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WORK AND DEBT

Neighborhood Trust's View

Workers' Reliance on Debt and the Role of the 'Nature of Work'

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Executive Summary

The majority of American workers rely on debt to make ends meet. This debt is often "bad debt," defined broadly as that which borrowers are unable to pay back at an affordable cost or within a reasonable time frame (e.g. payday loans). **Debt operates as the low-income worker's bridge capital, the only solution available for the challenges that define poverty today: persistently thin margins and inability to weather financial shocks.** These challenges, and workers' resulting debt burdens, are a product of low-quality jobs, characterized by **low-wages, volatile cash flow, unpredictable hours, and insufficient benefits**. Expensive, burdensome debt is then only further exacerbated by a landscape of financial services and policies that fail to meet the needs of workers in these low-quality jobs.

In contrast, "quality work affords an individual the opportunity to save, to build the security and confidence that allows one to plan for the future, and to participate in the life of and see oneself as a valued member of a community." Good jobs ought to reduce the risk of worker financial insecurity by paying livable wages, offering a range of benefits such as short-term emergency coverage, and providing predictable scheduling and guaranteed hours.

We hope to help you, the reader, better understand

1) the nature of the problem we are trying to address: most jobs cause a reliance on bad debt; therefore, tackling the enormity of outstanding, expensive debt is perhaps the key indicator of a healthier economy;

2) our collective responsibility to ground our solution-design and measure of impact in the relationship between work and debt, shifting the narrative from personality responsibility to one of structural inequities at work and financial services as a result; and

3) Neighborhood Trust's promise to help workers reduce debt via interventions for individuals and the market as a whole, as part of that collective action.

Neighborhood Trust thanks the researchers and thought-leaders highlighting the important connection between work and debt who are cited throughout this paper, particularly the U.S. Financial Diaries, United for ALICE, the Debt Collective, and the Aspen Institute. We are grateful to Aliah Greene, a board member of Neighborhood Trust, for offering her support and expertise throughout the development of this piece.

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Workers are Facing a Debt Crisis, due to a Job Quality Crisis

Today's workforce is overwhelmed with debt, inhibiting their near-term well-being as well as their long-term economic mobility. While the COVID-19 pandemic did not create the current debt crisis, the last year and a half has exacerbated and illuminated the extent to which workers in low-wage, low-quality jobs are financially insecure and reliant on debt to survive. Workers are facing persistent cash flow shortfalls and unmitigated financial shocks, due to insufficient action from stakeholders in the labor market. Both employers and policymakers have enabled the cost of living to continue rising without sufficiently adjusting workplace practices or regulations around scheduling, minimum wage, benefits packages, paid leave, unemployment insurance, or health insurance.

U.S. households currently carry a cumulative $14.64 trillion in debt and 29% of them have debt in default or collections. This burden is even greater for workers of color, 39% of whom carry debt in collections, relative to only 24% of white workers. In May 2021, the Consumer Financial Protection Bureau found that 50% of consumers who reported that they struggle to pay their bills, also reported borrowing money either using formal or informal credit. Of those who borrowed, 21% turned to alternative financial services, reflected by the 12 million Americans who take out payday loans each year. If they are unable to repay their debts, workers potentially face a collections account on their credit report, wage garnishment, bankruptcy (which is twice as likely among payday loan borrowers), or going without the essentials. And the impact of these debts matter. Overwhelming debt inhibits opportunities for economic growth, educational attainment, psychological well-being, and even physical safety by preventing access to secure housing.

The pervasiveness of the low-quality jobs driving this debt crisis is largely a result of the Great Risk Shift, a term coined by economist Jacob Hacker to refer to the series of changing policies and practices throughout the 20th century, which shifted the financial risks of retirement, illness, job stability and loss of income from government and employers to individuals. **This environment of individual-responsibility is not neutral; it is disproportionately more challenging to navigate for low-income workers of color.** And in the decades since the start of the Great Risk Shift, we have seen the nature of work continue to become less forgiving, as our economy increasingly relies on stifled worker power via industry concentration and weakened unions.

With weak and fraying mechanisms to exert worker voice, today's workers are trapped in poor quality jobs with low wages, making expensive debt an essential part of getting by. A perfect storm of rising costs of living, stagnated wages, reduced worker power, increased gig / contract work, and insufficient benefits has been brewing for decades, gradually forcing more and more workers, particularly workers of color, to lean on credit to stay afloat. For example, a study published in the National Bureau of Economic Research found that lower employer competition has correlated with lower wages since 1977, with the relationship merely growing stronger over the years. **44% of all U.S. workers are low-wage, earning a median hourly wage of $10.22, with Black and Latinx workers most likely to earn low-wages.** The lowest-earners are also the least upwardly mobile, with "workers in the lowest wage quintile having the highest likelihood to switch into another low paying job, and workers in the second lowest quintile having a 55% chance to remain or move into the lowest quintile."

Also consider the results of the U.S. Financial Diaries project, a groundbreaking effort to gather both quantitative and qualitative data that illustrates the complexity of the challenges facing low-income families. The data revealed that low-income families' financial insecurity and scarcity is as much driven by low-wages as it is by volatility and unpredictability. Only 36% of the U.S. Financial Diaries' sample of low- to moderate-income households exclusively received employment income from a job with recurring wages, with the remaining 64% piecing together income through part-time jobs, gig work, and/or government benefits. And even recurring income can vary substantially from paycheck to paycheck, often due to irregular hours. "To compensate for irregularity in income over time," and navigate unpredictable spikes and dips in paychecks, households either sacrifice certain bill payments or turn to credit cards and small-dollar credit products to close the gap—and hope they'll eventually have an income spike to catch back up.

United for ALICE reports that in 27 states, at least 40% of households live above the federal poverty line yet **"cannot afford the essentials in their communities."** Therefore, the "debt crisis" among low-income workers is not simply a result of compounding high interest rates and misinformation about how to pay off debt efficiently; nor frivolous overspending. In a national survey conducted by the think tank Demos, 40% of households with debt, and 45% of households earning less than $50,000 per year, reported using credit cards within the last year to "pay for basic living expenses such as rent or mortgage payments, groceries, utilities, or insurance."

Even "good debts" like mortgages and student loans, which can plausibly serve as a path towards wealth building, are persistently inaccessible or harmful to low-wage, particularly Black and Latinx, workers. Student debt in particular is devastating the financial health of communities of color across the country, with the median Black borrower still owing 95% of their original student debt balance 20 years after starting college, while in the same 20 years the median white borrower has paid down almost 95% of their original balance. Aspen Institute's EPIC initiative labeled the burden created by student loans as "a critical dimension of household financial security, [creating] liability for low-income students and students of color."

The Historical Roots of Debt Among Workers of Color

As a result of the legacy and persistence of racism and discrimination in the labor and financial services markets, Black workers today are 32% more likely to earn low wages, lack workplace benefits and face employment instability compared to white workers. For Latinx workers, it's 41%. As a result, Black households currently have a median wealth of only $17,100, one-tenth the median wealth of white households. Latinx households are only slightly better off with a median wealth of $20,600, one-eighth the median wealth of white households.

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The United States' longstanding racial income and wealth gaps are driven by a pernicious combination of bad jobs, exemplified by low-wages, lack of benefits and employment instability, alongside policies that push and keep workers of color in those poor-quality jobs. For example, New Deal legislation in the 1930s, for which President Roosevelt was celebrated, promoted occupational segregation and income disparities. The New Deal "established protections for workers including Social Security benefits, 40 hour work weeks and minimum wage standards," but these protections did not cover "service, domestic, and agricultural jobs," disproportionately excluding the Black, Mexican and other Latinx workers crowded into those industries throughout the prior decades.

The low-wages and lack of protections associated with service, domestic and agricultural jobs held disproportionately by workers of color, create a persistently vicious cycle of cash flow shortfalls and expensive short-term debt stop gap measures. Black and Latinx workers today remain trapped in this decades-long cycle.

Regulating Lenders and Credit Products Will Never Be Sufficient

A labor market that systematically puts workers in the red has created a massive market need for liquid cash, currently being met by a hugely profitable debt and lending industry. This industry includes creditors ranging from mainstream financial institutions to collection agencies to payday lenders, all supported by policies that enable wage garnishment, consumer debt lawsuits, and employer-run credit checks. The nature of work created a vacuum, and the debt market stepped in to fill it, resulting in a broken incentive-structure that benefits corporations and hurts workers.

While we must address job quality as the root cause of debt to truly set workers free, we are also accountable for addressing the entire system of broken incentives in parallel. Bad credit products, whether mainstream or alternative, are gouging borrowers. Predatory lenders design their products to keep borrowers dependent on them over time with features such as high interest-rates, balloon payments, auto-withdrawals, unexpected fees, and easy access via low underwriting standards. And if they can't keep up, borrowers then face a new set of challenges: collection agencies with often abusive practices, wage garnishments, and asset or tax liens.

The payday loan industry, for example, meets the need for small-dollar loans among those with poor credit by offering immediate, accessible cash—but not without a catch. Due to the widespread need, and a lack of competition in the small-dollar lending market, payday lenders are known for typically charging interest rates upwards of 400% and for trapping borrowers in a cycle, with 83% of loans taken out within two weeks of a previous loan. Their profit margin is not only higher than most lenders need to cover their operating costs, but is *much* higher than the double-digit APRs that banks or credit unions would need to charge on a profitable small-dollar loan. Ohio, Virginia, Colorado, and Hawaii have all already passed comprehensive payday loan reforms, demonstrating that it is possible to successfully balance the importance of retaining consumer access to small-dollar loans with fair prices, affordable payments, and a reasonable repayment time frame.

Given this landscape of exploitative and cyclical products and practices, the work of policymakers, particularly at the Consumer Financial Protection Bureau, to target the worst actors and practices should not be undervalued. The Credit CARD Act of 2009, for example, increased consumer protections for credit card users by limiting fees, banning undisclosed interest rate increases, and prohibiting inclusion of the prior cycle's average daily balance when calculating an interest charge. The Payday Lending Act was also a critical policy from the Obama-era, which implemented mandatory underwriting standards for payday lenders, banned withdrawals from borrowers' accounts if the prior two withdrawals failed, and required lenders to notify borrowers about upcoming withdrawals. Unfortunately, despite the benefits to consumers, the underwriting standards were revoked by the Trump administration in 2020.

Though these regulations show promise for improving the debt-work ecosystem, they are an intermediate step, not a means of achieving our desired end-state of worker financial empowerment and mobility. **The market need for more cash will remain in place until we address poor job quality.** And until we change the narrative about the root cause of debt and shift market dynamics so bad products lose their influence and grip on the market, we are preventing better products and solutions from being given the space to take hold.

Calls to Action for Stakeholders Across the Ecosystem

To effectively help workers escape this cycle of cash flow shortfalls and bad debt, we need a concerted effort from all stakeholders across the ecosystem. We need to first help those with power understand the nature of the situation we are facing: workers are drowning in debt as a feature of our economy. **We then need to implement the right policies, the right practices and the right products, in the right places.** Alignment on an accurate, core narrative is crucial for designing solutions that help people get out and stay out of debt. Workers are not responsible for creating the debt crisis. Rather it is a longstanding crisis grounded in racism and exploitation, further perpetuated by a landscape of financial services and products that are insufficient or predatory for low-income workers of color. We need to supplement existing financial products that are successful at helping consumers build assets once they have already achieved stability, with products that enable workers to first find equilibrium via innovative solutions that disrupt this cash flow / debt cycle (including savings, insurance, hardship funds, or other debt alternatives).

1. GET WORKERS OUT OF DEBT

We need effective, scalable solutions that get workers out of debt in the short term, guided by the realities of what got them into debt in the first place. Solutions will require the design of innovative financial products or processes—at the financial product, employer or policy level—that provide alternatives to predatory debt and / or enable workers to build long-term financial security. These may include public-sector solutions such as debt

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cancellation, repayment flexibility on government-owned debts (owed to the Dept. of Education, IRS, state-run child support agencies, etc.), a moratorium on wage garnishment, or leveraging the PPP model to offer targeted debt consolidation loans. Meanwhile, the private-sector ought to introduce solutions that circumvent or undermine exploitative systems, such as the debt-collections industry. For example, The Debt Collective serves as a blueprint for a "debtor's union," providing borrowers with leverage to negotiate, settle, and dispute their debts through education and collective power; and using aggregate data and stories to advocate for "a world where college is publicly funded, healthcare is universal and housing is guaranteed for all."

2. KEEP WORKERS OUT OF DEBT

Given widespread agreement on a core narrative around debt, and short-term solutions for getting workers out from under the debt they already have, we need sweeping systems-change that will enable workers to stay out of debt over the long run. At the policy level, this means implementing the proper regulatory frameworks needed to incentivize employers to reverse job deterioration, such as increasing the minimum wage and implementing back-stops so the increased personnel costs to businesses do not get passed entirely onto consumers.

State and federal agencies must also consider how to strengthen the social safety net such that workers qualify for the support they need to avoid falling into debt traps, and retain opportunities for upward mobility. For example, increased accessibility and affordability of health insurance—both employer and marketplace offerings—would help workers avoid medical debt and increase uptake of preventative care. Expanded public benefits would also have a substantial impact on debt-avoidance, including for example the removal or raising of asset limits, and "baby bonds" offering non-tax cash benefits for parents.

Meanwhile, at the market level, employers already have a range of new or emerging benefits and products, yet their awareness and take-up remain low. These include:

- Employer-sponsored Student Debt Repayment Plans that function similar to a 401k employer match, for which the regulations are already in place
- 401k with sidecar emergency savings accounts. Research has found that households who manage their finances well contribute, on average, an additional 4 percentage points if their 401k has a borrowing option. And even households that struggle to manage their finances still contribute an extra 1 percentage point.
- Employer-Sponsored Payday Alternative Loans with key behavioral features attached such as pre-commitment savings of wage increases or automatically sustaining monthly payments even when the loan is over & diverting those payments to a savings account

Worker-centric fintechs have already claimed a foothold in the employee-benefits space, offering products that help workers overcome cash-flow shortfalls. HoneyBee, for example, offers no fee, no interest small-dollar loans that workers can access with simple employment verification, with repayments made through payroll deductions.

In addition to better, more relevant benefits packages, employers also ought to implement employee-ownership models that, by design, are inclusive of lower-level employees who are typically left out of Employee Stock Ownership Plans. Project Equity, a nonprofit promoting employee ownership, and providing consulting for companies looking to make the transition, believes in "employee ownership for maintaining thriving local business communities, honoring selling owners' legacies, and addressing income and wealth inequality." They view employee ownership as "an important approach for increasing employee engagement and wellbeing. "

3. SHIFT TO A NARRATIVE OF SYSTEMIC-ACCOUNTABILITY

Successful narrative change means shifting accountability for today's debt crisis off of the shoulders of low-wage workers. We seek to embrace language that does not reinforce inaccurate biases about the role of individual behavior in creating poverty.

For example, we should reimagine how we define and discuss "savings" to facilitate an understanding that **savings can and should be a dynamic debt-avoidance tool rather than being only about achieving a certain balance.** There is already consensus that a strong credit profile is the best way to access affordable credit (and the best way to avoid bad debt). We ought to begin viewing savings as an equally impactful means of avoiding bad debt. As outlined in Aspen Institute's "Cycle of Savings" paper: for most workers, the goal of building emergency savings is not about creating a buffer as a permanent or static fixture. It's instead about the cycle of savings that will ebb and flow as a cushion against income volatility. This cushion is the best way to avoid bad debt such as credit card balances or payday loans, similar to the way in which people want good credit to access regulated products and lower-interest rates.

Therefore, we need to disentangle saving from asset-building and create new definitions: A stable balance in a savings account designated for a long-term goal, is an **asset**. Contributing to, and withdrawing from, savings on a regular basis is **emergency savings**. Under these definitions, the measure of successful emergency saving—especially for workers in underpaid jobs—is debt avoidance. Meanwhile assets, whether liquid or invested, are meant to grow over time undisturbed. For many, in particular low-income workers, any form of saving is an unreasonable expectation. Without positive cash flow, there is a high risk of going into debt, resulting in insolvency and a likelihood that any excess cash is spent on debt payments rather than to prepare for future debt avoidance. We need to first help workers establish emergency savings by reframing it as a debt-avoidance tool and by creating financial products that reflect this use-case, thereby setting them up to build assets and net worth if and when they do eventually experience positive cash flow.

Neighborhood Trust's Promise

Neighborhood Trust is holding ourselves accountable to effectively addressing the debt crisis and worker financial insecurity at the individual, employer, market and policy levels. Our agenda today and moving forward is about surfacing and addressing the

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troubling connection between work and debt, and having an impact on worker financial health in the context of opportunities to reshape work and workplace-related financial benefits and tools. We believe the absence or reduction of predatory or expensive debt in all its forms is the most concrete evidence our worker-clients are more financially healthy.

We are committed to facilitating a shift in widespread perceptions about debt and savings over the long-run by highlighting the ways in which they're anchored in a false narrative that people are poor because of bad behavior. **We aim to shift a focus from how much an individual can do to make the best of bad circumstances, to the opportunity to develop worker-focused financial solutions so that wages lead to financial security, measured by freedom from reliance on expensive debt to get by.**

In our direct service work, we are focused on selecting strategic customers and distribution channels to ensure we are reaching diverse worker segments who are vulnerable to predatory debt. We are over-laying today's product and business model with a more intentional debt reduction and debt avoidance lens. We are adapting our impact framework and service to focus squarely on debt. For example, we are more closely examining changes in overall debt, monthly debt expenses, debt-to-income ratios and credit profiles; and tracking activity related to credit cards, student loans, car loans, and informal debt (such as loan sharks). We are also capturing data on collection accounts, liens, court involvement, wage garnishments and credit scores.

By shifting from a set of savings metrics for evaluating outcomes, to a set of debt-related metrics, we will reflect the narrative change around worker insolvency that we want to see: from one of individual responsibility to systemic inequities and the nature of work. **Our work, therefore, is not to "fix" client behaviors. Instead, it's to support clients with innovative financial solutions so they may better navigate the workplace and financial systems around them, until systemic inequalities are truly fixed.**

Our recently launched Worker Insights Initiative draws on our experience as a direct service provider of one-on-one financial coaching and will bring the lived reality and complex financial lives of low-wage workers more powerfully to the market through a dynamic data mining system built into our secure Salesforce database. We will harness client insights and data to create feedback loops for financial institutions, fintechs, benefits providers, and human resources departments, so they can design and deliver more inclusive and productive financial solutions that promote worker financial health and debt reduction. And we will engage workers as collaborators in our efforts to strengthen the advocacy campaigns of mission-aligned worker-centered organizations, and directly motivate product innovation and policy change.

TrustPlus, a service of Neighborhood Trust Financial Partners, is a financial health benefit that blends human connection with action-oriented tools and workplace products, so that workers can make the most of every hard-earned paycheck.