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POLICY OPTIONS TO PROMOTE INCLUSIVE ASSET BUILDING THROUGH ACCOUNT-BASED SYSTEMS

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EXECUTIVE SUMMARY

Through an array of policies and programs, the public sector plays a significant role in the expansion of wealth and its distribution. Yet federal policy has historically discouraged asset building among households with fewer resources. The unintended consequence of this approach is that it creates a disincentive to engage in the types of activities which can help a family move up and out of poverty, namely savings and asset building. Specific policy proposals aimed to help lower-income families save have received less support than those that benefit middle- and upper-income households, such as the creation of tax-preferred accounts (IRAs, 401(k)s, and 529 College Savings Plans). Developing more inclusive asset building policies will likely require the development of new account-based structures and policy supports. This paper discusses the rationale for devising asset building policies using account-based systems, presents a set of principles to guide the policy design process for constructing such a system, and critiques several promising policy proposals currently under consideration at the federal level which employ account structures, specifically proposals to create children's savings accounts, individual development accounts (IDAs), and inclusive retirement savings accounts.

Introduction

In his groundbreaking book *Assets and the Poor* (1991), Michael Sherraden first outlined a potential rationale for asset-based policy and began to explore how individual accounts— if supported by the right incentives and institutional structures—could serve as a means to pursue asset building objectives for a targeted low-income population. In the intervening years, the notion that anti-poverty efforts should include opportunities for lower-income persons to build up their asset levels has made remarkable progress in influencing policy efforts. Several factors help explain the rise of asset-based policy discussions.

First, policymakers have easily grasped both the distinction between income and assets, and the importance of assets. Second, the idea debuted at a time when the nation and policymakers were highly receptive to new ideas for reforming welfare programs. And third, data generated by ongoing demonstration projects showed that poor people could save when given access to the right incentives and institutional supports (Schreiner et al., 2001). These research findings helped overcome the principal doubt among politicians and others as to whether asset building opportunities would lead to actual savings and asset purchases. Today, while the "income paradigm" still dominates the poverty policy discussion, the "assets paradigm" has made its mark and is now seriously considered in policymaking circles at all levels.

This is reflected in the calls by the Bush Administration to promote ownership. In his second Inaugural Address, and elsewhere, President Bush has offered his vision for creating an "Ownership Society" in America. By this he means encouraging more Americans to save in tax-benefited accounts for retirement, college, health care expenses, homeownership, and small business development. Americans who do this, the President believes, will be able to exercise more personal responsibility and better control their and their kids' economic futures.

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Although the goals of promoting ownership should not displace social insurance and other programs aimed at struggling but aspiring Americans, the claim that families benefit from being able to build up assets is compelling. The underlying assumption is that ownership creates stakeholders and expanding opportunities for people to accumulate productive assets has broad social and economic benefits. In fact, the data show that many Americans have experienced the benefits of building assets and associate success and security with the accumulation and holding of financial resources. It is the combination of both income and assets that provides the means to take advantage of the opportunities offered by a prosperous society and dynamic economy.

Yet regrettably, the asset-building system already in place that facilitates wealth creation disproportionately benefits those households with higher incomes, better job benefits, and larger income tax liabilities. Lower-income families are offered fewer, and less attractive, ways to build wealth. Developing more inclusive asset building policies is a prerequisite for establishing an ownership society that all Americans are given a chance to access. Among the characteristics of an inclusive system are universality, progressivity, and flexibility. This means that everyone is eligible to participate, those that need more assistance will get it, and the platform will be available throughout the life cycle. There are a number of ways to build such an inclusive asset-based policy system but it is likely to include at its core an account-based structure.

Who Owns America?

To understand the inherent challenge in creating an inclusive ownership society, it is useful to consider what ownership in America looks like today. Aided by policy incentives, Americans build wealth in both financial and non-financial assets. In 2004 the homeownership rate exceeded 69%, a historic high. The minority homeownership rate has risen in recent years as well, but continues to lag the overall population. In 2003, almost 50% of minority households owned their own home. In the aggregate, home equity makes up 27% of total assets for all households and the median home value is $121,000.[2] Home equity plays a particularly important role for many low-income and minority families. While their homeownership rates are lower, home equity makes up 77% of total assets for lower-income families and 55% of total assets for minority families.[3]

While home equity represents the single largest component of household wealth, families store resources in a variety of other assets, such as bank accounts, stock investments, and retirement accounts. The percentage of families holding assets varies considerably. It is estimated that over 90% of families have money stored in checking or savings accounts, while only 21% own stock directly in a company. Furthermore, 17.1% own shares of a mutual fund, 16.7% own savings bonds, and 28.0% have assets held in a life insurance policy. Meanwhile, over half of all families (52.2%) have a personal retirement account, such as an IRA or a 401(k).[4] However, the numbers for a defined contribution pension plan are lower and declining: 33.8% of American families own a defined contribution plan.[5]

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[2] U.S. Market Conditions (2004); Aizocorbe, Kennickell, and Moore (2003).

[3] Di (2003).

[4] Aizocorbe, Kennickell, and Moore (2003). Includes only all employment-based defined contribution plans plus IRAs and Keogh plans, but not defined benefit plans.

[5] Includes all types of defined contribution plans owned through a current employer or former employer.

Percentage of Families Holding Assets by Asset Type[6]

	Stocks	Mutual Fund	Savings Bonds	Retirement Accounts	Bank Accounts	Life Insurance
Percent of income						
Less than 20%	3.8%	3.6%	3.8%	13.2%	70.9%	13.8%
20%-39.9%	11.2%	9.5%	11.0%	33.3%	89.4%	24.7%
40%-59.9%	16.4%	15.7%	14.1%	52.8%	96.1%	25.6%
60%-79.9%	26.2%	20.6%	24.4%	75.7%	98.8%	35.7%
80%-89.9%	37.0%	29.0%	30.3%	83.7%	99.7%	38.6%
90%-100%	60.6%	48.8%	29.7%	88.3%	99.2%	41.8%
All Families	**21.3%**	**17.1%**	**16.7%**	**52.2%**	**90.9%**	**28.0%**

The percentage of families holding assets is strongly correlated with their incomes. Compared to those households in the top 10% of income, households in the bottom forty percent of income were less likely to own stock (11% to 61%), retirement accounts (33% to 88%), and transaction accounts (89% to 99%). The differences in retirement asset holdings are especially revealing. The number of families owning a retirement plan drops to less than 15 percent for families making $15,000 or less, while 75 percent of those making more than $50,000 have a retirement savings account. For defined contribution plans, over 54% of families with incomes over $50,000 have such plans, while only 18.9% of families with incomes under $30,000 have them.

Beyond differences in what households own, there are also differences in how much they own. The mean net worth is over $380,000, but 17.6% of households have zero or negative net worth, and slightly over 30% of households have a net worth of less than $10,000.

Family Net Worth[7]

Median	**$73,500**
Mean	$380,100
Percent with net worth	
a. Zero or Negative	17.6%
b. Less than $5,000	26.6%
c. Less than $10,000	**30.1%**

Further, the distribution of wealth by wealth class is highly unequal. According to data from the Federal Reserve, the bottom 40 percent of the nation owns less than 1 percent of the nation's wealth, while the bottom 60 percent owns less than 5 percent. The top 20 percent of the population commands 84 percent of the wealth. Another dimension with which to examine wealth holdings is race. In general, minority households own less than ten cents for every dollar of wealth owned by a typical non-Hispanic White family.[8] Even though their income is roughly two-thirds of that of White families, their wealth is only 10% as much.

[6] Aizocorbe, Kennickell, and Moore (2003). Figure for 2001.
[7] Wolff (2004).
[8] Wolff (2004); Kochar (2004).

Mean Net Worth by Wealth Class[9] *In thousands*				
	Top 20%	60-80%	40-60%	Bottom 40%
	$1,604.7	$215.3	$75.0	$2.9
Percent of Wealth Owned	**84.5%**	**8.8%**	**3.9%**	**0.2%**

Public Policy and Asset Building

Through an array of policies and programs, the public sector has played a significant role in the both the expansion of wealth and its distribution. American history is marked by a series of major policy initiatives that have successfully expanded ownership of capital and promoted stakeholdership. Historic initiatives, such as the Homestead Act of 1862, The GI Bill of 1944, and the creation of the Federal Housing Administration (FHA) in 1934, have expanded access to important elements of wealth creation and produced tangible results.

By providing land to those that would go west, stake a claim, and work it for five years, the Homestead Act provided an opportunity to build wealth by developing property. Of the million and a half people that successfully took the government up on its offer, passing this wealth and property on to the next generation proved to be one of the most enduring legacies of the Act.[10] The GI Bill offered veterans grants to pay for training and higher education, loans for setting up new businesses, and mortgages to purchase homes. Through this law, some $14.5 billion was spent by the federal government between 1944 and 1956 benefiting almost 8 million veterans.[11] A congressional report has estimated that the GI Bill generated returns of up to seven dollars for every dollar invested, an impressive performance by any standard.[12] In addition to the economic multiplier effects, the influx of veterans permanently transformed the American university system, creating "an avenue for mass mobility rather than gentlemanly certification."[13] The FHA was created to help many Americans purchase a home. Through its mortgage insurance and other financing products, FHA has played a role in the country's rising homeownership rate.

Each of these efforts was grounded in the twin objectives of ownership and opportunity. The underlying assumption being that ownership creates stakeholders and expanding opportunities for people to accumulate productive assets has broad social and economic benefits. The role of public policy in encouraging asset building continues to this day; it is a hallmark of the prevailing policy framework that identifies wealth creation as a central policy objective.

Many of the policy levers currently used to achieve these ends are promoted through the tax code. Tax expenditure programs in the form of tax deductions, tax credits, preferential tax rates, tax deferrals, or income exclusions are a primary vehicle for achieving many federal policy objectives. Collectively, they subsidize a broad range of activities, including many asset-building investments such as mortgage payments, business investments, retirement savings, and educational expenditures. As calculated by the government, the value of these asset building tax expenditure programs exceeds $365 billion on an annual basis, and thus deserves scrutiny.

The theory behind using tax expenditures as a policy vehicle is that it works best when the benefits or incentives are related to income and are intended to be widely available. While tax expenditure programs may subsidize worthy activities and generate sizeable social and economic returns, they are not accessible to a large number of citizens that would benefit from them the most. Many lower-income households do not have large enough tax

[9] Wolff (2004).

[10] Williams (2003) estimates that up to one-quarter of the adults in the U.S. potentially has ancestors that can trace their legacy of asset ownership to the Homestead Act.

[11] Skocpol (1996).

[12] Subcommittee on Education and Health of the Joint Economic Committee (1988).

[13] Skocpol (1996) cites the statistics that only 9 out of 100 young people attended college in 1939, but the rate doubled by 1947.

liabilities to take advantage of these tax expenditure programs. Not surprisingly, 90 percent of the benefits in the two largest tax expenditure categories (homeownership and retirement) reach households with incomes above $50,000 a year.[14] All told, the federal government offers over $156 billion a year in support of homeownership and over $117 billion to subsidize retirement savings. The retirement savings subsidies accrue to those with 401(k) and IRA accounts, and even though these are held by individuals, they are regulated and taxed according to federal policies. In this respect, these individual accounts are fundamentally "public."

The table below identifies the tax expenditures included in the Federal Budget related to asset building. Some are familiar and easy to understand, while others are obscure and more complicated. For the purpose of this presentation, tax advantages that can be claimed by businesses are not included, even if they help subsidize employee training.

Value of Select Asset Building Tax Expenditures:
Fiscal Year 2006
(in millions of dollars)

Housing	
Deductibility of Mortgage Interest on Owner Occupied Housing	76,030
Deductibility of Property Tax	14,830
Capital Gains Exclusion on Home Sales	36,270
Exclusion of Net Imputed Rental Income on Owner-Occupied Housing	29,720
Subtotal Housing	*156,850*
Investment: Commerce	
Capital Gains	28,370
Capital Gains Exclusion of Small Corporation Stock	250
Step-up Basis of Capital Gains at Death	28,760
Carryover Basis of Capital Gains on Gifts	290
Exclusion of Interest on Life Insurance Savings	24,070
Subtotal Commerce	*81,740*
Education	
HOPE Tax Credit	3,220
Lifetime Learning Credit	2,080
Education Individual Retirement Account	190
Deductibility of Student Loan Interest	800
Deductibility of Higher Education Expenses	1,840
State Prepaid Tuition Plans	650
Subtotal Education	*8,780*
Retirement: Income Security	
Net Exclusion of Pension Contributions: Employer Plans	51,050
Net Exclusion of Pension Contributions: 401(k) Plans	48,140
Net Exclusion of Pension Contributions: IRAs	7,310
Net Exclusion of Pension Contributions: Savers Credit	1,170
Net Exclusion of Pension Contributions: Keough Plans	9,980
Subtotal Income Security	*117,650*
TOTAL	**365,020**

Source: Office of Management and Budget, Executive Office of the President. Budget of the U.S. Government, Fiscal Year 2006, Analytical Perspectives. Table 19-1.

Exclusionary Policies

Federal policy has historically discouraged asset building among households with fewer resources. Not only has the structure of tax expenditure programs denied benefits to poorer households but also anti-poverty policy efforts

[14] U.S. Congress Joint Committee on Taxation (2003). Estimate of Federal Tax Expenditures for Fiscal Years 2004-2008.

have been, and remain, focused on facilitating income maintenance and short-term consumption. In this spirit, many federal programs impose asset limits as an element of means-testing program eligibility. The unintended consequence of this approach is that it creates a disincentive to engage in the types of activities that can help a family move up and out of poverty, namely savings and asset building.

Consequently, the benefits of stakeholding, which have made a difference for many American families, have not been experienced by all. One-quarter of white children and half of non-white children grow up in households without any significant levels of savings or resources available for investment.[15] This represents an important dimension to the problem of inequality, which is usually discussed in terms of income. Wealth inequality is more severe than income inequality. According to the most recent Survey of Consumer Finances, conducted by the Federal Reserve in 2001, the top 10 percent of households in the U.S. ranked by income earn 44 percent of the nation's income but own 57 percent of total family net worth.[16] In contrast, the bottom 60 percent earn 22 percent of the nation's income and own less than 17 percent of the nation's wealth.[17]

The pattern of wealth distribution is instructive because it reflects inequalities that have formed over an extended period of time. Yet the more pressing issue from a policy perspective is the plight of those households that are asset poor, possessing insufficient resources to sustain a household through any extended period of economic disruption.[18] Research on asset poverty has focused on developing measures of economic vulnerability that can provide an accounting of households without a stock of resources to survive a loss of income.[19] Haveman and Wolff have estimated that the number of asset poor households with precarious resource shortages substantially exceeds the official poverty rate, and that the disparity has grown over the last twenty years. In 1998, one out of eight Americans were officially classified as poor, 34.3 million people or 12.7% of households, but the ranks of the asset poor included one of every four, 69.1 million people or 25.5% of households.[20] And that disparity has grown. Between 1983 and 1998, income poverty declined about 16 percent, while asset poverty rose 14 percent.[21]

The Value of Assets

The value of assets is based not only on the economic security they provide but also in how they enable people to make investments in their future and exert a stake in the broader society that income alone cannot provide. Michael Sherraden, author of *Assets and the Poor*, observes that, "Few people have ever spent their way out of poverty. Those who escape do so through saving and investing for long-term goals."[22] Oliver and Shapiro write that "Wealth is a particularly important indicator of individual and family access to life chances…It is used to create opportunities, secure a desired stature and standard of living, or pass class status along to one's children."[23]

In a review of the literature on the effect of asset holding, Scanlon and Page-Adams found that much of the research focused on the impacts of homeownership, but a number of other studies focused on assets in the form of savings, net worth, or small business ownership.[24] Despite the variety of asset measures used in this literature, they concluded that together financial and property assets appear to have positive effects on economic security, household stability, physical health, educational attainment, and civic involvement.[25] This conclusion has also been supported by work in the United Kingdom which examined that effect of assets on life chances and found a "persistent effect of assets on a number of outcomes, which were impervious to a wide range of controls," and

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[15] Shapiro (2002).

[16] Aizcorbe, Kennickell, and Moore (2003).

[17] Aizcorbe, Kennickell, and Moore (2003).

[18] Oliver and Shapiro (1997) first proposed a definition for asset poverty in their 1997 book, *Black Wealth/White Wealth*. They defined "resource deficient" households as those without enough net financial worth reserves to survive three months at the poverty line.

[19] Haveman and Edward (2000) have built upon this approach and used existing data sources to estimate a series of asset poverty measures.

[20] Haveman and Wolff (2000).

[21] Haveman and Wolff (2000).

[22] Sherraden (1991).

[23] Oliver and Shapiro (1997), page 2.

[24] Scanlon and Page-Adams (2001).

[25] Scanlon and Page-Adams (2001).

"the assets effect was sustained, with employment, psychological health, belief in the political system and values, all appearing to be enhanced by assets."[26]

Thus, the body of evidence that links asset holding with positive outcomes is significant and growing. Asset building strategies have been shown to work for both the poor and non-poor alike. Recent findings from a national demonstration project of matched savings accounts for low-income individuals found that program participants responded positively to savings incentives, overcoming doubts among policymakers as to whether the poor could save.[27] The research results do not in and of themselves justify a rejection of income maintenance programs, but they provide support for building on approaches that combine an income and assets perspective.

Asset Building Accounts

Over the last three decades there has been a shift in assets policy that has elevated the role played by individual accounts and account systems. The profusion of accounts, including the advent of 401(k)s, Individual Retirement Accounts (IRAs) and Section 529 College Savings Plans, has carried a big price tag but more fundamentally is indicative of the trend to deliver public benefits through an account structure. Yet the distribution of benefits from these accounts, as delivered through the tax code, has been considerably more regressive than the proceeding social insurance and means-tested transfer programs developed after the New Deal.

Sherraden (1997) has observed that domestic policy goals are increasingly achieved through individual asset accounts instead of large, nation-bound, categorical programs. He predicts that, someday, all the existing individual asset account structures—IRAs, Medical Savings Accounts, 401(k)s, Individual Training Accounts, and Individual Development Accounts—are likely to merge into one system. Anticipating that, and recognizing that most of these accounts are currently delivered through the tax system, which excludes the majority of low-income persons, the challenge is to identify ways to make an account-based system work for those currently without tax liabilities, bank accounts, or asset holdings. It is very possible that at the center of such an inclusive asset building agenda is an account-based system that is simple, widely available, and portable, with incentives that are accessible to households with fewer resources.

Individual Development Accounts

The experience of Individual Development Accounts (IDAs) has been instructive in this regard. IDAs are matched savings accounts typically restricted to buying a first home, pursuing post-secondary education and training, and starting a small business. Recent experimental research has demonstrated that low-income persons can successfully save in IDAs, and that IDAs are effective in building assets (Boshara, 2005). Privately-funded IDA demonstration projects helped paved the way for federally-funded IDAs, but the effort remains small.

The Bush Administration has proposed expanding the number of IDAs available for low-income, working persons by 900,000 accounts. This would be funded by creating an IDA tax credit that would facilitate dollar-for-dollar matching contributions of up to $500 a year targeted to lower-income individuals through a 100 percent credit to sponsoring financial institutions. The Senate has previously endorsed such an approach but authorized only 300,000 accounts. This discrepancy highlights the challenges in scaling up this account-based system, but does not obscure the potential of creating an account vehicle with savings incentives accessible to households with fewer resources.

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[26] Bynner and Despotidou (2001).

[27] Key findings from Saving Performance in the American Dream Demonstration: A National Demonstration of Individual Development Accounts (Shreiner, Clancy and Sherraden, 2001) include the observation that the majority of people who participated in the demonstration were savers; and program characteristics, such as match rate, financial education, and use of direct deposit, are linked to savings performance.

Children's Savings Accounts

One of the most promising ways to achieve a universal, progressive asset building system over time would be to provide each generation of children a restricted, start-in-life asset account at birth, an idea first proposed by Michael Sherraden and, separately, by former IRS Commissioner Fred Goldberg.[28] This "accounts-at-birth" approach represents a social investment in every child at the same time as it gives the child a stake in broader society. Each child will grow up knowing they will have a modest pool of resources at their disposal to help them succeed. These accounts would establish a universal platform and infrastructure to facilitate future savings and lifelong asset accumulation. Beyond the individual benefits, investing in children could have large multiplier effects, especially when it is linked to increasing social engagement and expanding opportunity. In the long run, building wealth through children's savings accounts and other means has the potential to help break the vicious cycle of intergenerational poverty.

Children's accounts can also be a means of ensuring retirement security because they will offer a means of building assets that can be strategically employed in times of need or productively invested to generate future returns. The nature of assets is that they work as building blocks over a lifetime, serving as bridges connecting different stages of the life cycle—just as investing in one's human capital by going to college generates opportunities to increase income or buying a home serves as a forced savings plan that can be tapped at retirement. The path of security does not start at retirement but must be treaded throughout life.

While every child would have an account, it would especially benefit the 26 percent of white children, 52 percent of black children, and 54 percent of Hispanic children who start life in households without any resources whatsoever for investment. Different versions of children's savings accounts have been proposed by Members of Congress; most, however, are not progressive and are focused on building only retirement assets (most notably former Senator Bob Kerrey's "KidSave" proposal, which recently has received renewed attention). A great model for the U.S. is the newly established Child Trust Fund in the U.K. Also, the recently launched, privately-funded SEED Initiative, funded by the Ford Foundation and Charles Stewart Mott Foundation, among others, is already providing valuable insights on policy design.

The recent introduction of the America Saving for Personal Investment, Retirement, and Education Act (ASPIRE Act) by a strong bi-partisan coalition of legislators in both the House and the Senate offers a blueprint of what a universal accounts-at-birth system might look like. Sponsored in the Senate by Senators Rick Santorum (R-PA) Jon Corzine (D-NJ), Charles Schumer (D-NY), and Jim DeMint (R-SC) and in the House by Representatives Harold Ford, Jr. (D-TN), Patrick Kennedy (D-RI), and Phil English (R-PA), the ASPIRE Act would provide every child with an account at birth—called a KIDS Account—that would be endowed with $500. The account would be supported with progressive, targeted savings incentives until age 18, at which point it could be used for going to college, buying a home, or building up a nest-egg for retirement.

One of its novel features is that accountholders in eligible families will be given the opportunity to earn additional matching funds for amounts saved in the account. The Senate bill provides a dollar-for-dollar match of the first $500 contributed and the House bill provides a dollar-for-dollar match for the first $1,000 contributed. Access to account funds will be restricted until the accountholder reaches the age of 18, and parents or legal guardians would control investment decisions until that time. The bill will establish a national fund within the U.S. Treasury, similar in structure to the Thrift Savings Plan, which would provide a life-long savings platform and would be responsible for administering the accounts, holding all deposits, and managing investments.

The policy rationale supporting the children's savings accounts proposal is to provide a foundation for a broad account-based asset building system. Governed by a uniform set of rules and administrative structures that would serve as the "plumbing" to support a national system of accounts, and universally accessible to each and every child, these accounts will help integrate the currently disparate account-based vehicles at the same time as they guarantee everybody is included in the system.

In many ways asset building policies can be conceptualized as an investment strategy, with large multiplier effects for the entire economy. These effects could be magnified if focused on kids. Modest investments in children can

[28] See Cramer (2004) for details.

grow, and with responsible stewardship can provide a means of ensuring that every citizen is afforded opportunities to succeed. As such, these accounts are intended to play a role in supporting the achievement of diverse national policy objectives, including the promotion of child welfare, the increase in the national savings rate, the enhancement of financial literacy, the incorporation of the unbanked into the financial mainstream, and the support of educational achievement. These are broad and worthy objectives; fulfilling any of these goals would represent a major societal achievement. Yet the success of this effort could be found at the household and community level. Each child will grow up knowing there is an account with their name on it that can be used as they mature to help them make productive investments. These accounts provide a vehicle to enhance civic engagement and social participation. As a universal program, the accounts-at-birth approach offers each child an economic opportunity to participate in asset building, and also provides an opportunity to construct an integrated system for managing account-based asset building on a large scale. The importance of this achievement may be profound as it provides a unifying structure to integrate the asset building policies currently spread throughout the tax code.

For several reasons it makes most sense to focus on an asset building policy for children. The very nature of asset building is long-term, investing when children are born provides the most time for assets to grow, and the dynamics of accumulation will provide their own lessons. Also, the experience of asset holding may be transformative, changing attitudes for the better. Beyond the potential economic effects, stakeholder accounts could serve as a means of providing financial education, a skill set which will be in need of augmentation if the ownership of equities and investments is to become further democratized.

Creating a universal system of accounts for children is a powerful approach to social policy because it has the potential to contribute to both economic growth and social development. It does so by investing on an individual basis in a manner that creates widespread opportunities. While investment returns are not guaranteed, they are likely to offer each participant access to a modest stock of financial assets when they begin their adult lives. For some, this asset pool can be used to seed profitable and productive investments, for others, it may provide a sense of security many now lack. The public investment signals that society has an interest in the success of every child, and they, in turn, will be responsible to make appropriate choices throughout their lives.

Implementing children's savings accounts is consistent with contemporary approaches to social policy that have moved away from guaranteed entitlements and toward more account-based support mechanisms. In contrast to traditional income supports, the level of investments in the account is no substitute for social protection. Rather they are intended to promote social and economic development at the household level, at the same time as they advance fiscal stability, savings, and investment at the macroeconomic level.

Low-Cost Policy Options to Promote Savings

In contrast to the costs of erecting an immediately universal system, there are a number of policy options that would promote asset building among lower-income families that have relatively low costs. These include proposals designed to increase savings without specifically requiring links to an account–based system.

For example, firms could be encouraged to adopt inclusive policies for defined contribution plans, such as "opt-out" instead of "opt-in" enrollment, automatic allocation, and automatic escalation. Only about one-half of employers offer their employees 401(k) retirement plans. Roughly three-quarters of employees choose to participate, but participation tends to be linked with income. The problem is that currently workers are required to actively choose to participate in a company 401(k), or "opt-in." Many workers, especially low-income workers, choose not to do so. However, compelling research data has shown that participation in retirement savings plans increases if workers are automatically enrolled rather than compelled to sign up. In one study by Madrian and Shea, this "opt-out" approach was found to increased participation from 36 percent to 86 percent when employed at a Fortune 500 company, and the increase was higher for lower-income workers. Automatic allocation would ensure that all employee contributions would be automatically placed in a balanced, diversified set of low-cost funds. Many plans offer too many investment choices. Too large a variety of options can lead to paralysis, especially for novice investors. One outcome that should be avoided is the tendency for these investors to choose low-yielding funds rather than a more diversified portfolio in line with their life cycle needs.

Another low-cost proposal is to use tax returns to connect tax refunds to savings products. The tax system can be a gateway to the financial system and to building savings and assets. Last tax season the IRS sent refund checks averaging $2,300 to 130 million tax filers. These cash infusions are often the best chance people have to save some money in any given year. This is particularly true for lower-income families. Over 20 million lower-income families—one in six taxpayers—received an average $1,700 boost to their refund from the Earned Income Tax Credit (EITC), a refundable tax credit designed to reward work. People may spend rather than save their refunds because they do not have an easy way to convert a portion of their refunds into savings vehicles. Recent research finds that many Americans—including lower income ones—can and will save their refunds if offered appropriate incentives and a clear way to do so.

The challenge for policymakers is to facilitate and incentivize the savings of tax refunds into existing—and possibly new—savings products. The tax filing process should be changed to allow tax refunds to be split among multiple accounts. Under this proposal, people could deposit their refund into IRAs, 529 college savings plans or a variety of other savings accounts. Right now, taxpayers have only one choice; refunds are issued in a lump sum. If it is easier for people to save right on their tax forms, to split their refunds into "money to save" and "money to spend," people will save more, perhaps much more. Research has indicated that even low-income tax filers would use this "splitting" option to save. The Bush Administration has signaled an intention to implement this change to the tax filing process by the 2007 tax year; but the implementation schedule has not been announced. The potential of this change to actually promote savings is severely limited for those households without bank accounts.[29]

Meaningful Asset Building Requires Inclusion

The Bush Administration has picked up on the account-based approach with a set of far-reaching savings proposals. In its fiscal year 2004 budget, the Bush Administration first proposed creating three new tax-preferred accounts, to be called Lifetime Savings Accounts (LSAs), Retirement Savings Accounts (RSAs), and Employer Savings Accounts (ERSAs).[30] These accounts are designed to substantially expand opportunities for tax-sheltered savings and consolidate rules for tax- advantaged saving. Every individual could set up a LSA and a RSA; contributions to each account would not be tax-deductible and would be capped at $5,000. Because these accounts would have no limits on household income and substantially higher contribution limits than current Individual Retirement Accounts (IRAs), the Administration's proposal would provide a disproportionate share of benefits for higher income households, particularly those with incomes above existing limits on IRAs.

Noting the substantial tax sheltering opportunities created by the new accounts, some analysts have questioned whether the proposals would even raise the private saving rate because the transfer of existing taxable assets into LSAs would reduce taxes but not increase private saving.[31] The opportunity to shelter income is a less valuable incentive to lower income households even though they still would benefit from savings incentives. These proposals would be strengthened if they were revised to offer substantial matching deposits to the asset-poor. Still, one of the most notable features of the Bush proposal is the attempt to unify many of the diverse tax-preferred accounts into a more simplified account-based system. This represents an important trend that any proposal for asset building savings accounts should consider.

The Administration's focus on the ownership society will create the ongoing opportunity to focus on policy proposals that help families, and particularly lower-income families, build savings and assets beginning at birth. The ASPIRE Act may receive consideration in these debates as it offers a means of facilitating large-scale financial education and savings activity through a system of private, portable, and flexible accounts that is well-suited for the 21st century. Regardless of one's views on Social Security reform, it appears that these ideas could be supported by a broad range of policymakers.

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[29] It is estimated that up to 22 million households in the U.S. are "unbanked," meaning they do not have access to a basic transaction (savings or checking) account (Stuhldreher and Tescher 2005).

[30] See Burman, Gale, and Orszag (2003) for an in-depth analysis of the Bush Administrations proposal to create LSAs, RSAs, and ERSAs.

[31] Burman, Gale, and Orszag (2003).

The central problem with the current array of asset policies is that they are regressive and, for the most part, exclude the poor. A universal system is able to reach those currently excluded while providing every participant the opportunity to benefit. Asset building and savings are sound objectives for every citizen, and universal access to an account merely offers each citizen the opportunity to participate, regardless of the income status of their family.

The challenges in building a universal account-based system are significant, but they certainly can be addressed through the process of program design and implementation. Constructing a system of accounts that is workable and effective is achievable. The greater challenge is gaining political support for the proposal, sufficient to shepherd it through the legislative process. This may ultimately depend on policymakers accepting the premise that inclusive asset building policies are a means to promote social and economic development. These policy goals should be distinguished from other anti-poverty objectives because, at the core, asset-based policy is intended to enable individuals to exert greater control over their lives and expand their capacity to take advantage of the diverse opportunities offered by American society. Any large-scale asset-based policy effort should complement, rather than replace, existing policies that provide social insurance.

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