

CREATING A FINANCIAL STAKE IN COLLEGE: REPORT IV OF IV

IDEAS FOR REFINING CHILDREN'S SAVINGS ACCOUNT PROPOSALS

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“Creating a Financial Stake in College” is a four-part series of reports that focuses on the relationship between children’s savings and improving college success. This series examines: (1) why policymakers should care about savings, (2) the relationship between inequality and bank account ownership, (3) the connections between savings and college attendance, and (4) recommendations to refine children’s savings account proposals. This series of reports presents evidence from a set of empirical studies conducted by Elliott and colleagues on children’s savings research, with an emphasis on low-income children, relevant to large-scale policy proposals. One such proposal, The ASPIRE Act, would encourage savings by opening an account for every newborn child, seeding the account with an initial deposit and progressively matching contributions, and designating accumulated resources to support post-secondary education or other targeted uses such as homeownership or retirement. Collectively, these reports build on the compelling observation that children with savings in their name are given a stake in their future. As such, they are more inclined to take control over their educational experience and feel more empowered to attend college and persist through graduation.

This series of reports has suggested that Children’s Savings Accounts (CSAs) are a type of formal institution designed to alter children’s savings and educational behaviors. Specifically, CSAs have the potential to serve as a policy vehicle to allocate resources (intellectual and material) to low- and moderate-income children so that they can compete in the 21st Century. In today’s highly technical, specialized global world, effort and ability are no longer enough for low-income families to lift themselves out of

poverty. Access to high-quality institutions and the resources they provide are critical to being able to compete. Beginning in the 1990s, CSAs were proposed as a way to create an inclusive and accessible opportunity for lifelong savings and asset building (Sherraden, 1991). In the intervening years, Singapore, the United Kingdom, South Korea, and Canada have initiated policy efforts with CSAs that build upon this approach (Loke & Sherraden, 2009). In the United States context, CSAs have been discussed as a potentially novel and promising asset approach for helping

children think about their future and prepare for college. While no national CSA policy has been adopted in the United States, a number of legislative proposals have been developed, such as America Saving for Personal Investment, Retirement, and Education (ASPIRE) Act, Young Savers Accounts, 401k Kids Accounts, Baby Bonds, and Portable Lifelong Universal Savings Accounts (Cramer, 2010). These policies have champions spread across the political spectrum.

The ASPIRE Act is probably the most recognizable of the proposals and can serve as a placeholder for what a large, universal children’s savings account effort would look like. ASPIRE would create “Lifelong Savings Accounts” for every newborn, with an initial \$500 deposit, along with opportunities for financial education. Children living in households with incomes below the national median would be eligible for an additional contribution of up to \$500 at birth and a savings incentive of \$500 per year in matching funds for amounts saved in accounts. When account holders turn 18, they would be permitted to make tax-free withdrawals for costs associated with post-secondary education, first-time home purchase, and retirement security.¹ Report IV examines ways to refine CSA proposals, such as the ASPIRE Act, so they more effectively build on recent theoretical and empirical work in the field² by presenting specific policy ideas that can be incorporated into the policy design process.

3-in-1 Accounts

Differences between the accounts examined in this series and tax-advantaged accounts have implications for policy. Tax advantaged accounts—such as Coverdell Education Savings Accounts, 529 college savings plans, and Roth Individual Retirement Accounts—offer their owners benefits such as tax-deferred accumulation and tax-free withdrawals, if the accounts are used for the intended

purposes. These accounts are less liquid than a bank savings account. Moreover, people likely do not think of them in the same way. In other words, money is not entirely fungible, different accounts hold different purposes and meanings. These meanings affect how people deposit money into the accounts, and how they use the money (Xiao & Anderson, 1997; Winnett and Lewis 1995). Studies conducted by Elliott and colleagues that are reviewed in Reports I and III in this series examine children’s savings in a bank account. Unlike tax-advantaged accounts, local bank savings account deposits can be more easily withdrawn and used without penalty.

Typically, CSAs have been developed to solve the problem of financing college when children reach college age; however, findings suggest that a better design might allow children to also access a portion of their savings on a more regular basis to pay for day-to-day expenses.³ In this report it is speculated that the ability to use part of their savings for day-to-day expenses may help children, particularly low-income children, to associate savings with solving problems in their life that matter to them, further strengthening their sense of perceived control. Perceived control is one of the most robust predictors of student resilience and academic success (Skinner, Wellborn, & Connell, 1990).

Beyond liquid asset findings, there are other reasons for suggesting that it would be useful to include short-term and intermediate accounts in the design of CSAs. One reason is related to young children’s cognitive capacity. CSAs have been proposed as a lifelong savings tool. However, very young children lack the cognitive capacity to foresee future difficulties in the same manner as adults do, so they do not worry about problems like paying for college that are years in the future. This may be why behavioral economists find that very young children (under the age of 12) value saving

¹ A description of the ASPIRE Act and its provisions can be found in Cramer and Neville (2009).

² Many of these findings were presented in the first three reports of this series.

³ Research on household assets also suggests that liquid forms of assets are consistent predictors of children’s education outcomes. For a review of this research please see Elliott, Destin, and Friedline (2011).

for short-term goals (consumption goals) over long-term goals (Furnham & Thomas, 1984).

Yet children living in low-income families may also value short-term savings goals over long-term savings goals for reasons other than their cognitive capacity. In his hierarchy of needs theory, Maslow (1954) contends that people will attempt to fulfill higher-level needs only after lower-level needs have been met. From this perspective needs can be categorized into two types: a survival (or lower-level) need, and a growth (or higher-level) need. People seek to fulfill their survival needs first. Only after fulfilling survival needs do they begin to act in ways that are congruent with fulfilling growth needs. Accordingly, it would be advantageous to design a policy that can effectively allow children to meet both types of needs over extended time horizons. One way to do this would be to restructure CSAs as a three-in-one account that includes a “short-term account,” an “intermediate account,” and a “long-term account” which would each align with short-term, intermediate, and long-term savings goals.

Savings in the *short-term account* would be available for discretionary spending. It would not be interest-bearing, and children would not receive a match for money deposited in the account. The *intermediate account* would be an interest-bearing account dedicated to achieving intermediate goals. Unlike the short-term account, private contributions to the intermediate account would be matched dollar-for-dollar (1:1) up to a specified amount per year. Money could only be withdrawn a limited number of designated times during the school year to be eligible for the match. The purpose of the match and the limitations is to encourage saving for intermediate goals (such as school fees, books, supplemental tutoring, SAT/ACT preparation and/or fees associated with advanced coursework, and computers). Savings in the *long-term account*, an interest-bearing account, would also be matched (perhaps at an even higher rate) up to a specified amount per year. The purpose of matching the long-term account is to encourage saving for college. In line with existing CSA proposals,

savings in the long-term account could only be used for college tuition or college-related expenses (to include trade schools and two-year colleges) upon reaching college age or the match would be forfeited.

People seek to fulfill their survival needs first. Only after fulfilling survival needs do they begin to act in ways that are congruent with fulfilling growth needs.

As proposed in this report, the 3-in-1 account would not be three separate accounts but a single account that earmarks savings for short-term, intermediate, and long-term goals. This approach involves a greater degree of accounting, but the basic mechanisms for creating a three-in-one account already exist. One bank has created an innovative Virtual Wallet account, for example, that offers accountholders three separate sub-accounts (“spend account”, “reserve account”, and a “growth account”).⁴ All resources in these accounts can be managed entirely online, supported by features such as a daily planning calendar that allows account holders to check balances, see past activities and future payments, and mark paydays. There is also a money bar which helps accountholders easily see and keep track of how much money they have after they pay expenses, the money they have put aside, and how close they are to reaching their savings goals. These types of supportive account features could provide numerous teachable moments within the context of a financial education curriculum.

The concept of spend and reserve accounts for educational purposes is similar to Singapore’s Edusave accounts (Loke & Sherraden, 2009). Edusave accounts were implemented by the Singaporean government in 1993 for children ages six to sixteen. The main objective of the accounts is to

⁴ For more information, see PNC Bank’s Virtual Wallet: <https://www.pncvirtualwallet.com/>.

maximize children’s educational opportunities during their primary school years. According to Loke and Sherraden (2009), these accounts are automatically opened for each child in Singapore, and the government makes annual contributions to each account ranging from \$112 to \$132 in 2007. Singapore funds the Edusave program with interest earned on the \$3.3 billion Edusave Endowment Fund established by the government. Any funds left over in the Edusave account when children reach age 17 are rolled over into Post-Secondary Education Accounts (Singapore’s equivalent CSA policy), which in turn is integrated into the larger Central Provident Fund system. The Post-Secondary Education Accounts are opened for eligible children when they turn 7 years old.⁵ In this manner, children’s accounts in Singapore are a foundation of a social policy approach where everyone owns their own lifelong asset account (Loke & Cramer, 2009).

Incentives for Asset Building – Savings-Linked Conditional Cash Transfers

In addition to a three-in-one account, findings that liquid assets are potentially important predictors of children’s educational outcomes coupled with findings of low savings amounts among children suggest that savings incentives might be an important component for supporting asset accumulation among children. Research on financial incentives and children’s allowance from their parents may help inform how effective incentives for asset building should be structured.

Research findings indicate that incentives targeted at *strategies* for doing well in school, such as completing homework assignments, reading books, and attending class, are more effective than incentives for *performance* on tests (Fryer, 2010). Accordingly, it may make sense to direct incentives toward the acquisition of skills that eventually lead to better educational outcomes. Similarly, research on allowances suggests that receipt of money is not by itself

linked to increased savings or financial literacy. The conditions around receipt of the allowance appear to matter a great deal (Mortimer, Dennehy, Chaimum & Finch, 1994). Receiving an allowance has been found to be a statistically significant predictor of children’s behavior depending on how the conditions of receipt are evaluated (e.g., do children see it as entitlement or as a way of working toward a goal such as college), the extent of work obligations (e.g., is it unconditional or do they have to do well in school), and whether there are constraints on the amount, use and withholding of the allowance (e.g., are they required to save a certain portion) (Mandell, 2010).

Incentives for asset building are a way for society to level the playing field and restore the education path as the “great equalizer.”

Since low-income families and neighborhoods by definition struggle to meet survival needs, it might mean they are able to spend little time developing informal institutions that provide strategies for savings for college, a growth need. The cost of fulfilling growth needs might simply be too high. It requires personal, family, and community sacrifice that goes well beyond what is required of high-income children to achieve similar levels of success at college. This violates a basic tenant of the American Dream, that people with similar levels of effort and ability should achieve similar outcomes, and raises questions about whether the education path does serve as the “great equalizer” in society. Incentives for asset building are a way for society to level the playing field and restore the education path as the “great equalizer.”

An example of an existing program that attempts to link incentives to asset building is savings linked to conditional cash transfer (CCT) programs. CCT programs, designed to reduce poverty, offer compensation to participants for specific behavior or actions, such as enrolling children in school or receiving vaccinations. An emerging version of

⁵ For more information, go to <http://www.moe.gov.sg/initiatives/post-secondary-education-account/eligibility-and-usage/#eligibility>.

the CCT approach links cash transfers to deposits in savings accounts (Zimmerman & Holmes, 2011). While savings linked to CCTs is a relatively new policy intervention, particularly in America, findings from a growing number of international efforts have linked CCT programs to significant improvements in earnings and savings as well as education and health outcomes (Gertler, Martinez, & Rubio-Codina, 2006; Ravallion, 2009; Zimmerman & Moury, 2011).

In sum, there is an opportunity to craft CSA policies to provide incentives for engaging in behavior that is linked to academic achievement. It does not have to be a policy of “paying for grades.” Rather, by providing a match to deposits in targeted accounts owned by children in lower-income families, there would be both an incentive to save and assistance in preparing the child to pursue a college degree. It would also have the practical implication of providing additional and much needed financial resources for low- and moderate-income children to cover the costs of their post-secondary education. In addition, incentives provided by the government might help form more positive perceptions about college by giving them power over much needed financial resources. Equally important, the conditional nature of incentives (i.e., earn incentives for doing school related activities) may provide children with strategies for overcoming difficulties they face in regards to college.

Enhanced Experiential Learning

Most CSA proposals are designed to include the provision of financial education to improve financial capability as well as encourage asset building. Financial educators and scholars have learned that children are more excited by and may learn more when financial education curricula are experiential, include discovery and other experiential applications, and take advantage of teachable moments (Hilgert, Hogarth & Beverly, 2003; Lopez-Fernandini & Murrell, 2008; Lucey & Giannangelo, 2006). Financial education that demonstrates relevance to children may be more effective in motivating learning and improving

retention (Russell, Brooks & Nair, 2006). By their very nature CSAs offer an opportunity for experiential learning. Because all children in a national CSA program would have an account, they would all have access to a financial product or the opportunity to act. Importantly, this combination of financial learning and access to financial products is critical to developing financial capability. According to Margaret Sherraden (2010), “Financial capability requires financial literacy, but also requires access to appropriate financial products. In other words, financial capability requires both the *ability to act* (knowledge, skills, confidence, and motivation) and the *opportunity to act* (through access to beneficial financial products and institutions” (p. 2).

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3-in-1 accounts may enhance experiential learning opportunities in several ways. First, if children, particularly low-income children, have access to 3-in-1 accounts, it would provide them with the opportunity to act on information learned in financial education classes about how to coordinate long-term goals with short-term and intermediate goals. Further, Xiao and Noring (1994) find that adult low-income consumers are more likely to report saving for daily expenses (i.e., survival needs), than for emergencies (i.e., security needs) or future opportunities

(i.e., growth), in contrast to middle- and high-income consumers. Similarly, research suggests that low-income children are more likely to save for short-term or survival needs (Xiao & Anderson, 1997). Even when lower-income children have savings, fewer of them have savings specifically designated for school (Elliott, 2011). This highlights the need for lower-income children to learn about the need to save for all three types of goals from institutions outside of the family. It might be that a 3-in-1 account would help to provide them with the opportunity to act upon these teachings. In addition, incentives for asset building may provide children with greater opportunities to act by providing them with additional income. However, this is more speculative and research is needed to test.

Gaining Early Awareness and Readiness for Undergraduate Programs, or GEAR UP, may provide one opportunity for conducting such tests. A study by Elliott and Beverly (2011) was recently cited by the U.S. Department of Education as a major influence on their decision to include financial education and savings programs as a priority for their GEAR UP initiative. GEAR UP grants are aimed at improving college outcomes for more than 275,000 low-income middle-schoolers. Grant recipients at the University of Kansas are setting up a study to develop CSAs that offer both short-term, intermediate, and long-term savings opportunities along with financial education classes and incentives. Children can earn financial incentives for building assets by completing homework, attending school, and attending GEAR UP events. It is only through such investigations that we can gain a better understanding of the potential effects of such innovations to CSAs.

Combined Financial Education/College-Bound Identity Education

To make financial education most salient, it might be necessary to design CSAs to provide children with strategies for investing in their human capital needs as well as strategies for saving. Research findings provide some evidence that when children's savings are combined with positive expectations the effects of children's savings appear

larger (see, Elliott & Beverly, 2011; Elliott, Chowa, & Loke, 2011). These findings are in line with findings that suggest that the effectiveness of financial literacy classes is related to children's perceptions of future goals such as attaining a college degree, a professional job, or a higher paying job (Mandell & Klein, 2007). Consistent with expectations and goal-setting theories of motivation, Mandell and Klein (2007) find that low-financial literacy scores are associated with a lack of motivation for developing financial literacy skills. According to Mandell and Klein (2007), their results suggest an approach to teaching financial literacy that emphasizes the importance of financial literacy for children's futures.

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There are many ways that financial education curriculums could be adapted to cue college-bound identities. For example, they could be designed to also teach children about the cost of college, about financial aid, student college debt, and the role savings can play in meeting college costs. Children could also be taught about how much they can expect to save by earning incentives, initial deposits, savings matches, and interest. With this approach, not only will children gain valuable strategies for financing their human capital needs, but CSAs can provide additional cues which constantly put children's college-bound identities at the forefront of their minds.

In addition to what is being referred to here as innovations to proposed CSA policies (i.e., components not currently in CSA proposals), there is also increasing empirical evidence to make automatic enrollment a standard feature of CSAs. Automatic enrollment may be critical to whether CSAs are successful or not at reaching low-income children. This is

because, as Report II in this series discussed, low-income children are more likely to have parents who are not equipped to be effective economic socializers (e.g., less likely to be banked and less likely to have taken a financial education course) (Elliott, 2011). As a result, they may be less likely to be enrolled in a CSA program that does not automatically enroll all children, potentially exacerbating existing financial inequalities.

Automatic Enrollment

The SEED for Oklahoma Kids (SEED OK) experiment, a large-scale study with newborn children, is the first randomized, controlled trial of a universal and progressive CSA in the country. The SEED OK research aims to assess CSA feasibility while examining short- and long-term impacts on savings for children, parent's expectations and behaviors, and children's development outcomes. The most important result thus far in SEED OK is the success of automatic account opening for treatment participants. Due to automatic ("default") account opening and the \$1,000 SEED OK deposit, nearly 100 percent of the treatment group held a 529 account, compared to 2.3 percent of the control group. Only one member of the treatment group opted out of the SEED OK state-owned account (Nam, Kim, Clancy, Zager, & Sherraden, 2011).

Another Center for Social Development study examines early enrollment in Maine's statewide CSA program, called

the Harold Alfond Challenge. The Alfond Challenge uses the state's 529 college savings plan platform and offers a \$500 financial incentive for post-secondary education to every newborn in the state. Enrollment is not automatic in the Alfond Challenge. In January 2010, the overall enrollment rate was 21% among all eligible children, and data suggest that financially sophisticated parents were more likely to enroll their child. This study authors conclude that if near universal enrollment is a policy goal of a CSA, automatic enrollment (with an opt-out option) is likely the ideal design (Huang, Beverly, Clancy, Lassar, Sherraden, 2011).

Summary

In sum, CSAs may be an effective strategy for helping children prepare for college, enroll in college, and complete college. However, current CSA policy proposals could be refined to include the following features: (1) account structure that allows for multiple savings goals over extended time horizons (3-in-1 accounts), (2) incentives for asset building, (3) experiential learning, and (4) combined financial education/college-bound identity education. Moreover, evidence suggests that automatic enrollment is likely to be a key factor in determining whether or not CSAs will help in reducing existing financial inequalities and not simply further worsen the problem.

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