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1775 Massachusetts Ave., N.W.
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Individual Development Accounts: Policies to Build Savings and Assets for the Poor

RAY BOSHARA

Individual Development Accounts (IDAs)—matched savings accounts for low-income households—are a relatively new means of improving the lives of the poor. Advocates of IDAs argue that those with assets are more economically secure, have more options in life, and can pass on status and opportunities to future generations. They further argue that assets have positive social, psychological, and civic effects that are independent of the effects of income. Over the last decade, research and demonstration projects have been initiated to address these claims; some of the key findings are that IDAs do lead the poor to save or acquire assets, but do not necessarily increase their net worth (assets minus debt). While costs are declining, IDAs are expensive to administer and are often used by the poor as checking and savings accounts as well as a means to accumulate wealth, reflecting in part the dearth of savings products aimed at the poor.

In a recent Welfare Reform & Beyond policy brief, Ron Haskins and Isabel Sawhill write: “Providing [cash and cash-like] assistance has been the dominant strategy for combating poverty in the United States for many years. Yet it has been remarkably unsuccessful.” Proponents of Individual Development Accounts (IDAs) share this view, especially regarding policies aimed at children and working adults, and accordingly aim to add savings and asset development to the mix of strategies to achieve economic security and opportunity for the nation’s poor.

IDAs are matched savings accounts targeted to low-income persons. Withdrawals are typically restricted to the purchase of assets,

such as buying a home, pursuing post-secondary education and training, and starting a small business. Other uses, especially the purchase of a car or computer for work-related purposes, are sometimes permitted. Accountholders are usually required to attend financial education courses prior to an asset purchase. Today most IDA programs obtain the resources to match contributions by low-income families through a blend of public and private funding.

IDAs are one among many emerging tools that aim to broaden asset ownership. Why assets? Washington University Professor Michael Sherraden, in his seminal 1991 book *Assets and the Poor*, offers two rationales.



First, those with assets are more economically secure, have more options in life, and can pass on status and opportunities to future generations. Second, assets have positive social, psychological, and civic effects that are independent of the effects of income. Over the last decade, research and demonstration projects have been initiated to address these claims; some of the key findings are discussed in this paper.

BRIEF HISTORY AND STATUS OF IDAs

IDAs debuted in federal law in the welfare overhaul of 1996 when states were given the option of including IDAs in their welfare reform plans and were encouraged to revise restrictive asset limits on eligibility for cash welfare, which suppressed asset accumulation. According to the Center for Social Development at Washington University, which is monitoring and leading state IDA policy efforts, 34 states presently include IDAs in their state cash welfare plans, although funding levels vary widely. Nearly all states have raised welfare-related asset limits.

By the end of 2003, at least 300 IDA programs spread across the nation supported at least 15,000 accountholders, according to CFED (formerly the Corporation for Enterprise Development). The largest source of funding for IDAs is federal grants, followed by financial institutions and private foundations. Public funding to date for IDAs totals about \$225 million, with roughly \$185 million provided by the federal government and the remainder by the states. The level of total non-public funding is not available.

IDAs were initially developed and implemented by foundation-funded, community-based organizations; government was

reluctant to invest in them until it had been shown that the poor would in fact contribute. Once demonstration projects produced evidence that the poor would contribute to IDAs, federal policymakers expanded IDAs in two ways. First, in 1998, Congress passed the Assets for Independence Act, which authorized a five-year, \$125 million IDA demonstration project, of which nearly \$120 million has been appropriated. Second, in 1999, the federal Office of Refugee Resettlement established an IDA program for refugees that has disbursed \$66 million in grants thus far, although continued funding appears uncertain. Additional legislation that would further expand IDAs is now pending in Congress.

The IDA concept has also been embraced by leaders abroad. Both the Child Trust Fund, which establishes a long-term savings and investment account for every child born in the United Kingdom since September 2002, and Canada's learn\$ave demonstration were directly inspired by the U.S. experience and informed by research on IDAs.

RESEARCH ON IDAs

The first systematic study of IDAs was the American Dream Demonstration (ADD)—a foundation-funded national demonstration of IDAs organized by CFED and the Center for Social Development that ran from 1997 to 2003. This study has thus far yielded two major reports.

The first, *Saving Performance in the American Dream Demonstration*, published in 2002, examined contributions and related outcomes among the 2,364 participants who participated in thirteen IDA programs over a 24-month period. *Saving Performance's* key

research question was: Would the poor contribute to and accumulate assets in IDAs? ADD data suggest that the answer is yes, though only one site included a control group to which the savings of those receiving IDA matches could be compared. In any case, this finding has been corroborated by similar IDA demonstrations in the United States, as well as by the 3,626-account learn\$ave demonstration in Canada, the 1,478-account Savings Gateway pilot in the United Kingdom, and the nearly 200-account Family Development Accounts demonstration in Taiwan. These demonstration projects have found that contributions by the poor are modest, ranging from \$18 to \$38 per month in net contributions (defined as gross deposits less unmatched withdrawals plus contributions in excess of allowable caps). Highlights from the *Saving Performance* report are summarized in Table 1.

Saving Performance also showed that contributions were not strongly related to income, welfare receipt (past or present), or most other individual characteristics. ADD researchers view these findings as consistent with an “institutional” view of saving, which suggests that saving is not solely a function of income and preferences (the more common theory of saving) but also of the institutions—government policies, employers, financial institutions—that structure and encourage opportunities for saving and wealth accumulation. Employer-sponsored and tax-benefited 401(k) plans, in which participants usually make one decision to participate and the rest is done automatically, embody this institutional view. In IDAs, however, it is community-based organizations that perform such institutional functions as

providing financial education, setting IDA balance targets, and matching contributions. It is also notable that twice as many participants made unmatched withdrawals as made matched withdrawals (64 percent versus 32 percent). Several factors may have contributed to this outcome. First, the number of matched withdrawals will increase as balances grow large enough to purchase the desired asset. Second, many of the unmatched withdrawals were repaid to the account, thus preserving the match; not repaying can, in a few programs, result in expulsion from the program. Third, high levels of unmatched withdrawals seem to be explained by participants’ use of their IDA as a checking account, even though this was not its intended purpose.

“Is it worthwhile for people with very limited income to try to build assets?”

Table 1. Highlights from the American Dream Demonstration

Deposit, Withdrawals, and Savings Outcomes

- Average monthly net deposits per participant were \$19, and average gross deposits were \$40
- Net deposits for the average participant were \$528, and net deposits plus match per participant were \$1,543
- With an average match rate of about 2:1, participants accumulated about \$700 per year
- 32 percent made a matched withdrawal at time of data collection (more did so later), with an average value of \$878 and \$2,586 with matches
- Matched withdrawals were used for home purchase (28%), micro enterprise (23%), higher education (21%), and home repair (18%)
- About 64 percent of participants made unmatched withdrawals, and the average amount removed was \$451
- The average participant contributed 51 cents for every dollar that could have been matched
- The average participant made a deposit in about 6 of every 12 months
- On average, the contribution rate was 1.6 percent of monthly income

Source: *Saving Performance in the American Dream Demonstration*, 2002.

Note: Number of account holders = 2,364; mean length of participation = 24.5 months



“Overall, data suggest that the poor would contribute to IDAs and that IDAs can increase some forms of asset accumulation by the poor, but do not necessarily increase their overall wealth.”

Despite its useful empirical observations, the *Saving Performance* report contained no evidence on IDAs’ net effects on the overall accumulation of wealth by poor households. This question was the focus of the second report, *Evaluation of the American Dream Demonstration*, published in August 2004 by Abt Associates. This report, which analyzes results from one experimental ADD site over a 48-month follow-up period, compares 412 “treatment” cases (families that were offered participation in the Tulsa IDA program) with 428 randomly assigned control cases that were not offered participation. Abt’s key research question was: What effects do IDAs have on overall saving and wealth (not asset) accumulation? Table 2 presents the highlights of the *Evaluation* report, which concludes that access to the IDA program had a significant influence on the accumulation of assets, especially in promoting home ownership, and especially among African Americans. However, there was no evidence that IDAs raised the net worth (assets minus debt) of participants relative to controls.

Findings from these reports should be tempered by several considerations. Participants were generally self-selected, suggesting that they may have had higher levels of motivation and greater predisposition to save than those who did not enroll. Also, little is known about how and why the poor contribute to IDAs. Preliminary qualitative research suggests that the poor contribute primarily through consumption efficiencies such as eating out less often, reducing their smoking, using coupons, and more effectively managing their credit cards—as opposed to enduring increased hardship (skipping meals or doctor appointments, for example), though ADD data cannot resolve this issue. Nor is it known to what extent the effects of IDAs result from matching funds, financial education, case management, or other factors.

IDAs are also costly to administer: about \$64 per participant per month, which excludes the cost of the match but includes the costs of recruitment, financial education, monitoring deposits and withdrawals, and providing other high-tech services. IDA costs have been declining over time, but IDAs are not yet large enough to achieve economies of scale. Indeed, administration costs appear to be higher than that of 401(k)s, IRAs, and other “pure” savings products. This high cost may have a sobering effect on the expansion of IDAs. Yet it is not known whether the benefits of IDAs exceed the costs, or if other programs aimed at the poor deliver more benefits per unit of cost than IDAs. Accordingly, it is not certain what the best use of scarce public funds for economic advancement may be.

A more basic issue, however, is whether the accumulations in IDAs are large enough to make a difference. In other words, is it worth-

**Table 2. Effects of IDAs on Savings and Assets Accumulation
Experimental Findings from the Tulsa, Okla. IDA Program**

Asset	Finding
Home ownership	Significant positive effect on rate of home ownership, especially for African Americans
Real assets (businesses, vehicles, and homes) and total assets	Positive impact on real assets and total assets for subgroups that experienced increases in home ownership
Retirement savings	Positive impact on retirement savings for African Americans
Liquid assets	Negative effect (effect appears due to process of acquiring other assets, such as obtaining a mortgage to buy a home)
Liabilities	Negative effect (effect appears due to process of acquiring other assets, such as obtaining a mortgage to buy a home)
Net worth	No measured effect, positive or negative
Educational attainment	Significant positive effect on educational outcome (whether one had taken a non-degree educational course)

Source: *Evaluation of the American Dream Demonstration*, 2004.

Note: Sample size: 840 (412 treatment cases and 428 control cases); Time period: 48 months

while for people with very limited incomes to try to build assets? *Saving Performance* researchers considered this question and came to the conclusion that “participants do use IDAs to purchase assets expected to have high enough returns [relative to whatever assets they currently own] and that mark key steps in the life course.” More important, participants said that their asset accumulations have changed their outlook for the better. The researchers suggest that “what matters is not only the amount, but the existence of accumulation.”

On this point, research analyzed in 2001 by Deborah Page-Adams and Edward Scanlon of the University of Kansas found some evidence that assets—home ownership, savings, net worth, and small business ownership—are associated with household economic stability, educational attainment, lower rates of intergenerational poverty transmission, local civic involvement, and other positive effects. Qualitative research is under way to determine the extent to which these positive “asset effects” are associated with IDAs.

Overall, while many important questions remain for future ADD research, data suggest that the poor would contribute to IDAs and that IDAs can increase some forms of asset accumulation by the poor, but do not necessarily increase their overall wealth.

IMPLICATIONS FOR POLICYMAKERS

Savings policies for the poor could incorporate these initial experiences in three ways. First, because IDAs here and abroad have shown that the poor are willing to contribute to accounts and accumulate assets, savings strategies could be included

in the mix of interventions to help poor families. Given what is still not known, however, further research and evaluations are necessary to determine the extent to which public funding of savings subsidies is justified—a standard that should apply to savings subsidies for persons at all income levels, not just the poor.

To the extent that policymakers intend to expand savings strategies for the poor, the institutional view of saving described above should be considered. Accordingly, policymakers could structure savings opportunities for the poor in the same way that they currently structure them for the non-poor: through employers, financial institutions, and other entities that reach or could reach low-income persons.

Second, multiple savings policies—not just one for long-term asset accumulation—could be established for the poor. When IDAs were introduced, they sparked spirited debates about definitions: “What exactly is an IDA?” and “What is an asset?” Some argued that IDAs should be used only for long-term appreciating assets such as houses, while others argued that durable goods such as automobiles and computers were needed to generate the employment and income critical for long-term asset accumulation. Still others viewed IDAs as a convenient tool to fund the broad range of needs faced by the poor, such as affordable rental housing, day care, and health insurance. While these debates persist, a more important issue is the ways in which IDAs are actually used and what that tells us about the savings needs and goals of the poor.

IDA withdrawals in public and private programs have largely been for home

“Policymakers could structure savings opportunities for the poor in the same way that they currently structure them for the non-poor: through employers, financial institutions, and other entities that reach or could reach low-income persons.”



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purchase, post-secondary education, or small business development—reflecting, for the most part, the programs' rules. It is noteworthy that when home purchase is an option, it frequently draws the largest percentage of IDA participants. What is not known, however, is how the poor would use their savings in the absence of restrictions on use.

However, in nearly all IDA programs unmatched withdrawals for unauthorized uses are high. In ADD, 64 percent of participants made an unmatched withdrawal, and the total amount withdrawn by individuals averaged \$451, or 43 percent of gross deposits. While no evidence is available on how unmatched withdrawals were used, data do show that race, gender, ethnicity, income, and receipt of public assistance could not predict who would make unmatched withdrawals. However, the risk of unmatched withdrawals was lower for owners of homes and cars as well as for holders of bank accounts.

Because access to their own savings was relatively easy—perhaps too easy—many participants were using the IDA as a checking account. It is obvious that the significant loss of matching funds—typically, twice the amount withdrawn—was not always a strong enough incentive to convince IDA holders to defer immediate consumption. Clearly, saving is difficult for many, if not most, of the poor.

Perhaps the best interpretation of these high levels of unmatched withdrawals from IDAs is that the poor have many reasons to save, not just one, and that IDAs should not attempt to meet them all. Multiple savings policies are therefore needed. Economist

Constance Dunham suggests that policymakers develop at least three savings options for the poor: one, like IDAs, for long-term productive assets; another for shorter-term goals, such as durable goods (automobiles and washing machines, for example) and travel; and yet another for precautionary or unanticipated purposes.

A third implication of the IDA experience thus far is that IDAs must be seen as only one part of scaling up savings and asset-building strategies for the poor. Several leaders in the assets field have observed that a large, simple, low-cost asset-building policy is desirable to reach scale, but also that intensive, community-based models should be complements. These two approaches, in other words, are not mutually exclusive. Indeed, future asset-building policy is very likely to be a mixture of low-cost financial products and high-cost community-based programs.

RECOMMENDATIONS

The following recommendations attempt to incorporate these research findings and implications into savings policies for the poor currently under consideration in Congress as well as into other, larger-scale proposals being discussed or developed. Given that many of these policies and proposals are already—without the benefit of definitive research—receiving serious consideration, policymakers should be mindful of the concluding words of *Saving Performance* researchers: "Thoughtful and conscientious research should accompany these policy developments so that we can better answer questions about saving and asset accumulation by the poor."

Expand IDAs at the federal and state levels, and allow IDAs to be used for a wider range of purposes. While funds to administer IDA programs are themselves both necessary and scarce, the most significant barrier to expanding IDAs is the steady availability of public matching funds. Policymakers committed to expanding IDAs could, accordingly, encourage the

- use of IDAs in the Temporary Assistance for Needy Families program (TANF);
- reauthorization and full funding of the Assets for Independence Act (AFIA);
- continued funding of IDAs under the refugee resettlement program; and
- passage of the additional legislation now pending before Congress such as the Savings for Working Families Act.

Combined, these policies—at a 10-year cost of about \$600 million—could extend matched IDAs to 500,000 people or so within a decade, though this would represent only about 2 percent of the income-eligible population (defined as roughly twice the federal poverty line, or nearly \$38,000 for a family of four). To reach more low-income workers, the current 300,000-account cap in the Savings for Working Families Act could be removed, at a cost of \$12.5 billion over 10 years.

Given the multiple savings needs of the poor, the allowable uses of IDAs could be broadened. The Bush administration's proposed Lifetime Savings Accounts, which would offer tax-preferred savings for any purpose, might be too broad, but in any case would do little to encourage the poor to save because they have either low taxes or no taxes, thereby reducing or eliminating the incentive. In the short term, and at no cost

to the federal government (since funding levels are fixed), IDAs funded through AFIA and TANF could allow the purchase of an automobile for work-related purposes; this has been a very popular use in programs that already permit it, such as the refugee resettlement program.

Link existing refundable tax credits to asset-building products. Much can be accomplished by making changes, even small ones, to existing financial products and tax provisions. Along these lines, the Internal Revenue Service (IRS) should—at no cost to the government—allow taxpayers directly on their tax returns to divide their current Earned Income Tax Credit refund and Child Tax Credit refund into at least two separate accounts, one of which should be a savings account. Presently, refunds must be deposited into only one account or delivered as a paper check; but the Bush administration has formally stated its support for the separate accounts idea, which is presently under consideration at IRS. Policymakers could also consider raising the amount of these refunds, say by \$300, provided any increase is directed into an Individual Retirement Account (IRA), IDA, or other restricted savings product.

Make the Savers Credit refundable. The 2001 tax bill authorized a five-year non-refundable tax credit, called the Savers Credit, to encourage low-income persons to contribute to existing retirement products such as 401(k)s. To maximize the now-limited reach and impact of this credit, it should be made permanent and refundable. This would cost the government from \$3 billion to \$5 billion per year, according to estimates by Brookings Institution economists William Gale, Mark Iwry, and Peter Orszag.

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Production/Layout Pauline Liacouras

The Brookings Office of Communications 202/797-6105 communications@brookings.edu

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Consider more expansive policies. If supported by research, policymakers could consider more ambitious asset-building policies over the longer-term. One might be to establish restricted savings accounts at birth for every newborn child in the United States, while funding those accounts progressively. The America Saving for Personal Investment, Retirement, and Education (ASPIRE) Act, introduced in 2004 with bipartisan support and slated for re-introduction in early 2005, would provide accounts of this type. Other promising ideas include: using the state-based “529” college-savings infrastructure (not the 529 product per se) to broaden savings by poor children and families; further revising asset limits in public assistance programs, especially in the Supplemental Security Income, Food Stamp, and Medicaid programs; and establishing a system of low-cost IRAs or citizen-based “Universal 401(k)s” to boost retirement security.

CONCLUSION

Wealth inequality in America dwarfs income inequality, with low levels of asset ownership affecting a majority of the country. Thus the bottom 60 percent of the nation collectively possesses less than 5 percent of the nation’s wealth. Broadening the ownership of assets—through IDAs, children’s savings accounts, and targeted tax subsidies for wealth accumulation—may help expand economic security and opportunity for the nation’s poor. Substantial federal resources would be necessary to significantly broaden asset ownership in the United States, and there is not enough evidence to know whether such a massive public investment would be worth the cost. However, the federal government already commits well over \$300 billion per year to enable non-poor Americans to accumulate and bequeath wealth. If encouraging middle- and upper-class citizens to own assets is already public policy, and a quite popular one, should it not be public policy for all Americans? B

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