

SEED

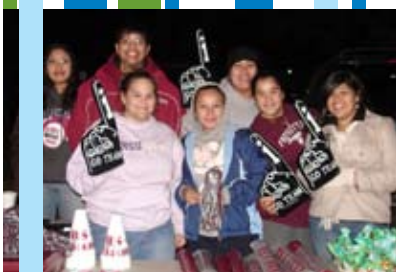
Why Children's Development Accounts?

Arguments and Evidence to Support Long-Term Asset-Building Accounts for America's Youth

Imagine a world in which every child in America grew up knowing that she or he had a nest egg to attend college, buy a home or start a business. Children's Development Accounts (CDAs), also known as Children's Savings Accounts, are an innovative new policy proposal that can make that world possible. CDAs are universal, long-term asset-building accounts established for children as early as birth and allowed to grow over their lifetime. In their ideal form, accounts are seeded with an initial deposit of \$500 to \$1,000, and built by contributions from family, friends and the children themselves. In addition, accounts are augmented by savings matches and other incentives. Savings in CDAs are usually restricted to financing higher education, starting a small business, buying a home or funding retirement. The programs also couple financial education with savings.

More than a dream, CDAs are becoming a reality in the United States and elsewhere. An early demonstration of CDAs in the United States – the SEED Initiative – has already established more than 1,000 accounts and leveraged policy proposals at the state and federal level. In the United Kingdom, more than 3 million accounts have been established using a voucher that the government sends for each newborn to open what's known as a Child Trust Fund.

Why are CDAs so promising and what kind of impact are they likely to have on children, families and communities?



The SEED Initiative

The Saving for Education, Entrepreneurship, and Downpayment (SEED) Initiative is a 10-year national policy, practice and research endeavor to develop, test, inform and promote matched savings accounts and financial education for children and youth.

The SEED Initiative seeks to set the stage for universal, progressive American policy for asset building among children, youth and families. The initiative was designed as an integrated, multifaceted effort that includes rigorous research, federal and state policy development, and demonstration at 12 sites that are testing and documenting specific aspects of children's savings programs. At the 12 demonstration sites, accountholders receive an account with an initial deposit (\$500 at most sites), a 1:1 match on deposits (typically up to a cap of \$1,000), and "benchmark" incentive payments for engaging in specific activities, such as financial education, that reinforce savings or lead to positive behaviors. Accounts are restricted to postsecondary education, home purchase, business start-up and retirement, though in practice most sites focus on saving for post-secondary education. As of June 30, 2007, a total of 1,253 SEED accounts were open at these 12 demonstration sites with a total accumulation (savings and matching incentives) of \$1.6 million.

CDAs Provide Opportunities for Economic Mobility

There is a small but growing body of research that supports the notion that assets play an important role in helping families move up the economic ladder.

Several recent studies, for example, show that regardless of a family's income level, the children of parents who own assets are more likely to have higher academic achievement and complete more years of education.¹

- In one study, children in families with as little as \$3,000 in savings had greater odds of graduating from high school than children in families without savings.²

Another recent study shows that assets may help young men to move out of low-wage jobs.

- A 1% increase in wealth provides a 5% boost to a young man's chance of escaping a low-wage job.³



CDA's Change Expectations for the Future Including Plans for College

Although a majority (57%) of Americans in the top income quintile have a four-year college education, that number is only 10% for those in the lowest income quintile.⁴ CDAs address the achievement gap by helping low-income parents and students see college attendance as an attainable goal, which in turn can improve students' K-12 academic performance and broaden the pool of low-income students who are college-ready by age 18.

Possessing assets is related to expectations about the future.

- People who own assets – such as a savings account for college – are more likely to have a more positive outlook and higher expectations for their futures and the futures of their children.⁵

Parental expectations are an important factor in predicting children's academic outcomes.

- One study using longitudinal research shows that children of mothers with higher expectations are more likely to have higher GPAs and to graduate from high school.⁶ The gap in expectations between low-income and high-income parents for their children's college attendance – a gap of 30 percentage points – mirrors the gap between college enrollment of low-income and high-income high school graduates.⁷

Also important are the expectations of the children themselves.

- Interviews with children in the SEED Initiative show that children begin to formulate ideas about their futures – including college attendance – as early as elementary school.⁸
- Other research suggests that having savings increases a child's expectations about attending college, with students holding college savings nearly twice as likely to have higher expectations for attending college than students with no college savings.⁹
- Interviews with several youth participating in the SEED initiative suggest that having an account has made them more hopeful about the future and their prospects for attending college.¹⁰

The cost of college is often a factor in why low-income families think that college is unattainable. Although it is true that tuition increases at public two- and four-year colleges continue to outstrip inflation, public perception of cost tends to be greatly exaggerated. Low-income parents tend to overestimate the cost of college – often by double the actual amount.

- The education that parents and children receive as a part of a CDA program can help families understand the true cost of college; this understanding, in turn, can lead to greater college savings for these families.¹¹

CDAs Can Increase Savings

With the national savings rate hovering near zero and Americans saving at the lowest levels since the Great Depression, CDAs represent an opportunity to address the current savings crisis facing the nation.

By making regular deposits into a children's development account, parents and children can develop a pattern of saving and make saving a habit.

- In the SEED Initiative, 1,220 children and youth have saved more than \$1.6 million in three years.¹²

Savers can build a sizeable account balance in a CDA.

- After just three years of saving in the SEED Initiative, the average saver has accumulated more than \$1,300 and, with additional deposits and compound interest, account balances could be considerably higher by age 18.
- According to modeling by The Aspen Institute's Initiative on Financial Security (IFS), for a low-income family who is eligible for a 1:1 match on personal contributions, saving just \$20 each month would build over \$14,000 in 18 years. If that same family maxed out contributions – saving \$1,000 a year matched 1:1 – they would have saved \$55,277 in 18 years.¹³

CDAs not only provide the means to build assets, they provide the opportunity for “teachable moments.” Financial education, a key component of most CDA initiatives, can be a powerful companion to ownership of a CDA and can help young savers and their families to build financial aspirations, knowledge and skills.

CDAs Can Help Expand the Economy and Create Stable Communities

CDAs are a long-term investment in children's futures with the potential for impressive financial and social returns.

- According to an IFS projection, for a state with universal CDAs in which 100,000 children are born each year, a government outlay of \$675 million over 10 years could result in \$2.5 billion dollars in asset accumulation after 18 years.¹⁴
- Those with bachelor's degrees pay almost twice as much in local, state and federal taxes as those with a high school education and nearly 3 times as much as those with no diploma.¹⁵
- Higher homeownership rates have been associated with more stable communities, higher property values, better maintained properties and increased civic involvement.¹⁶

As young adults use money in CDAs to attend postsecondary education, buy a home or start a small business, the benefits from CDAs go well beyond this \$2.5 billion. The direct benefits to children and their families reverberate in their communities and the larger economy.

CDA's are a win-win economic development strategy, at once expanding the economy by including within it communities often left out. The United States has long subsidized and incentivized asset-building opportunities through programs such as the GI bill and the mortgage interest tax deduction. However, certain communities have been excluded from these opportunities. Historically, it has been women and minorities, and today it is poor and low-income families. Most current asset-building subsidies are delivered through the tax code, but for the many Americans who have no or a very small tax liability, nonrefundable tax credits, for example, are meaningless and do not act as effective incentives for saving and investing.

A targeted match for CDA's – providing \$1 for each \$1 saved for low-income families – is an effective incentive for families who might not otherwise open accounts or save.

- An experiment that offered matching incentives for IRA contributions found that more people opened an account when a match was offered and deposits were 4 to 7 times larger than those of people not offered a match.¹⁷
- In addition, offering a match can encourage people to save by setting a savings goal: the cap on the amount matched sets a target that accountholders will try to meet.¹⁸ A perceived loss can often be a more powerful motivator than a potential gain, so avoiding losing a potential match can be a very powerful incentive to sacrifice present consumption in favor of saving.¹⁹
- Incentives can also help alter low-income families' perceptions of their own economic hardships and help those families that once thought that they were unable to save begin to engage in asset-building activities. There is a long-held belief that the poor do not have the ability to save. Low-income families do face significant barriers to asset accumulation, most notably in the form of income poverty, housing costs, disincentives of asset limits in public benefit programs, demands from relatives and friends, and other economic pressures.²⁰ However, demonstrations like the SEED initiative and others on matched savings programs have proven that the poor can and do save when they have the opportunity and the right incentives. In fact, research suggests incentives given to low-income families can result in new savings as opposed to a reallocation of existing savings simply for tax benefits.²¹

Conclusion

With CDA's, all children will be free to dream. Better yet, they will have the means to begin pursuing their dreams. The upfront costs won't be cheap, with approximately 4 million children born each year in the United States, but the benefits would be substantial. These would likely include increased economic mobility, changed expectations about the possibility of college attendance, an increase in savings, and more stable communities. Ultimately, funding a CDA at birth for all newborns will require public policy support at the federal (and even state) level. Although the idea itself may sound like a dream, the creation of the Child Trust Fund in the United Kingdom and the numerous proposals currently under consideration at the federal and state level in the United States suggest CDA's are a big idea whose time may have come.



Children's Development Accounts: Policy Precedents

A system of children's development accounts at scale is feasible, and in fact has precedent. Seven states currently offer a statewide matching grant program for the state's 529 college savings plan, and two others are administering pilot matching grant programs. In Puerto Rico, the city of Caguas began providing a savings account for all children born in the city in 2007; at least half a dozen municipalities in the United States are looking into establishing similar systems of accounts at birth. Internationally, the United Kingdom, Singapore, and Canada all have enacted national children's savings account policy.

According to polling data from the SEED Initiative, the concept of a savings account at birth receives significant support from the general public. Voters, especially parents, strongly support a universal system of accounts at birth. Support cuts across partisan lines, and the data also show that support for CDAs increases support for both Republican and Democratic candidates for public office. Voters make the connection between accounts at birth and positive outcomes for individuals, families and society; voters believe that children's development accounts would raise young people's ambitions, teach the value of saving, strengthen the middle class and the economy and reduce student debt.²²

Maine Provides Match for 529 College Savings Plan

Maine began a matching program for the state's 529 College Savings Plan, the NextGen College Investing Plan, in 2002. At that time, Maine residents with incomes at or below \$54,500, who opened a NextGen Account with a minimum deposit of \$50, could receive a one-time \$200 initial deposit from the state. These families also received a 50% match of additional contributions up to \$200.

After several years of operation, Maine assessed its enrollment by income and discovered that lower-income families were participating at a lower rate. The state concluded that the minimum initial deposit of \$50 was a barrier to participation. In 2006, Maine began offering one-time \$50 vouchers to all newborns in the state and launched a marketing campaign to encourage families to sign up. Also in 2006, Maine launched a Lifelong Learning Account program to encourage employers to match workers deposits into NextGen accounts. In 2007, Maine added additional benefits to participating in the NextGen program by allowing a \$250 state tax deduction for contributing families who have incomes at or below \$100,000 single/\$200,000 married.

In December 2007, the Harold Alfond Foundation announced the Alfond College Challenge, which will provide a \$500 grant to be invested in a NextGen Account for all Maine newborns. The first phase of the initiative began on January 1, 2008, in two cities in Maine, and will be taken statewide on or before January 1, 2009.

Data from Maine reveal that incentives were very important in accountholders' decisions both to open an account (initial deposit) and to continue saving in the account (annual match of contributions to the account).²³ Furthermore, these accounts represent new savings: two-thirds of account owners had not saved in any way for the beneficiaries' college education prior to enrolling in the 529 plan.²⁴

UK Child Trust Fund

In 2005 as a part of Tony Blair's anti-poverty strategy, the United Kingdom launched the Child Trust Fund, which provides a voucher for an account for every child born. A Child Trust Fund is an account with an initial government endowment of £250, with another £250 for low-income children. The government provides an additional contribution for accountholders when they reach age seven, and the trust fund is converted to an adult savings account when the accountholder reaches age 18. There are now more than 3 million Child Trust Fund accounts open.

Data from the Child Trust Fund program show that nearly 75% of families redeemed their government vouchers through 2006, a take-up rate that compares favorably with savings rates in 401(k) plans in the United States. Nearly a quarter of accounts have seen additional deposits beyond the initial government contribution.²⁵

Endnotes

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- ¹⁰ Scanlon, E., & Adams, D. (2005). *In-depth interviews with SEED youth: Profiles of participants in a pilot study*. [Working Paper 05-11] St. Louis: Center for Social Development, Washington University in St. Louis.
- ¹¹ Elliott & Wagner.
- ¹² Center for Social Development. (2007). *SEED account monitoring research: Participants and savings outcomes at June 30, 2007*. St. Louis: Author. Note: This total figure includes participant savings, savings matches, initial deposits and monetary rewards for certain behaviors associated with regular savings, known in SEED as "benchmark incentives."
- ¹³ IFS's model assumes a \$500 initial endowment with a maximum of \$2,000 on all account contributions placed in a lifecycle investment fund resulting in projected 8% rate of return until age 6 and decreasing to a 4.6% return at age 18. Dollars are not adjusted for inflation; present-value calculations are offered. For more information, see "The Case for Child Accounts" by IFS.
- ¹⁴ Personal correspondence with Matthew Baumgart, IFS, 3/31/08. Projections are based upon account assumptions described in note 13.
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