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GEORGE WARREN BROWN SCHOOL OF SOCIAL WORK

# RESEARCH & POLICY BRIEF

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## Savings and Educational Attainment: The Potential of College Savings Plans to Increase Educational Success

by Michael Sherraden

*“The President’s Middle Class Task Force has directed the Department of Treasury to investigate improvements to 529 savings plans to help families save for college more effectively and efficiently.”*

The above statement is from a July 2009 White House statement entitled *The American Graduation Initiative: Stronger American Skills through Community Colleges*. The major emphasis of this Obama Administration initiative is post-secondary access and degree completion. Saving is almost always one part of paying for college. It is noteworthy and wise that improved College Savings (529) Plans are part of the President’s vision and agenda.

This brief on savings and educational attainment has been prepared by the College Saving Initiative as a resource on the potential of 529 College Savings Plans to become more inclusive and effective in promoting educational access, achievement, and completion.<sup>1</sup>

### Saving for College: What Does the Public Say?

Overall, the American public reports strong interest and involvement in saving for college. When asked, 92% of parents say that it is likely their child will receive a higher education, and 62% of these parents say they are saving for college (Sallie Mae, 2009, for data in this section). In fact, as a general saving priority, college is tied for second with emergencies (14%), trailing only retirement (27%). However, when narrowed to the top three saving priorities, saving for college is in first place (46% of respondents).

Saving among parents of college-bound children does not vary by ethnicity; saving rates among white parents (62%) are comparable to those of African-American parents (61%) and Hispanic parents (64%). Saving does, however, vary by income. Only 32% of the parents earning below \$35,000 say they are saving for their college-bound children, but saving reaches 80% for parents earning over \$100,000.

Among parents who say their children are college bound, 79% expect to pay half or more of the costs, while 21% expect to pay little or none. Of parents who



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say they are saving for college, some (31%) use automatic deposits and others (19%) save regularly with manual deposits. Over half of parents who say they are saving for college (55%) have a separate investment for this purpose. When asked about the type of vehicle, only 33% say they use a 529 plan, while 59% use cash savings accounts and 41% use stocks or bonds.

College savers who do not use 529s and non-savers have very low familiarity with 529s; more than half (56%), in fact, have no familiarity at all.

Among those who are not saving for college, reported reasons are: don't have enough money (62%), focusing on other saving priorities (49%), expect child to qualify for scholarships (35%), and haven't gotten around to starting a savings plan (34%).

## Can the Poor Save for Education and Other Goals?

It is important to ask if low- and moderate-income Americans are able to save for college.

Although there has been little research on saving among low-income families in 529 savings plans, research on Child Development Accounts, Individual Retirement Accounts, Individual Development Accounts, and other research can inform the potential for an inclusive 529 college savings plan.

Studies in the United States and abroad show that the poor save, especially in savings products that fit their needs. In the poorest households around the world, families save for emergencies, life cycle needs, and opportunities (Hogarth & Anguelov, 2003; Matin, Hulme, & Rutherford, 2002; Rutherford 2000). Although saving is not easy for low-income families, and they typically save small amounts, many are able to save more with well-designed products and incentives.

Perhaps more important, there is growing evidence that savings and household assets—even small amounts—are associated with positive differences in children's lives.

## 529 College Savings Plans

In a study of Maine's 529 college savings plan matching grant participants, 46% reported adjusted gross income below \$40,000, with 26% below \$30,000 and 11% below \$20,000 (income eligibility requirements ranged from \$50,000 to

\$52,500). Mean average annual contributions for all participants were \$901 (median \$475) per year, over a three-year savings period. Income level was not statistically associated with saving performance when controlling for other factors (Clancy, Han, Mason, & Sherraden, 2006).

## Child Development Accounts (CDAs)

In the Saving for Education, Entrepreneurship, and Downpayment (SEED) children and youth initiative, 1,171 participants at 10 community-based programs accumulated over \$1.7 million through a combination of SEED incentives, their own deposits, and earnings (Mason, Nam, Clancy, Loke, & Kim, 2009). Average total SEED accumulation is \$1,518 per participant over a three-year savings period.

Findings from multi-method SEED research indicate that despite barriers—including inadequate or fluctuating income streams and high household expenses—many low-income families are able to or desire to save more (Wheeler-Brooks, 2008). The mean for average quarterly net savings (AQNS) is \$30, which excludes incentives deposited into accounts by programs. Savings in SEED vary across individuals and programs. For example, mean AQNS by program ranges from \$9 to \$69. Multivariate analyses suggest that a higher match limit—the amount of saving that can be matched—is positively associated with savings (Mason, et al., 2009).

Despite challenges, there is enthusiasm for saving among children and youth and their families. Older youth in middle and high school participating in SEED said they were motivated to participate in the savings program because of the matching funds that would help them reach their savings goals, and the opportunity to learn about savings and finances (Scanlon, Buford, & Dawn, 2007).

In the United Kingdom, 72% of low-income households opened accounts or had initiated contact with the Child Trust Fund (CTF). During 2007-2008, 14% of low-income families made additional contributions into CTF accounts (mean £172), while 24% of all CTF accountholders saved (mean £279) (HM Revenue and Customs, 2008). One of the largest providers of CTF accounts reports that 31% of accounts opened by parents of low-income children made regular contributions via monthly direct deposit into CTF accounts (The Children's Mutual, personal communication, November 24, 2008). In Korea, over 31,000 CDAs were opened for children-in-care<sup>2</sup> by the end of 2007 (Kim, Kim, & Hong, 2007). Almost every participant (98.1%) made at least one deposit during the first eight months.

On average, each account received deposits of \$29 per month (Nam & Han, 2008).

## Individual Retirement Accounts (IRAs)

Although there has been little rigorous research on IRAs, one experiment provided matching incentives at the time of tax preparation to low- and middle-income families. Only 3% of the control group (offered no match at all) contributed to an IRA. Eight percent of those study participants with a 20% match rate contributed, and 14% of those offered a 50% match made deposits to the IRA. Average IRA contributions (including non-contributors and excluding the match) for the 20% and 50% match groups were four and seven times higher than in the control group, respectively. The findings suggest that low- and middle-income households react favorably to a combination of factors, including a match for saving, an easily accessible savings vehicle, the opportunity to save part of an income tax refund, and professional assistance (Duflo, Gale, Liebman, Orszag, & Saez, 2006).

## Individual Development Accounts (IDAs)

In the American Dream Demonstration (ADD), the first national study of IDAs, 13 organizations established 2,300 accounts for low-income families. Across four years, average monthly net deposits (AMND) were about \$17, with the higher saving group (52%) saving about \$32 each month. The poorest saved a greater proportion of their income than those with higher incomes. In the experimental design ADD program, savings translated into asset ownership with a net increase of five percent of new homeownership for IDA participants versus the control group. Researchers also find positive impacts on real assets for IDA participants by \$6,310, and both real and total assets for blacks and those over age 36 (Mills, Patterson, Orr, & DeMarco, 2004).

Qualitative research finds that participants perceive of matched savings as “opportunity.” They say that savings provide security, provide productive options, and lead the way to a better future (Shobe & Boyd, 2005; Shobe & McMullin, 2005). For example, one adult respondent in ADD said, “It shows me I have a goal ahead of me,” and another noted that saving helps “visualize a future” (Sherraden, McBride, Hanson, & Johnson, 2006). Savings goals help families overcome saving barriers in low-income households (Hogan, Solheim, Wolfgram, Nkosi, & Rodrigues, 2004; Sherraden & McBride with Beverly, forthcoming)

Research in ADD suggests that certain program features help poor families save. Matching incentives stimulate participation and help savings accumulate faster (Schreiner & Sherraden, 2007; Sherraden et al., forthcoming). Financial education helps people know how to set money aside. Every hour of financial education, up to 10 hours, increases AMND by \$1.16 (Schreiner & Sherraden, 2007). Automatic savings features and annual savings goals facilitate saving, increasing the likelihood of being a higher saver by 16.7% and 21.4%, respectively (Schreiner & Sherraden, 2007).

A quasi-experiment on IDAs, based on the federal Assets for Independence Act, finds that after 36 months, participants—42% of whom were below the federal poverty level—deposited an average of \$935 (AMND \$19). Homeownership increased by 17.8%; new business ownership increased by 8%; and 46% engaged in post-secondary coursework (Mills, Lam, DeMarco, Rodger, & Karol, 2008). Canada’s government-sponsored IDA program, “Learn\$ave,” helps low-income families save for post-secondary education and training or microenterprise. Participants saved an average of \$945 (AMND \$57) in the first 18 months of the four-year demonstration. Participants who received a match saved 71% more than a control group who did not receive the savings match (Leckie, Michael, & Gyorf-Dyke, 2008).

## Effects of Savings and Assets on Outlook and Life Chances

### CDAs

In-depth interviews and focus groups in SEED find positive behavioral effects for both parents and children. Effects for parents include higher self-esteem, sense of efficacy, fiscal prudence, future orientation, hope for the future, sense of security, and verbal interaction between parents and children about finances and the future. Reported effects for children include increased financial knowledge and future orientation (Scanlon, Adams, & Williams Shanks, 2008). These perceived effects of participation in the savings program seem to occur even for those participants who had low savings deposits. Thus, having an account may matter, even when children and families deposit little additional savings for periods of time.

In one SEED program, interviews with children in fourth grade suggest that participants were more likely to mention savings as a way to finance college compared to a comparison group, who mentioned grants and scholarships but not savings as a way

to pay for college (Elliott, Sherraden, Johnson, & Guo, 2008). Moreover, children participating scored significantly higher ( $p=.002$ ) on a fourth grade financial literacy assessment compared to nonparticipants (Elliott, et al., 2008).

## IDAs

People saving in ADD programs express more confidence about the future and greater control over their lives that they attribute to holding an IDA savings account (Moore, et al., 2001). Self-reports among IDA participants in ADD find an increase in orientation and confidence about the future, including increased ability to plan for children's education and retirement (McBride, 2003; Sherraden, et al., 2006).

## Longitudinal survey data<sup>3</sup>

Controlling for other social and economic factors, assets appear to have positive effects on people's expectations and confidence about the future, and their future plans (Yadama & Sherraden, 1996). Regarding education, parents' assets are positively related to children's math scores (Orr, 2003; Williams Shanks, 2004; Yeung & Conley, 2008; Zhan, 2006;), behavior (Williams Shanks, 2007), high school graduation (Axinn, Duncan, & Thornton, 1997; Green & White, 1997; Kane, 1994; Nam & Huang, 2008; Zhan & Sherraden, 2003); and college enrollment (Conley, 1999, 2001; Nam & Huang, 2008), controlling for various socioeconomic factors, including income. In addition, household assets provide a way to finance future schooling (Conley, 1999, 2001; Shapiro, 2004). The causal path between parent assets and children's education may be mediated by higher parent expectations for the child's education (Axinn, et al., 1997; Zhan, 2006; Zhan & Sherraden, 2003).

Children with college savings are significantly more likely to expect to attend college compared to those without college savings, controlling for income (Elliott, 2008). Similar to parents' assets, evidence suggests that the causal path between children's assets and children's education may be mediated by higher expectations among children for attending college (Elliott, 2008; additional studies in progress). This body of research is in early stages; we will learn more going forward.

## Experimental evidence

In a "lab" experiment, Destin and Oyserman (2009) find that saving has an impact on educational outlook and expectations. In a large applied

experiment in a total population (State of Oklahoma), SEED for Oklahoma Kids, led by the Center for Social Development (CSD) and RTI International, is testing impacts of opening 529 plan accounts automatically at birth, with an initial \$1,000 deposit, plus matching of savings for low- and moderate-income households (Sherraden & Clancy, 2008). At SEED OK wave 2 in 2011, we will have rigorous data on whether having a 529 plan account affects parent's educational expectations for children.

## Research on Savings and College Completion

A small body of empirical research has examined associations among various measures of assets (savings, home ownership, total assets, net worth) and educational outcomes, including college enrollment. We have summarized this research elsewhere: in general, associations are positive.

However, research has usually stopped short of assessing relationships among measures of assets and college *completion*. Below we address the very limited existing research on this question, and point to potential for additional research in the future.

## Studies that connect assets, including savings, with college completion

Conley (2001), controlling for many other variables, finds that parental net worth is positively related to children's college completion. This provides a general empirical foundation that wealth probably matters for college completion, but does not address specific effects of savings or liquid assets.

In a recent study, Nam and Huang (2008) of CSD, controlling for many other variables, find that a high level of parent liquid assets is positively associated with increased years of child schooling, high school graduation, and college attendance, but not college completion. These findings may suggest that liquid assets may be overshadowed by other factors in influencing college completion. Nam and Huang also find that credit card and other unsecured debt may be the culprit in overshadowing the effects of savings and other liquid assets on college completion.

## Research in the pipeline

New research by Min Zhan (in draft) using the National Longitudinal Study of Youth 1979 (NLSY79)

finds that both liquid and non-liquid assets are positively associated with later college completion. She also finds that unsecured debt is negatively associated with college completion. Zhan is continuing this work with another paper (in draft) examining these effects by race. In these analyses, also using NLSY, she finds that racial differences in college completion are no longer significant when financial and non-financial assets are included in regression models. In general, savings and assets are associated with college completion, and income is not (when assets are in the regression models). These two studies are in external review and will be available as CSD working papers by September 2009.

## Policy Directions: Toward Greater Inclusion in 529 College Savings Plans

The evidence on savings and educational attainment is encouraging. But how should public policy build on this knowledge?

At this stage, we know from research in behavioral economics that most people, most of the time, may require a plan structure in order to save regularly and effectively. Unfortunately, current participants in 529 college savings plans are mostly mid- to high-income families. But this can change.

The 529 savings plan platform lends itself to more inclusive saving. Plan features of 529s—especially public oversight and outreach, safe investment options, centralized accounting and record keeping, economies of scale, low deposit minimums, simple and low-cost investment options, and matching incentives—can be building blocks for more inclusive saving for college.

As documented in other CSD publications (Clancy & Sherraden, 2003; Clancy, Cramer, & Parrish, 2005; Clancy, Mason, & Lo, 2008; Clancy & Miller, 2009), the 529 plan structure also lends itself to innovation, and many creative partnerships are possible. Progressive innovations in 529s, such as matching savings (in at least 11 states) and connections to GEAR UP, are occurring in the states to make them more inclusive. These innovations document states' interest in using 529s to reach more low- to moderate-income families.

Recent innovations include the following: Union Plus (related to the AFL-CIO) announced a \$500 grant to union members for 529 savings, provided they add at least another \$1,000. In North Carolina,

an entire school was given a college savings account in association with school-based banking. A philanthropist in the State of Maine has initiated a project to make 529s available to all newborns.

Combined, these 529 innovations are an example of states as “laboratories for democracy,” testing policy solutions in the US federalist system of government. It is likely that some states will figure out how to create more effective 529s, reaching more low- to moderate-income families. Successful innovation at the state level, in turn, can influence federal legislation in the future.

Given this vibrant context of 529 innovations in the states, we suggest two policy ideas:

First, make 529s less regressive by placing a national cap on the maximum contributions eligible for federal tax benefits at a reasonable level, not to exceed \$200,000 per beneficiary.

Second, to spur and learn from state innovations, set up a 529 R&D fund of \$100 million (recommended by Ray Boshara) specifically designed to increase participation by low- to moderate-income families. Rigorous research should be required, so that systematic knowledge can identify successful strategies to disseminate to other states, and also inform long-term development of federal 529 policy.

Eventually, reformed federal 529 legislation should promote more inclusive and effective 529 savings, based on research evidence. This larger federal framework should include greater fairness in public subsidies for 529 savings, automatic or default features for enrollment and depositing, and simple, safe, and low-cost investment options.

Overall, 529s are a valuable but underutilized public good. Much more is possible in federal and state policies to make 529s a significant factor in increasing household savings, college expectations, and college completion.

## Endnotes

1. This brief was prepared following consultations with Center for Social Development colleagues Min Zhan, Yunju Nam, Trina Williams Shanks, William Elliott, Margaret Clancy, and Youngmi Kim, and New America Foundation colleague Jackie Williams.
2. “Children-in-care” refers to care by the child welfare system.
3. Data for these and other studies of assets come from nationally representative longitudinal datasets that provide reliable information on household savings, including Panel Study of Income Dynamics (PSID), Survey of Income and Program Participation (SIPP), National Longitudinal Study of Youth 1979 (NLSY79), and the National Survey of Families and Households (NSFH). In addition, a cross-sectional dataset, Survey of Consumer Finances (SCF), provides detailed data on family financial assets. These datasets offer rich information on financial assets among households with children, and frequently are used in studying the distribution of asset holdings (especially financial assets in US families), and in investigating the effect of parents’ asset holding on children’s development and economic outcomes (e.g., health, cognitive skills, educational achievement, and employment during adulthood). However, they provide limited information on households’ savings designated for children’s college education, especially savings in 529 accounts (Curtin, et al., 1998; Ratcliffe, et al., 2008).

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Learn more about the College Savings Initiative at <http://collegesavingsinitiative.org>.

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