Individual Development Accounts:  
Frequently Asked Questions

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Individual Development Accounts: Frequently Asked Questions

1. What are Individual Development Accounts (IDAs)?

Individual Development Accounts (IDAs) are matched savings accounts. IDA programs promote savings by offering participants 1:1, 2:1 or higher ratio matches for their deposits. The original proposal for IDAs was for a universal policy, with higher matches for the poor. In the demonstration phase, IDAs have been targeted to low-income households. IDA participants save toward asset-building purposes such as home purchase, post-secondary education, and microenterprise--assets that promote long-term well-being and financial self-sufficiency (Sherraden, 1988, 1991). IDA programs are implemented at the local level through community-based organizations in collaboration with financial institutions that hold the accounts. The matched savings account is accompanied by mandatory general financial education focusing on money management and asset specific financial education that prepares participants for their asset building purposes such as buying homes, starting small businesses and applying for post-secondary education. Matched contributions are funded through public and private sources (non-profit organizations, foundations, churches, etc.).

2. What was the political and social context that contributed to the creation of IDA programs?

The IDA concept was first introduced in the late 1980s by Michael Sherraden, Washington University Professor and Director of Center for Social Development, who proposed that U.S. social policy take a more progressive approach by including asset-building opportunities for all. Sherraden argued that there had been a shift toward asset-based policy in the U.S since 1970 with the introduction of 401(k)s, IRAs, educational savings accounts, etc.
However, these programs primarily benefit middle- and upper-income households and leave out the poor (Sherraden, 2000). Sherraden proposed IDAs as an inclusive asset-based policy in his 1991 book, *Assets and the Poor*.

*Assets and the Poor* contributed to the national discussion of the welfare state in the United States. Although existing welfare policy provided assistance to the poor, it did not provide an institutional structure that would allow the poor to accumulate assets leading to self-sufficiency. Means-tested programs imposed penalties on participants whose assets exceeded a predetermined limit. Furthermore, welfare policy offered very few long-term social and economic development opportunities for poor families, limiting their ability to save and improve their financial situation (Grinstein-Weiss, Edwards & Wagner, 2005).

In the 1990s when discussion about IDA policy emerged, two contextual factors contributed to the development and later diffusion of the IDA policy (Grinstein-Weiss et al., 2005). First, with the recognition that the American welfare program was in crisis and poverty was still on the rise, policymakers became more open to considering new alternatives to fighting poverty. Secondly, the 1990s were marked by a booming economy that created a more favorable environment for the adoption and funding of innovative policies to build assets for families – even policies targeting poor families.

### 3. Were there similar asset assistance programs prior to the creation of IDAs?

There were asset based policies in the U.S. prior to the creation of IDAs; however, these policies have served primarily middle- and upper-income families. In fact, the U.S. government has allocated a great deal of funding towards asset-building for the middle and upper classes. The U.S. government spends over $300 billion annually on asset-building tax breaks or
incentives; however, over 90 percent of these expenditures go to households with incomes over $50,000 per year (Boshara, 2006). Many of these asset based policies operate primarily through the tax system by providing tax benefits on assets such as homes, investments, and retirement accounts (Sherraden, 1991, 2005). Tax benefits for retirement accounts such as IRAs and 401(k)s and the home-mortgage interest tax deduction are examples of how the government helps American families acquire assets. However, these policies exclude the poor. Since the poor have little or no tax liability and are less likely to own investment assets, they do not benefit from these policies and have little incentive for asset accumulation (Sherraden, 2005). In addition, asset limits in means-tested programs serve as disincentives for the poor to save and accumulate assets.

4. Compared to income assistance programs, such as TANF, what are the strengths and weaknesses of IDA programs?

Public programs targeted at combating poverty in the United States have traditionally focused on income transfers such as income support, rental assistance, or other types of consumption assistance. While these kinds of programs have succeeded in easing hardships for many families, they have failed to provide the poor with the asset-building tools that are necessary for long-term social and economic development (Boshara, 2001).

One disadvantage of income assistance programs is that they focus on the immediate needs of low-income families but not on long-term solutions. Alternatively, assets, defined and measured as the total amount of an individual’s accumulated wealth held at a given time, offer resources that create opportunities for investment in long-term economic and social well-being (Sherraden, 2005). A major strength of IDAs is that they assist individuals in developing
resources for education, homeownership, microenterprise, and retirement security. Furthermore, individuals that accumulate assets can pass on wealth to future generations, thus helping to break the cycle of poverty.

Another limitation of income assistance policies and programs such as TANF is their adherence to strict asset limits. As participants in these programs reach or exceed asset limits, their benefits are either reduced or eliminated altogether (Lowe & Weisner, 2004). Thus, even the most modest asset accumulation can jeopardize a low-income family’s eligibility for assistance with meeting basic needs. A growing body of research demonstrates a significant negative relationship between government support and wealth accumulation among low-income households (Gruber & Yelowitz, 1997; Hubbard et al., 1995; Powers, 1998).

The negative stigma associated with receiving public assistance is another limitation associated with income assistance programs. Welfare recipients indicate that they feel ostracized, looked down upon and that people view them as lazy because of their participation in the program (Rogers-Dillon, 1995). Asset-building initiatives such as IDAs, on the other hand, empower participants to become actively engaged in setting and achieving asset building goals. IDA participants report that they feel more independent, more in control of their lives and have a more positive outlook for the future. In addition, participants report that saving in IDAs and asset building represents hope, security and intergenerational pride (Sherraden et al., 2005.; Shobe & Christy-McMullin, 2005).

A main limitation of IDA programs is that in their current form they are costly to administer because they are intensive, community-based programs in this “demonstration” phase. A large-scale IDA policy should be centralized and efficient (see additional discussion on costs in question number 9).
In summary, when considering the strengths and weaknesses of income assistance and IDA programs, we should not view either as the only solution but rather should see them as complements to one another. While IDAs focus on long-term development, low-income families still face barriers to meeting their day-to-day needs, which may make saving difficult. IDAs can be part of a comprehensive strategy, along with income assistance, to meet both the immediate needs of poor families as well as assist them in longer-term planning and savings (Sherraden, 2005).

5. How are IDAs funded?

Funding for IDAs in the United States is provided through three main avenues: federal, state and private resources. Federal grants are the largest source of funding for IDAs, followed by financial institutions and private foundations. Annually, public funding for IDAs totals approximately $225 million; roughly $185 million is provided by the federal government and the remainder by the states (Boshara, 2005). In 1998, Congress passed the Assets for Independence Act (AFIA), which authorized a five-year, $125 million IDA demonstration project. TANF is another federal funding source for IDAs since states may opt to use TANF funds for IDA programs (Miller & Gruenstein, 2002).

Additional federal legislation that would expand asset-building programs is before Congress. Introduced in 2005, The Savings for Working Families Act (H.R. 4571, S. 922) is a tax-credit that would support matching contributions to IDAs. Legislation aimed at providing asset building opportunities starting in childhood was also introduced in Congress in 2005. The American Savings for Personal Investment, Retirement and Education Act (H.R.1767, S.868)
would create savings accounts at birth for all children with added incentives for lower-income children.

States provide funding for IDAs in a number of ways including: direct expenditure of federal funds under state control (e.g. TANF), direct expenditure of general state revenue, or through tax credit programs (Miller & Gruenstein, 2002). Thirty states include IDAs in their state welfare plans and 34 states, Washington, DC and Puerto Rico have passed some form of IDA legislation (Center for Social Development, n.d.). Private funders for IDAs may include philanthropic organizations, companies through charitable giving, and financial institutions. Compared with public funding sources, private grants often have fewer restrictions and reporting requirements (Miller & Gruenstein, 2002).

It is important to understand the way different funding sources operate as they may shape the goals and structure of IDA programs through restrictions on the use of funds, participant characteristics and/or expenditures and program design (Miller & Gruenstein, 2002). Some funding sources provide the matching funds only and programs must find other alternatives for the administration costs. In addition, funding streams may target specific populations and/or limit the ways in which participants can spend the savings (buying a home, starting a business, etc.) Furthermore, funders may influence the program design by requiring specific matching rates or financial education.

6. Are IDAs widely available in the U.S.? How many people are participating?

Currently, IDAs are not widely available as most of the current initiatives are small local programs; however, states and coalitions are working to expand IDA programs to more communities (Center for Social Development, n.d.). The Corporation for Enterprise
Development (CFED) estimates that there are between 500 and 1,000 IDA programs across the country with more than 15,000 participants (CFED, 2005). According to the Center for Social Development at Washington University, IDA programs exist in all of the states. In addition, 30 states include IDAs in their state welfare plans and 34 states, Washington, DC and Puerto Rico have passed some form of IDA legislation.

7. How much are IDA participants saving? What are their sources of savings?

It is difficult to estimate the amount that IDA participants are saving overall because we do not have access to all participant financial information. However, data from The American Dream Demonstration (ADD), the first large scale test of IDAs, indicate that IDA programs can help low-income families save for long-term goals (Schreiner et al., 2002). In ADD, a 4-year, 14-site IDA policy demonstration, the average monthly net deposits per participant were $19, with the average participant making deposits 6 out of every 12 months. Including matches, participants accumulated an average of $700 per year. As of June 30, 2003, matched withdrawals were used for home purchase (40%), microenterprise (18%), higher education or job training (22%) and retirement accounts (11%) (Friedman, 2005, citing data from the Center for Social Development).

IDA participants describe a variety of strategies they use to generate the funds they are saving through the IDAs. Participants are reducing consumption by shopping more carefully, eating out less often and reducing leisure expenditures. They are also spending more efficiently and increasing their earnings by working additional hours. A few participants indicated that they borrowed from family and friends or used credit cards to save (McBride et al., 2003; Sherraden et al., 2005; Shobe & Christy-McMullin, 2005). Some participants use their tax refunds each
year for savings and others deposit money into savings accounts when cashing child-support checks (Shobe & Christy-McMullin, 2005).

8. What effects are participants reporting as a result of saving through IDAs?

Evidence from in-depth interviews and cross-sectional surveys of IDA participants indicates a number of psychological, cognitive, behavioral and economic effects (McBride et al., 2003; Sherraden et al., 2005). IDA participants report increased feelings of short- and long-term security and reduced stress, greater self-confidence, increased ability to set and achieve goals and a greater sense of responsibility and heightened civic attitudes. Some IDA participants with children felt that their savings would benefit their children by saving to pay for their children’s education, improving their living environment, or generally providing for their future.

In general, IDA participants reported greater economic effects than control respondents, including an increased ability to save, more savings and investment in assets, and greater determination to save in the future. Respondents indicated that in order to save, they modified their behavior in a number of ways including reducing consumption, monitoring resources and increasing their spending efficiency. One participant indicated that he quit smoking after starting the IDA program because it helped him to realize how much he had been spending on cigarettes. In addition, in a survey with IDA participants, respondents indicated that they were more likely to stay employed and more likely to make educational plans for themselves and their children.

9. Does the matching fund rate influence the participation and savings rates?

Data from the ADD suggest that a higher match rate is positively associated with staying in the IDA program and is also associated with fewer unmatched withdrawals. A higher match
rate is not associated with the amount of savings (Schreiner et al., 2002), however a few studies found that a higher match rate is associated with more frequent savings (Grinstein-Weiss, 2004; Zhan, 2003). A recent study by Schreiner (2005a) finds that higher match rates are associated with an increased likelihood of saving something in IDAs, but for the savers group – those participants who made a matched withdrawal or who had at least $100 of net IDA deposits – a higher match rate is associated with a decrease in savings. Regarding the negative association between match rate and savings amount in some studies, Sherraden et al. (2003) offers three possible explanations. First, programs may set match rate levels regardless of saving expectations of the participant. Second, regardless of match rate, participants may try to use all their match eligibility. Third, when the saving goal is set from the beginning, participants may choose to save less and still enjoy the same return. Overall, it appears that the match rate may be an important factor in attracting people to the program and retaining participation, but may have little effect on their saving rates (Schreiner, 2005a).

10. Is the IDA program a cost-effective policy?

It is difficult to know how cost-effective the IDA program is without being able to document all of the benefits associated with IDAs. Some benefits may be long-term and have not yet been realized and measured. In addition, benefits that impact other members of the family may not be captured. The costs associated with one of the ADD sites, the Community Action Project of Tulsa County, were $61 per participant per month, not counting the matched funds (Schreiner, 2005b). However, this is based on a pioneering IDA program that includes costs associated with designing and implementing a new program, research, policy involvement, and other unusual costs of a demonstration (Sherraden, 2002). The Center for Social Development
indicates that IDA costs have been declining over time, but IDAs are not yet large enough to achieve economies of scale. Average program expenses after start-up in the American Dream Demonstration were less than $45 per participant per month (Center for Social Development, n.d.)

It is also hard to compare the costs and benefits of programs that have different goals and designs. Given that difficulty, while the administration costs appear to be higher than that of 401(k)s and IRAs, the costs appear to be in the same range as human capital programs (such as Women, Infants and Children) but are significantly less than for other programs such as Head Start (Schreiner et al., 2006).

11. Do IDA programs work?

Research on IDA programs in the United States indicates that they do work. Data from the American Dream Demonstration, the first large-scale test of IDAs, show that poor people—and even very poor people—can save and accumulate assets when provided with institutional support and structured mechanisms to save. Participants in ADD accumulated an average of $700 per year (Schreiner et al., 2002). Moreover, controlling for other factors, income had very little effect on savings; households with very low incomes were as successful at saving as others. Furthermore, research shows that these households are using IDA funds towards asset purchases. Data from ADD indicate that matched withdrawals were used for home purchase, microenterprise, higher education or job training and retirement accounts (Schreiner et al., 2002; Sherraden, 2002).

Research suggests that participation in IDA programs has many positive effects beyond financial outcomes (Sherraden et al., 2005). Participants report positive changes in behavior,
beliefs, feelings and attitudes. For example, participants indicate greater self-confidence, more hope for the future, increased goal setting and greater participation in the community. One participant said the following about participating in an IDA program:

"The IDA program “played a most important part in my life. It has restructured a lot of things that I never thought that was possible for me normally, than before I entered this program...[The] IDA has already set me on the road with an idea, with a goal and an achievement with a purpose in life.” – Charles (Sherraden et al., 2005)

In summary, IDAs appear to be effective as a means for saving and accumulating assets among the poor, as well as changing behavior and creating hope for a better future.
References


