Asset Building Program

Children's Savings Accounts

The Case for Creating a Lifelong Savings Platform at Birth as a Foundation for a "Save-and-Invest" Economy

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The recent economic crisis has revealed that Americans had become so reliant on credit that debt levels finally became unsustainable at both the household and national level. The resulting recession, with its accompanying uncertainty and job loss, this year led to a dramatic increase in Americans' savings rate for the first time since the 1980s. Unfortunately, many families remain unable to take advantage of savings incentives that in this country are delivered primarily through the income tax system and employer benefit packages.

A growing chorus, including President Obama, now believes that a prosperous future for our country will depend on the creation of a save-and-invest economy that will enable all Americans, regardless of circumstances, to accumulate savings and assets.[1] While in the short-term, public investment should be expanded in order to stabilize the economy, any long-term plan for sustainable economic growth will have to involve increased household savings over an extended time horizon. One promising approach to that goal is children's savings accounts (CSAs), which would be established at birth for every American.

Financial stability and economic mobility are linked not only to having a job and a growing income but to the ability to save and accumulate a wide range of assets. Savings help families pay for emergency expenses without incurring high-priced debt, and they allow for investments that improve the capabilities, earnings, and life circumstances of families over time and across generations. The inability of many American families to accumulate assets places their children at a disadvantage.

CSAs would guarantee that all children would grow up knowing that they will have access to at least a modest pool of resources, and, with savings accounts that had been instituted at birth, they would have an infrastructure for meeting their savings needs throughout their lives. The accounts would help individuals pay for their educations, buy homes, and realize a secure retirement. In short, CSAs would be the foundation for lifelong economic security and mobility.

This paper makes the case for establishing a universal system of children's savings accounts in the United States. It starts with a brief overview of the essential components

[1] In his April 14, 2009, speech on the economy at Georgetown University, President Obama called for the creation of a new foundation for the economy that moves us from "an era of borrow and spend to one where we save and invest."

of a CSA and how they would work. It then provides the arguments in favor of CSAs, describes the evidence that supports the plan, and addresses relevant concerns. Of paramount consideration is the way in which a CSA policy could promote national economic growth and security while providing a means for households to save, build assets, access meaningful financial education, and plan for the future. Further, a growing body of evidence supporting the case for CSAs has been generated by several national demonstration projects and international programs, and material from those programs will be examined for insights into effective CSA policy design and implementation.

Children's Savings Accounts in Concept and Practice

In the early 1990s, Michael Sherraden, a professor at Washington University in St. Louis, Mo., articulated the idea of giving all individuals tax-advantaged savings accounts at birth. Sherraden posited that income support policies, such as welfare, were not enough to help poor families climb out of poverty and that asset-building policies such as CSAs and Individual Development Accounts (IDAs), in which savings of low-income depositors are matched, were needed.[2] His concept helped drive the development of both a privately funded national demonstration project and a series of legislative proposals including the America Saving for Personal Investment, Retirement, and Education Act (the ASPIRE Act). These efforts have generated a series of insights which continue to inform policy development.

In 2003, a national demonstration program called the SEED Initiative (Savings for Education, Entrepreneurship and Downpayment) was launched to explore the potential of CSAs.[3] More than 1,000 matched savings accounts were opened for low- and moderate-income children at 13 sites nationwide. Nonprofit community partners helped manage the accounts and deliver support services. Since its implementation, the SEED Initiative has been studied extensively, with special attention given to variations in program elements such as support services, match rates, savings products, and differing age cohorts.[4]

Research findings led to the identification of the following four characteristics that would be central to a successful national CSA policy:

- *Universal:* Every child, regardless of income or background, should be given an account at birth in order to ensure that no one is left out of this foundational system for saving, developing assets, and building wealth. Universality would build a sense of unity and participation, essential features for maximizing the impact of the policy.

- *Lifelong:* While people have different savings goals that depend on both age and personal preferences, the need to save for one's future is a lifelong endeavor. Requiring that all accounts retain at least some minimum balance throughout a person's lifetime would ensure that all Americans remain connected to a savings system. If accounts were allowed to close, some people inevitably would be left behind, which would undermine the benefits of universality.

- *Progressive:* Research has demonstrated that poor families, though constrained by circumstances, can save. These families, however, have almost no access to federal savings incentives, which are provided mainly through the income tax system and through employers. A progressive CSA system would provide the greatest benefits to the low- and moderate-income families that need the most help with saving.

[2] Sherraden (1991).
[3] The SEED Policy & Practice Initiative is a partnership between funders, CFED, The Center for Social Development (CSD) at Washington University in Saint Louis, University of Kansas (KU) School of Social Welfare, New America Foundation, Aspen Institute Initiative on Financial Security (IFS), and the other state policy, community and experimental partners.

[4] Mason et al. (2009).

- *Asset Building:* Asset building should be a key goal of any CSA system. Savings provide the greatest returns when they are put toward productive investments in areas such as postsecondary education, homeownership, small business creation, and retirement. A CSA system should encourage the use of savings for such purposes, although it should not necessarily forbid the use of savings for other purposes.

Other important features of an effective large-scale CSA system have been identified. They include creating a system that would be:

- Automatic: Manual enrollment can be difficult and costly. Automatic enrollment at birth would be simple, and it would ensure a universal system.

- Simple: The more complex a CSA system, the less likely individuals are to participate. The system should be as simple as possible in both design and function.

- Appropriate Choice: Behavioral economics shows that too many investment choices can lead to indecision. However, individuals need to have enough choices to be able to meet their personal savings and investing needs and preferences.

- Adequate: To amass balances large enough to make a meaningful investment in postsecondary education, homeownership, or a business, government should assist low-income families through seed deposits and annual matching funds.
- Low Cost to Participants: Because high fees can reduce returns, costs must be kept low, particularly for low-income families with smaller balances.

- Protective of Consumers: The CSA system must have similar and consistent management and oversight regardless of the type of account investment or where it is held.

- Linked to Financial Education: Paring CSAs with financial education could lead to improved savings outcomes.

- Engaged With Partners: To maximize the effectiveness of a national CSA system, stakeholders such as financial institutions, community groups, local governments, and nonprofits would need to be engaged.

Although a CSA policy could be structured in many ways, the America Saving for Personal Investment, Retirement, and Education Act (The ASPIRE Act) is one example that has been developed in detail. Since 2004, a bipartisan coalition of legislators has supported this bill, which incorporates many of the principles just outlined and represents some of the best thinking in the asset-building field.

The ASPIRE Act would automatically provide a savings account for each child born in the United States when he or she is issued a Social Security number[5] and would remain open throughout the child's lifetime. Each account would be endowed with $500 and supported by incentives to encourage additional savings. Low- and moderate-income families would receive larger seed deposits and annual matching funds. The only qualified uses for account resources would be postsecondary education, homeownership (after the age of 25) and retirement (after the age of 59 ½).

Accounts would be administered by an entity similar to the one that oversees the Thrift Savings Plan (TSP), which is the retirement account system for federal employees. The TSP has low administrative fees and a limited, but diverse, set of investment options. Under the ASPIRE Act, participants would be free to roll their accounts out of the TSP-like entity and into one managed by a private financial

[5] The current version of the bill calls for each child to be given a "Lifetime Savings Account. This account would receive similar tax treatment to a Roth IRA and could provide the basis for universal access to IRAs, such as the Auto-IRA proposed by the Obama administration.

institution. Accounts would also be supported with financial education services that would be available to both account holders and their families.[6] A new version of the ASPIRE Act is being crafted for introduction in the 111th Congress.[7]

Savings and National Economic Growth

One of the primary forces behind the financial crisis was the high level of consumer debt. Before the recession, consumer spending had helped fuel the growth of the national economy, but much of the consumption was paid for with credit. Meanwhile, savings were decreasing to unprecedented levels. To put the national economy on a sound footing and to create sustainable economic growth, the optional distribution of consumption, debt, and saving needs to reconsidered. As part of this equation, domestic savings has to increase. A universal CSA system could facilitate that process.

In the near term, large amounts of government spending, despite rising deficits, are and will be necessary to offset the drop in consumer spending brought on by the financial crisis. The so-called paradox of thrift is that reduced economic prosperity drives consumers to spend less, which, in turn, exacerbates recessionary pressure. The role of savings during a recession has been debated, but the consensus is that over the long term, savings drive economic growth by providing the resources to fund productive investments by entrepreneurs, businesses, and government.

If a country has a low rate of saving, less capital is available to lend, which generally leads to higher interest rates and less investment. However, the evolution of global capital markets has appeared to make internal savings less relevant in the United States, which has continued to attract capital for investment from foreign sources at relatively low interest rates. In the long run, though, foreign countries may not be a reliable or desirable source of capital. Increased borrowing from overseas also fuels a larger trade deficit, which, again, in the long run, has a negative effect on domestic economic growth.

Before the recent increase in personal savings caused by the recession, the U.S. saving rate had been plummeting since the early 1980s. As recently as the first quarter of 2008, it hovered just above zero.[8] At the same time, household debt skyrocketed. According to the Federal Reserve's 2007 Survey of Consumer Finances, American families went from carrying a median debt load (in real dollars) of $24,000 in 1989 to $67,300 in 2007.[9]

A universal CSA system eventually would support savings by all Americans and lead to the creation of a sizable pool of domestic capital, a necessary feature of a sustainable, dynamic, and growing economy.

CSAs represent a vehicle for increasing personal savings and, in turn, raising the national savings rate because accounts seeded with a small government deposit could serve as magnets for additional savings over a lifetime. During an account holder's childhood, resources would flow only into the account. What's more, if the system were progressive and provided greater incentives and benefits to lower-income families, a good portion of the savings likely would be new.[10] Even more significantly, a universal CSA system eventually would support savings by all Americans and lead to the creation of a sizable pool of domestic capital,

[6] For more information on the ASPIRE Act, see Cramer (2009).
[7] Sen. Charles Schumer (D-N.Y.), Rep. Patrick Kennedy (D-R.I.), Rep. Tom Petri (R-Wis.), and Rep. Cooper (D-Tenn.) will be initial co-sponsors.

[8] U.S. Department of Commerce, Bureau of Economic Analysis, Personal Savings Rate: http://www.bea.gov/BRIEFRM/SAVING.HTM.
[9] 2007 Survey of Consumer Finances, 2007 Survey of Consumer Finances Chartbook, p. 831.
[10] Tax Policy Center Briefing Book: A Citizen's Guide for the 2008 Election and Beyond. Savings and Retirement section.

a necessary feature of a sustainable, dynamic, and growing economy.

Savings and Economic Security

At the household level, the case for savings is rooted in its role facilitating economic security and mobility. When families have an unanticipated expense or a shortfall in income, such as a large medical bill or job loss, savings can help them avoid having to cut back on basics, but low- and moderate-income (LMI) families often lack that fallback option. Research shows that financial emergencies affect them more than their wealthier counterparts and that their recovery time from a financial crisis is longer.[11] For a low-income family, for example, an expensive car repair that cannot be covered can lead to a job loss and being short on rent can lead to eviction.

It does not necessarily take a large amount of savings for low- and moderate-income families to avoid financial disaster. One study showed that having access to as little as $500 to cover an unanticipated expense could benefit a family as much as a tripling of their income.[12] An alternative to savings is credit, of course, but payday loans and credit cards can trap low- and moderate-income families in a cycle of high-cost debt. Additionally, if families have savings and assets to fall back on, they can be more strategic about taking on debt, borrowing less often and being able to get lower interest rates because they have collateral.

Statistics clearly show the need for Americans, particularly low- and moderate-income Americans, to save more. According to the Federal Reserve's 2007 Survey of Consumer Finance, Americans in the lowest income quintile, with a median income of $12,300, have a median of $1,700 in financial assets, and more than 20 percent of families in this quintile have zero financial assets. Almost 8 percent of all American households also have no access to a savings account.[13] According to the Consumer Federation of America (CFA), less than one-third of low-income households have a savings account, and less than three-tenths of low-income households have $500 or more in emergency savings.[14] The CFA also reports that less than half of moderate-income households have a savings account, and less than half of moderate-income households have $500 or more in emergency savings.[15] Despite this lack of savings and account access, most low- and moderate-income Americans recognize the importance of saving and would like to be able to do so. In a survey of low- and moderate-income households in Detroit, 78 percent of respondents said that one of their main motivations for saving was "to feel financially secure"; however, 70 percent reported having had a recent emergency that made achieving that security more elusive.[16]

On the other side of the ledger, American families went from carrying a median debt load (in real dollars) of $24,000 in 1989 to $67,300 in 2007, according to the Federal Reserve's 2007 Survey of Consumer Finances, with more than 18 percent of the average debtor family's income going toward debt payments. [17] Families in the lowest income quintile saw their debt burdens double from 2000 to 2007,[18] with more than a quarter devoting more than 40 percent of their income to paying off debt.[19] Low- and moderate-income households with credit card debt have fewer financial assets than those without credit card debt, too.[20] According to a study by Demos and the Center for Responsible Lending, seven out of 10 low- and moderate-income families use credit cards to pay for basic living

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[11] Mayer and Jencks (1989).
[12] Mayer and Jencks (1989).

[13] 2007 Survey of Consumer Finances, 2007 Survey of Consumer Finances Chartbook, p. 146.
[14] Brobeck (2008).
[15] Brobeck (2008).
[16] Barr (2008).
[17] 2007 Survey of Consumer Finances (Checking Box). http://www.federalreserve.gov/Pubs/OSS/oss2/2007/bulletin.tables.int.xls.
[18] Baily, Lund, and Atkins (2009).
[19] 2007 Survey of Consumer Finances (Table 18). http://www.federalreserve.gov/Pubs/OSS/oss2/2007/bulletin.tables.int.xls.
[20] García (2008).

expenses.[21] In addition, about 15 million people, most of whom are low or moderate income, take out high-interest payday loans every month.[22]

CSAs would not be a primary source of emergency savings. Instead, they would offer a means for developing and supporting the habit of saving, but in the direst of financial circumstances, it still might be more desirable for families to tap CSA savings intended for long-term needs rather than face a debilitating outcome such as foreclosure or bankruptcy.

Savings and Asset Building

One of the primary justifications for creating a system of children's savings accounts is that it creates a pathway to the large-scale accumulation of assets. Savings built up over time can be deployed in a variety of productive ways that make a significant difference in people's lives. These include being able to pursue post-secondary education and training, saving up for a downpayment on a home, or savings for retirement security. These investments can then provide returns that lead to greater economic stability, mobility and prosperity for families. A universal CSA system would provide all Americans access to a savings platform that would begin this process early in life.

The U.S. government has a long history of policy initiatives that encourage the accumulation of assets, often by providing access to capital. Three of the biggest were the Homestead Act of 1862, the GI Bill of 1944 and the creation of the Federal Housing Administration (FHA) in 1934. The Homestead Act provided ownership of land to those who would go west and work their land claim for five years. More than a million people took advantage of that opportunity to build wealth, and many passed their assets on to next generation. The GI Bill helped veterans pay for higher education and training, acquire loans to start new businesses, and get mortgages to purchase homes. Over 12 years, almost 8 million veterans benefited. In addition, a congressional report estimated that the GI Bill generated as much as $7 for every $1 invested. The FHA was created to help more Americans purchase homes. Through its mortgage insurance and other financial products, it has played an important role in expanding homeownership.

Today, the federal government mainly promotes asset building and long-term savings through the tax code, but tax incentives do not reach many lower-income families because they have little or no tax liability. A universal and progressive CSA system would be a major step toward remedying this. Low-income families face significant barriers to saving, including their incomes, high housing costs, and public assistance eligibility rules that put a low cap on asset holdings. However, several rigorous national demonstration programs have shown that the poor can save and build assets, especially if given access to meaningful incentives and support structures. For example, over three years, 1,220 children saved more than $1.6 million through CSAs that were opened through the SEED Initiative. Their average account balance was more than $1,300 and probably would show much more growth during 18 years of compound interest and additional deposits.[23]

Another groundbreaking program was the American Dream Demonstration (ADD).[24] The ADD opened Individual Development Accounts (IDAs) for more than 2,300 low-income adults at 13 sites nationwide. After seven years, the average account balance was more than $1,500 (including matching funds). Most participants used their savings to purchase a home, start a small business, or pay for postsecondary education. [25]

[21] Demos and CRL (2005).
[22] The Commission on Thrift (2008).

[23] SEED Account Monitoring Research: Participants and Savings Outcomes, June 30, 2007. St. Louis, Mo.: Center for Social Development, George Warren Brown School of Social Work, Washington University in St. Louis.
[24] The American Dream Demonstration was a seven-year national demonstration program that examined the potential of Individual Development Accounts (IDAs) to help low-income individuals improve their economic circumstances.
[25] Sherraden (2002).

Both the SEED and ADD demonstration projects included direct matching of deposits, which probably would be a key feature of any progressive CSA system. Research has shown that matching deposits encourages people who otherwise would not save to start saving and that they can encourage savers to save more than they otherwise would. The cap on the amount matched sets a target many account holders try to meet, because any match money left on the table is often seen as a missed opportunity or even as a loss.[26] For example, a research experiment that offered matched incentives for IRA contributions at tax time found that more people opened an account when a match was offered and that their deposits were four to seven times larger than those of people not offered a match.[27]

One insight from the growing field of behavioral economics is that a perceived loss can be a more important motivator than a potential gain, so avoiding the loss of matching funds can be a powerful incentive to save.[28] Other mechanisms that could be part of a universal CSA system, such as automatic account opening and automatic regular deposits, also have been found to help low-income families build meaningful levels of assets.[29] Additionally, to be effective, a CSA system should be structured to make it relatively easy for third parties, such as extended family members, nonprofits, and businesses, to contribute to the accounts. The United Kingdom enacted a universal CSA system earlier in this decade, and initial study has shown that third-party contributions have played an important role in helping children in the system attract deposits.[30]

All Americans should have the opportunity to build assets beginning at birth, with particular attention given to helping children in lower-income families. If supported by the right set of incentives and institutional structures, in time, a significant level of resources could be built. While the return on savings and investment would vary, a steady stream of contributions would lead to a meaningful accumulation of assets. If a child's account were seeded with $500 at birth, and the family was able to make deposits of $50 a month, by age 18, that child's account would reach more than $19,000 based on a 5 percent return and more than $27,000 by the time the child turned 25.[31] Such an amount could make a meaningful difference in a young adult's life and serve as a foundation for future savings and asset building.

[26] Schreiner and Sherraden (2006).
[27] Duflo et al. (2005).
[28] Mullainathan and Thaler (2000).
[29] Grinstein-Weiss, Wagner, and Ssewamala (2006).
[30] Cramer (2007).

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Savings Throughout Life

One significant challenge for policymakers is how to ensure that vulnerable workers have access to savings opportunities throughout their lives and how to encourage the deployment of their assets in ways that enhance rather than undermine their economic security. The nation's current savings policy is failing many of these households

Today's voluntary, employer-based system for savings covers only about half the workforce. It misses the tens of millions who are in part-time, temporary, or nonstandard jobs. Further, while the majority who lack an account and means for easy, automatic, payroll-deducted saving could use an Individual Retirement Account (IRA), few in fact do have one. One reason is the upside-down tax incentives for saving: tax deductions provide the greatest incentive (35 cents on the dollar) to high-bracket earners, but no incentive at all for the 40 percent at the bottom of the

[31] Cramer (2006).

income ladder who have no income tax liability to offset. Another failure of the nation's savings policy is its exclusive focus on building assets for use during retirement. Creating opportunities to save for other purposes, such as education, homeownership, or entrepreneurship, is a necessary precursor for helping families build a solid bridge to retirement.

A new savings infrastructure, therefore, should include targeted and accessible incentives and be designed to ensure that everyone can participate. Those who need more resources or stronger incentives should receive them, and the vehicles for accumulating assets should be available throughout an individual's life. There are a number of ways to build such an inclusive, asset-based policy system, but it is likely to include, at its core, an account-based structure, like the Singapore Central Provident Fund.[32] That account-based system was initially designed to promote retirement savings, but it has been augmented since its establishment in 1955 to facilitate savings for additional purposes. Today, it functions as a savings pipeline that extends throughout a participant's lifetime.

In the United States, a new savings policy could be phased in, beginning with a universal system of children's savings accounts started automatically at birth and linked to other long-term savings vehicles, such as IRAs and 401(k)s. Proposals to create access to a portable savings platform, such as the Auto-IRA, which would enroll workers in savings plans funded through automatic payroll deductions—would be improved through the universal provision of children's accounts.

Not only would this ensure that everyone has an account but it starts the savings and learning process early in life. An additional feature of this infrastructure is the potential to draw upon the insights from the emerging field of behavioral economics. If the first step is to provide every citizen access to a portable savings account system, the second is make sure the infrastructure, incentives, and power of inertia are capable of producing the levels of savings that can make a difference over the long-term.

[32] Loke and Cramer (2009).

Savings and Asset Effects

Supporters of children's accounts initially believed that the accounts would lead to positive changes in the way children think about the future, and recent research has supported that theory. Specifically, research has found a strong link between postsecondary education and economic mobility. Students who earn two- or four-year college degrees typically have higher incomes than those who do not. Low-income students, in particular, who earn a college degree are much more likely to advance their economic status than those who do not earn a degree.[33] Given the evidence, policies that promote postsecondary educational attainment among low- and moderate-income students, appear to be a promising strategy to help alleviate intergenerational poverty. One such policy that could help accomplish this is a universal system of CSAs.

Several studies have found a positive association between parental assets and indicators of children's academic achievement, such as high school graduation rates, test scores and college enrollment.[34] Further, the association between assets and some of these outcomes is typically much stronger than the link between these outcomes and other factors, such as parental income and race.[35] This can be explained partly by the direct effects of assets on children's educational outcomes, effects that include having the resources to pay for postsecondary education and related expenses along with access to better resources to prepare for postsecondary education. However, there is also evidence of indirect effects of assets on children's educational outcomes. The hypothesis is that having even a relatively small amount of assets changes the expectations and behaviors of both children and their parents. For example, in one study mothers with assets, in the form of a home or savings, had higher expectations for their

[33] Haskins, Holzer, and Lerman (2009).
[34] Sherraden (2009).
[35] Conley (2009).

children's educational outcomes than mothers without assets.[36] Another study found that children with savings were twice as likely to have higher expectations for attending college than students with no college savings.[37]

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Other studies have found that children from families that own their homes were less likely to have emotional or behavioral problems than children from families that rent.[38] Another study also found that daughters of homeowners were less likely to become teenage mothers than daughters of renters.[39] While these results may reflect the impact of housing stability rather than ownership, they reinforce the connection between assets and the ability to control one's life. In addition to behavioral benefits, assets also have been found to have effects on the psychological well-being of children. One study found that 23-year-olds whose parents put aside money for their college educations starting at age 1 reported higher self-esteem than those whose parents did not put aside money.[40]

Additional evidence from the SEED Demonstration found that CSAs specifically are associated with beneficial behaviors in both parents and their children. In detailed interviews, parents of SEED participants reported effects such as future orientation, greater sense of security, higher self-esteem, and better fiscal behaviors. Their children reported future orientation and greater financial knowledge as a result of saving in CSAs.[41]

[36] Zhan and Sherraden (2003).
[37] Elliot et al. (2007).
[38] Boyle (2002).
[39] Green and White (1997).
[40] Axinn, Duncan, and Thorton (1997).
[41] Scanlon, Adams, and Shanks (2008).

Overall, the assets effects described above maybe one of the greatest and most transformative benefits of savings and building assets for children. The changes in behavior and expectations are linked with many positive externalities, some of which could have a profound influence on economic opportunity and mobility for the most vulnerable children in this country. A universal system of CSAs may be the ideal delivery mechanism for ensuring that all children have access to a savings platform that can trigger these "asset effects."

A Meaningful Trigger for Financial Education

Account access and ownership provides an excellent vehicle for the delivery of financial education, which can be offered to accountholders and their families. The opportunity to actively contribute to one's own account is a powerful tool for developing a savings habit, a behavior linked to healthy personal financial management. Financial education is widely recognized as a necessary component of economic security. Regardless of income, families that have a poor understanding of personal finance have a harder time managing and holding on to their resources. A 2008 study on asset building and low-income families found that the benefits of asset ownership "might be raised significantly with the addition of expanded financial education, especially for low- and middle-income families."[42]

Several surveys have found low levels of financial literacy among Americans, particularly among lower-income Americans. A 2001-2002 survey of low-income adults entering the Financial Links of Low-Income People (FLLIP) financial management-training program found an average correct response rate of 63 percent on a 48-question test.[43] Another survey found even lower levels of financial literacy among young people. In 2008, the Jump$tart Coalition gave high school and college students a 31-question financial literacy test.[44] High school students with very-low-

[42] Lerman and McKernan (2008).
[43] Anderson, Zhan, and Scott (2004).
[44] Mandell (2009).

income parents[45] answered only 43 percent of the questions correctly. Performance on the test was better among students who had higher-income parents, but still topped out at an average score of 52 percent for the high school students with very-high-income parents.[46] College students, probably because of their higher academic attainment, faired somewhat better. Among college students with very-low income parents, the average score was 52 percent; for those with very-high income parents, the average score was 65 percent. Such dismal scores make it is hard to argue against the need to increase levels of financial education for Americans of all ages.

But what makes a financial education program effective? Empirical studies are rare, though several provide insight into how particular interventions can yield positive changes in financial behavior and decision-making. One study evaluated the impact of financial education on low-income people participating in a special, matched-savings (Individual Development Account) program. It found that people who had 12 hours of financial education deposited on average $10.80 more each month into their accounts than did those who did not have the 12 hours of education—a significant amount for low-income people. Each additional hour of financial education, up to six hours, resulted in an additional $1.24 in monthly deposits, while each additional hour between seven and 12 hours of education resulted in $0.56 more in deposits per month.[47] Another study delved into the effect of retirement seminars on savings and wealth and found that financial education through retirement seminars increases savings by about 18 percent. Most affected were those at the bottom of the income distribution, where accessible savings in the bottom quartile was 70 percent higher because of financial education.[48] Still another study found that those who scored well on credit management evaluations said that they followed recommended credit management practices.[49]

Unfortunately, there is little information on the effectiveness of financial information for youth. Childhood financial education needs to be prescriptive, preventative, developmental and delivered on a massive scale. Evidence suggests that young people will respond to individualized programs targeted to a specific area of finance, but before we can craft a financial education program that can be delivered on a massive scale, we need a better understanding of how to motivate students to learn and participate and how to improve teacher training.[50] Nevertheless, increased financial knowledge gained through classes obviously contributes to increased fiscal prudence, an orientation toward the future, and a sense of security.[51]

Educating parents not only engages them in their children's savings accounts but ensures that financial education will flow from parent to child.

Parental education and involvement are also key components of a CSA program. Educating parents not only engages them in their children's savings accounts but ensures that financial education will flow from parent to child. The education that parents and children would receive as a part of a CSA program would help them understand the true cost of college, which, in turn, could lead to greater college savings.[52] Financial education, targeted to specific behavior savings in CSAs, ensures that families understand the value of their child's CSA and can maximize the potential benefits from owning an account.

[45] Parents with annual incomes under $20,000.
[46] Parents with annual incomes of $80,000 or more.
[47] Clancy, Grinstein-Weiss, and Schreiner (2001).
[48] Lusardi (2003).
[49] Hilgert, Hogarth, and Beverly (2003).
[50] McCormick (2008).
[51] Scanlon and Adams (2005).
[52] Elliott and Wagner (2007).

Increasing Financial Inclusion

The lack of access to mainstream financial services is a primary source of economic insecurity for millions of American families. Costly alternatives, such as payday loans, refund anticipation loans, and pawn shops, often serve to strip away assets and savings rather than help families build them up. The broad provision of children's savings accounts cannot solve the unbanked and underbanked problem, but for a number of reasons it would offer a potential avenue for greater financial inclusion. First, these accounts could offer access to a long-term savings platform. Second, these accounts would represent an affordable and safe point of entry into the world of personal finance. Third, the accounts have the potential to be linked to other more mainstream financial services. Creating access to low-cost and high-quality financial services is essential for undermining the higher cost products that are currently used by low- and moderate-income families.

The precise role of financial institutions in a CSA system will vary depending on policy design, but almost all viable proposals involve some form of partnership between the private and public sectors. In fact, it is this partnership that can lead to increasing financial inclusion on a large scale. Funds invested in CSAs and the accounts themselves likely would be managed by private financial institutions, while the public sector would establish the rules and infrastructure for the accounts. The public sector also could provide seed funding and access to incentives, such as matching deposits of targeted participants. Regardless of the exact design of the policy, a universal system of CSAs will have roles for both the public and private sector to fill.

In the United States, the 529 college savings plans provide the best large-scale example of a public/private partnership for providing savings accounts for children. These plans, named after section 529 of the Internal Revenue Code, were authorized by the federal government, although each state administers its own program. Private financial institutions bid for contracts to manage the funds in each state. As of the end of last year, over 11 million children benefited from 529s, which represent billions of dollars in investments. While these accounts typically have not been geared toward encouraging low- and moderate-income families to save for their children's postsecondary education, many states have offered and experimented with such features. A universal system of CSAs could build on the success of the 529 model and expand its benefits to all children throughout their lifetimes.

The United Kingdom's Child Trust Fund Experience

Earlier this decade, the United Kingdom created and implemented a universal accounts at-birth policy.[53] Today, the UK Child Trust Fund, with over 4 million accounts created, is the most developed CSA system in the world.

To date, 4 million accounts have been created.[54] Twenty-four percent of all accounts have received additional contributions, including those most recently opened. Although the value of contributions has varied, the average amount has been 289 pounds.

The total value of contributions has been 278 million pounds. The total market value as of April of 2008 was 1.9 billion pounds. This represents approximately $3.7 billion in assets under management, with an average account balance of over $900.[55]

Previous analysis of program data from 2007 revealed that of the roughly one-third of families that received an additional payment when the account as opened due to their low incomes, only 15 percent made contributions after the account was opened. The amount of these contributions has been lower than those from higher income families.

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[53] Cramer (2007).
[54] The most recent data from the Child Trust Fund was released in October 2009 and covers the period from the policies inception in 2002 up until April 2008.
[55] All of these figures are from HM Revenue and Customs (2009) Child Trust Fund Statistics.

The Basic Parameters of the UK's Child Trust Fund

Every child born in the United Kingdom after September 1, 2002 has been issued a voucher worth 250 pounds to open the account. Children from lower income families, those with incomes in the lower third, receive an additional 250 pounds. Additional funds can be deposited into the account from a variety of sources and earnings are tax-free, but there is a limit on annual contributions of 1,200 pounds (approximately $2,400). No withdrawals can be made until the accountholder turns 18, after which there are no restrictions on what the funds can be used for. Accountholders will also have the option of rolling over the CTF account balances into other savings products.

The CTF vouchers are issued when parents sign up for the Child Benefit, which is a tax-free monthly payment to anyone bringing up a child. Eligibility for the child benefit is not affected by income or savings and it has a near universal take-up rate. Parents then take the vouchers to the designated financial provider of their choice that has agreed to offer CTF accounts. If the voucher is not redeemed within one year of issue, the government will automatically open an account in the name of the child and notify their parents.

Providers of CTF accounts are required to offer a standard product called a stakeholder account, which invests in a diversified stock portfolio and is subject to rules designed to reduce risk, such as lifecycle investing. There is also a cap of 1.5% on the fees providers can charge for these accounts. There are also non-stakeholder account options, but these accounts do not have the same consumer protections as stakeholder accounts and have only been marketed to families that want a higher degree of choice.

Contribution Levels for All Accounts Receiving Contributions

	All Accounts	Accounts with Additional Payments
Under $200	31%	45%
Between $200 and $600	43%	44%
Between $600 and $2400	21%	11%
Over $2400	5%	0.10%

Source: Analysis by Cramer (2007) from HM Revenue and Customs Data.

Further, there was variation in the market values of the accounts. As of 2007, 31% had values under $600, 48% had values between $600 and $1,200, 15% had values between $1,200 and $2,400, and 6% had values over $2,400.

Child Trust Fund Account Market Values

	All Accounts
Under $600	31%
Between $600 and $1200	48%
Between $1200 and $2400	15%
Over $2000	6%

Source: Analysis by Cramer (2007) from HM Revenue and Customs Data.

Since its creation, the Child Trust Fund has continued to pick up support from both political parties and government officials. Although some of this support was eroding given increasing fiscal pressures brought about by the financial crisis of 2008 and 2009. Previously, several steps have been taken to both expand the program and better integrate it with other government services. The government has committed to making top-off contributions when the accountholder turns 7 and is considering another contribution at age 14. Additional consideration is being given to making further contributions to the accounts of children in foster care (and disabled children?). The program has also been widely recognized by the public. Through an extensive marketing campaign, the Child Trust Fund office has also helped to make awareness of the program among parents at 98 percent.

While the program itself is still in its infancy, there are many valuable lessons that can be gleaned from it for policymakers in the United States, especially with regard to how different families initially interact and contribute to these savings vehicles for their children. At its heart, the CTF has the same major objectives as would be expected from any universal CSA system: ensuring children have savings when they enter adulthood; promoting the savings habit; educating children about the basics of saving and personal finance.

The Required Investment

Ultimately, the costs of implementing a large-scale children's savings account policy will depend on the size of the initial investment, the structure of incentives to promote deposits, and the amount of support for administration. For example, the ASPIRE Act would cost an estimated $40 billion across 10 years. This figure represents a $500 seed endowment for each of the estimated 4 million children born each year, another $500 for families with lower incomes, and the potential to match deposits of targeted families.[56] A policy that provided a $250 savings account for every newborn would have an annual cost closer to $10 billion across 10 years; even that level of investment, however, might be sufficient to trigger the positive effects detailed in this paper.

Reviving an economy capable of producing long-term sustainable growth will require both increased savings and investment, but this change in Americans' approach to finances will not happen by itself. We need policies that will provide the right set of incentives, institutions, and vehicles to support savings. Recent efforts here and abroad as well as a growing body of research have demonstrated how a system of child savings accounts could be the centerpiece of such an effort. Not only would CSAs empower people to start saving early, they would also encourage positive behavioral changes, increase their financial knowledge, and facilitate greater financial inclusion. These changes would provide the foundation for a more vibrant U.S. economy in which the benefits could accrue to all Americans.

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[56] See Cramer (2006) for a more detailed cost estimate of the ASPIRE Act.

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