause interruptions in care for chronic health conditions. Some families in *The Financial Diaries* moved in and out of poverty, a phenomenon that is not uncommon in America. U.S. Census data indicate that "90 million people, nearly one-third of all Americans, experienced poverty for two months or more between 2009 and 2011" (p. 159) vs. 10 million people who were poor the entire three years.

- Appearances can be deceiving if financial practitioners rely solely on numbers such as annual income and expenses and assume that people are "comfortably middle class." Many *Diaries* households had adequate cash flow on an annual basis, but were clearly stressed by income volatility. Expenses simply came due before income was in hand. In addition, they lacked less visible markers of middle income financial stability including peace of mind, financial "breathing room," and adequate savings for emergencies and retirement. Federal Reserve data indicate that even 21% of households earning $100,000 cannot come up with $400 easily. "Nearly half of American families have no retirement savings" (p.96).

- It can be difficult to persuade people to save part of their tax refund because many already know how they are going to spend it- and long-term savings isn't on the list. Instead, people plan to pay for long-delayed urgent needs and arrearages on debts and household bills. Tax refunds are a key component of a process the authors call "Smoothing [consumption] and

ISSN: 1945-7774

Spiking [income]" In addition to over-withheld taxes, other ways to "stash surpluses" including filling up a freezer and stockpiling items purchased inexpensively with coupons. These coping strategies were ones gave *Diaries* participants a sense of control. When they did manage to save money, it was generally depleted and built up repeatedly.

- People make financial choices in the context of relationships, which can help or hurt financially unstable families. The book describes savings groups (a.k.a., tandas), where people who know and trust each other save together to build a "pot" to help each other out, when needed. In other words, people might save, but not in ways that financial advisors recommend. Some people were also expected to lend money to others. One participant joined an IDA program to "lock up" her money and have an acceptable excuse to say "no."

Readers will appreciate the mindset of financially unstable individuals after reading *The Financial Diaries.* You may not teach a class or counsel a client in quite the same way. For example, automatic savings plans will not work for those with volatile incomes who will resist strategies that involve regular payments or deposits that won't allow them flexibility to "juggle" expenses when needed. *Diaries* participants used many creative strategies to get by. One didn't reorder checks to avoid being trapped by payday lenders. Perhaps the best thing financial practitioners can do to help financially unstable households is provide useful tools and strategies to smooth their incomes and help reduce stress. The book concludes with several practical solutions including apps to align income spikes and spending, employers paying workers income daily as it is earned, simple financial decision-making rules, and retirement savings plans with "sidecar" emergency funds.

ISSN: 1945-7774