Saving in ADD: Measures from MIS IDA

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Abstract

Can the poor save? Data collected with the Management Information System for Individual Development Accounts (MIS IDA) in the American Dream Demonstration (ADD) show that they can. About half of participants had net IDA savings of more than $100, and monthly savings averaged $16.60. While participant characteristics were linked with IDA savings, no single characteristic (such as receipt of welfare or very low income) precluded saving. More relevant for policy is that several aspects of IDA design—including the match rate, match cap, time limits, use of automatic transfer, financial education, and restrictions on unmatched withdrawals—were strongly linked with saving. Overall, it seems that institutions for saving, when offered to the poor, work much like they do for the non-poor.

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Saving in ADD: Measures from MIS IDA

1. Saving by the poor in ADD

Can the poor save? Data from the American Dream Demonstration (ADD) of Individual Development Accounts (IDAs) provides a unique window on this question. Developed by the Center for Social Development to facilitate administration and research, the Management Information System for IDAs (MIS IDA) tracked monthly cash flows through IDAs owned by the poor in ADD. Besides recording deposits and withdrawals, MIS IDA also recorded aspects of institutional design (such as match rates) as well as characteristics of participants (such as income). The data are unusually clean, and the cash-flow data come straight from bank statements.

The poor did indeed save in IDAs in ADD. About 52 percent of the 2,350 participants were "savers" with net IDA savings of $100 or more,[1] and net IDA savings per participant was $558 ($997 for "savers"). Net IDA savings per participant-month was $16.60 ($29.08 for "savers"). Counting matches, participants accumulated $576 per year ($1,000 for "savers"). On average, they saved about 1 percent of their income in IDAs, making a deposit in half of the months. They saved 42 cents for each dollar of match eligibility, and one in five "maxed out" their match eligibility.

Was this saving a lot? It was, compared with liquid assets owned by "savers" in passbooks and checking accounts at enrollment (mean $675, median $220). All IDA

[1] *Net IDA savings* were those used in matched withdrawals or eligible to be matched.

savings could not have been shifted from existing accounts. Furthermore, if "savers" had accumulated $675 in bank accounts in all their years before enrolling in ADD, they probably would not have saved $1,000 more in the next 2–3 years without IDAs.

In strict terms, it is not known whether IDAs increased overall saving. MIS IDA tracked only IDA saving by participants, not net worth for both participants and non-participants who differed only in access to IDAs. Indeed, IDA deposits in ADD came from some mix of "new" saving and "reshuffled" assets (Moore *et al.*, 2001 and 2000). Still, research on 401(k) plans and IRAs finds that "new" saving is more likely for the poor than the non-poor (Benjamin, 2003; Engelhardt, 2001; Engen and Gale, 2000; Bernheim, 1997; Joines and Manegold, 1991; and Venti and Wise, 1986). If nothing else, the poor have fewer resources available to reshuffle (Sherraden, 1991).

So the poor can save. Still, about half of ADD participants saved less than $100. Is "something" versus "nothing" the proper benchmark? Whether the proverbial glass is half-full or half-empty is—like all questions about the importance of empirical magnitudes—a matter for discussion (McCloskey, 1998). For policy, it matters that the poor can save. Subsidizing only saving by the non-poor can no longer be justified by claiming that the poor would not save anyway.

The rest of this paper discusses the links between IDA savings by the poor in ADD and the characteristics of participants and of the IDA itself. The final section presents a policy proposal for the direction of inclusive asset-based policy.

2. Participants in ADD

This section reviews links between participant characteristics and saving. Policies are more malleable than people, and knowing how differences in people are associated with differences in saving may suggest ways to make policy more inclusive.

The results come from a two-step regression that controls for a wide range of factors. For all participants, the first step looks at the likelihood of being a "saver". The second step then looks at net IDA savings per month for "savers".

While saving did vary with participant characteristics in ADD, no single factor precluded saving. In particular, single mothers, students, the unemployed, welfare recipients, and very low-income people all saved. Thus, at least some poor people could save if they had the types of incentives provided to the non-poor.

2.1 Participants versus the low-income population

Participants in ADD were not a random sample of poor people nor even of IDA-eligible people. Rather, they were program-selected (they met eligibility criteria) and self-selected (they voluntarily enrolled). Thus, the people most likely to enroll were those in targeted groups who expected the greatest net benefits from participation. Thus, the results extrapolate only to IDA-eligible people who would enroll if they could.

Compared with low-income people in general, ADD participants were disadvantaged in that they were more likely to be female, African-American, or never-married. IDA participants were less disadvantaged, however, in that they were more educated, employed, and "banked". Thus, participants were not generally among the

"poorest of the poor" nor the "richest of the poor". This likely reflects programs' targeting of the "working poor" and their pre-existing client base.

2.2 Demographics

Gender. Four in five participants were women, and one in two was a single mother. Other factors constant, women and single mothers were more likely to be "savers" than men and the childless. Women and single mothers represent a disproportionate share of the poor and were disproportionately likely to save in ADD.

Age. The relevance of IDAs varies with age, whether because the menu of relevant matched uses depends on age and/or because saving in general varies with age.

The most common matched use was home purchase, followed by microenterprise, home repair, post-secondary education, retirement savings, and job training. Participants planning for home purchase saved more and for a longer time as they built a large lump sum for a down payment and navigated the home-buying process. In contrast, matched withdrawals for home repair were smaller and quicker.

Not all participants were offered matches for retirement savings, but among those with the option, one in five used it. These withdrawals were larger and more common among older people. Similarly, home ownership was a more common matched use among renters; post-secondary education was more common among the young; and microenterprise was more common among the self-employed. In general, the relevance of specific matched uses depended on age and existing assets.

Including more young people may require making saving for post-secondary education more relevant to them or providing matches for assets (such as cars or computers) with immediate benefits. Because children and youth often have very low incomes, policy might also provide higher matches or deposits from third parties based not on the participant's saving but rather on milestones such as passing a grade.

Race/ethnicity. About 47 percent of participants were African-American, 37 percent Caucasian, 9 percent Hispanic, 3 percent Native American, 2 percent Asian-American, and 3 percent "Other." Although monthly net IDA savings for all groups was at least $11.76 and the share of "savers" was at least 44 percent, there were group differences. All else constant, Asian Americans and "others" saved the most, followed by Hispanics and Caucasians and then African Americans and Native Americans.

Of course, these differences stem not from race/ethnicity *per se* but rather from a constellation of socially produced characteristics that both cause low saving and are correlated with race/ethnicity. If *all* else were really held constant, there would be no link between saving and race/ethnicity.

While IDAs narrowed racial gaps in ratios of net worth, they widened absolute differences in net worth. So far, there are few specific ideas on how to boost IDA saving for African Americans and Native Americans. Of course, they might be offered higher match rates, higher match caps, more financial education, and/or one-on-one support.

Unfortunately, explicit targeting by race/ethnicity attracts controversy. An alternative policy that broadly targets the poor—regardless of race/ethnicity—would

likely benefit to African Americans and Native Americans disproportionately (Conley, 1999). Future work should explore how the institutional features of IDAs interact with race/ethnicity, looking for simple changes that might benefit African Americans and Native Americans disproportionately.

Education. Given that they were poor, ADD participants were highly educated. Most (61 percent) had attended college, and a third of these had graduated. About 15 percent were high-school drop-outs.

Overall, IDA savings improved with education, highlighting the potential benefits of financial education, especially for less-educated participants. Still, 42 percent of high-school drop-outs were "savers", and drop-outs had monthly net IDA savings of $12.19.

Employment. About 89 percent of participants were employed and/or were students. The most likely to be "savers" were employed students, and the least likely were homemakers (including the retired and disabled) and the unemployed. Employed students also had the highest levels of savings, perhaps because they had both funds available to save and an immediately salient, divisible matched use.

Lack of employment did not preclude saving; the not employed had monthly net IDA savings of $12.68, and 48 percent were "savers". Thus, the focus of many IDA programs on the "working poor" is superfluous, restricting access and sending the message that the "non-working poor" cannot or should not save.

Welfare receipt. About 45 percent of participants had received means-tested public assistance, but this was not generally associated with saving. There was nothing

"different" about welfare recipients that made them save less. About 38 percent of those on TANF at enrollment were "savers", saving $10.85 per month. If asset-building policy included welfare recipients, some of them would save.

2.3 Income, assets, and debts

2.3.1 Income

ADD participants were poor, with mean income of 127 percent of the poverty line (median 107 percent). One in five was under 50 percent of poverty.

Theory suggests that—at least in some range—saving should rise with income. In ADD, the associations were positive, but small. In fact, the higher the income, the lower the share of income that was saved in IDAs.

Why was income so weakly related with saving? Sherraden, Schreiner, and Beverly (2003) speculate that institutional factors had stronger effects for lower-income people. For example, they may learned more from financial education, and they may have been more likely to change the match cap into a saving target.

Like single mothers, the not-employed, and welfare recipients, people with very low incomes saved in ADD. For example, about half of those below 50 percent of the poverty line were "savers", and their monthly net IDA savings was $14.91. Asset-based policy can include people across the full range of income.

2.3.2 Assets

Asset ownership was generally associated with more saving, for three reasons. First, it proxies for omitted characteristics (such as financial sophistication) that caused

higher past saving and will cause greater future IDA saving. Second, it makes more resources available to "reshuffle". Third, assets directly facilitate IDA saving. For example, checking-account owners can make IDA deposits by mail or automatic transfer, and car owners can more easily go to the bank to make a deposit.

Bank accounts. Participants who owned a checking account—whether or not they also owned a passbook account—were more likely to be "savers", and they also had higher monthly net IDA savings. The converse was true for passbook owners.

Checkbooks differ from passbooks mostly in the need to track balances to avoid overdrafts, so checkbook ownership probably proxies for financial sophistication. The policy lesson is that financial education may boost saving by the poor, especially those without checking accounts and the "unbanked".

Looking at account value, the association between liquid assets and net IDA savings for "savers" was positive but weak, again suggesting that participants probably reshuffled few existing assets into IDAs.

Being "unbanked" did not preclude saving in IDAs; 34 percent were "savers", and monthly net IDA savings was $9.43. Similar results hold for participants who owned only a passbook account.

Non-bank assets. Participants who owned homes, cars, and/or financial investments were more likely to be "savers". Furthermore, "savers" who owned cars or microenterprises had higher net IDA deposits.

These illiquid assets probably were not reshuffled into IDAs. Instead, they probably reflect owners' financial sophistication. Whatever caused owners to save before enrollment probably also caused them to save more in IDAs. Furthermore, asset ownership directly facilitates saving by reducing cash expenses and transaction costs (Sherraden, 1991 and 1989).

At enrollment, 13 percent of participants were "asset-less" with no passbook or checking accounts, homes, cars, financial investments, or small businesses. Of these, 25 percent were "savers", and monthly net IDA savings was $7.05. They saved less than others, but some still saved (and probably all of it was "new saving").

2.3.3 Debts

In general, debt was associated with lower saving. For example, "free-and-clear" car owners were more likely to be "savers" than those still making payments. In the same way, participants with credit-card debt were less likely to be "savers". In terms of the level of IDA savings, free-and-clear home owners and free-and-clear car owners saved more, and participants with overdue household bills saved less.

Still, debt did not preclude saving. Denying access to IDAs to debtors would not likely improve their well-being. The non-poor participate in IRAs and 401(k) plans regardless of debt (and tax deductions for home-mortgage interest *require* debt). While "credit repair" is sometimes necessary (especially when matching home purchase), saving is possible in spite of debt.

2.4 Planned use

Participants were more likely to be "savers" if they planned for home repair, followed by retirement savings, post-secondary education, microenterprise, and home purchase. Thus, "savers" tended to plan for small, divisible uses that did not require major life changes. In particular, home purchase calls for sustained effort (and a clean credit record), increasing the risk of falling short, getting discouraged, and quitting.

There is value in a menu of matched uses, some of which work even with little saving (for example, "roll-overs" into IRAs or 529 College Savings Plans). Participants who can change their plans will be less likely to give up if they save less than planned.

2.5 Summary of participant characteristics

The section makes two broad points. The first is that (with other factors constant) participant characteristics in ADD were associated with savings outcomes. The second is that (with other factors *not* constant) all groups saved. This is true even for those whose willingness and ability to save had been doubted: single mothers, African Americans and Native Americans, high-school drop-outs, the not-employed, welfare recipients, the very poor, the "unbanked", and the indebted.

While even the poorest can save in IDAs, it is still unknown how IDA design should vary with participants' characteristics. Even if one size does not fit all, two simple, inexpensive, and effective policies are automatic sign-up (beyond universal access, everyone is given a permanent account) and automatic transfer. Finally,

programs could use statistical profiling to identify those participants likely to benefit from additional, targeted support (Schreiner and Sherraden, 2005b).

In ADD, participants of all stripes saved, contradicting the presumption that some groups would not save even in a structured, subsidized saving program. Universal access would promote long-term improvement in well-being more than limited access. The poor seem ready to be included; most likely, they have always been ready. The question is whether policy is ready to include them.

3. Institutional characteristics of IDAs

Unlike participant characteristics, institutional characteristics are set by policy. In turn, institutions shape what people do. While people do weigh expected costs and benefits, rational analysis is often replaced by habit, culture, and the path of least resistance, all factors under the influence of policy.

Saving in particular is less logical than psychological. With imperfect self-control and weak imagination, people do not always see how saving's certain, definite sacrifices in the present connect with saving's uncertain, indefinite rewards in the future.

Knowing this, policy often seeks to make saving a "no-brainer". For example, automatic transfer from employers to 401(k) plans means that saving runs on auto-pilot. Likewise, tax breaks on 401(k)s make the choice to save difficult to miss.

Tax breaks, of course, are worth little to the poor. Furthermore, asset tests on public assistance imply that saving by the poor can be heavily taxed (Chen and Lerman, 2005; Sullivan, 2004; Ziliak, 2003; Powers, 1998). The non-poor get a lot of help with saving, but the poor are sent empty away.

Designing the institutional structure of IDAs to help the poor save fits the "liberal paternalism" of Thaler and Sunstein (2003). It is "liberal" because there is no coercion, and it is "paternalistic" because it helps people to do what they would choose, in moments of rational lucidity, for their own good.

This section discusses results from the same two-step regression as in the previous section. Overall, institutional characteristics were strongly associated with saving in ADD, suggesting that policy has a lot to say about how the poor save.

3.1 Match rates

Match rates are the marquee feature that attracts participants to IDAs (Sherraden *et al.*, 2005; Kempson, McKay, and Collard, 2003). In ADD, match rates were typically 1:1 or 2:1, with some as high as 7:1.

Higher match rates tended to be linked with being a "saver". If this is more cause than correlation, then higher match rates increase inclusion.

At the same time, "savers" with higher match rates had lower monthly savings. This fits the hypothesis that participants had fixed goals, and higher match rates allowe them to reach their goals with less saving (Schreiner, 2004).

Thus, higher match rates improve inclusion by increasing "savers", but they decrease savings per "saver". On net, higher match rates increased asset accumulation. Given these trade-offs (and the cost of higher match rates), the policy question whether the main goal of IDAs is to improve inclusion, saving, or asset accumulation.

3.2 Match caps (savings targets)

Logically, the match cap is a limit on match eligibility. Psychologically, however, participants may turn it into a target. Controlling for censoring, a $1 increase in the cap was associated with a 57-cent increase in net IDA savings. (Milligan (2003) found a similar effect for a saving program in Canada.) Perhaps participants tried to "max out"

eligibility because they believed that they "should" save up to the cap. If participants try to save more when match caps are higher, then increasing caps can increase saving.

Of course, higher match caps increase program costs, and higher caps are usually combined with lower match rates. For the match-rate/match-cap combinations in ADD, a "low" match rate with a "high" match cap was linked with fewer "savers" but higher monthly net IDA savings (both per "saver" and per participant). Costs were lower, and asset accumulation was hardly changed. Here again, there are trade-offs between costs, inclusion, saving, and asset accumulation.

3.3 Match-cap structure

ADD had two match-cap structures, one with *annual* limits on match eligibility and a second with a *lifetime* limit over the total time of participation.

Both types of structures have pros and cons. With their "use-it-or-lose-it" incentive, annual structures discourage procrastination. At the same time, they may discourage large deposits, and participants who start out slow (and who lose unused match eligibility) may get discouraged and quit.

Lifetime structures do not penalize procrastination; participants can always wait until next year and hope to catch up with large lump sums.

ADD had little within-program variation in match-cap structure, so the effects of different structures could not be estimated. A hybrid structure, however, might improve outcomes. Annual caps would provide a reason not to procrastinate, and limited carry-

over of unused match eligibility year-to-year would keep slow starters from losing hope. Some savings programs in Canada use such a hybrid structure.

3.4 Saving from tax refunds

Deposits by people with annual match caps (but not by those with lifetime caps) increased markedly in February and March, probably due to saving from tax refunds.

This has a couple of possible policy implications. First, annual caps—but not lifetime—seem to help people to save lump sums. Setting annual deadlines at the end of tax season (as for the non-poor with IRAs) would increase this tendency. Second, the poor might save more if they could split tax refunds between checks and direct deposits, much like the direct deposit of 401(k) contributions from the pay of the non-poor.

3.5 Time limits

Unlike IRAs and 401(k)s for the non-poor, ADD set time limits for deposits and matched withdrawals. Participants with more time to save were more likely to be "savers", better serving the goal of inclusion.

At the same time, longer time limits were linked with lower monthly saving for "savers". Permanent access (no time limits) would probably further reduce monthly saving while increasing lifetime saving and asset accumulation. More important, it would create a social norm of asset-building by the poor.

Sherraden (1991) proposed IDAs as universal, permanent accounts, opened at birth, with greater subsidies for the poor. IDAs should not be short-term "programs" any more than IRAs or 401(k)s are. IDAs so far have had time limits because they have

been funded as demonstrations (Edwards and Mason, 2003). If the goal is to improve long-term well-being, though, some practices common in demonstrations are counterproductive (such as setting deadlines for matched withdrawals or kicking out participants with low or irregular deposits). After all, IRAs and 401(k)s do not kick out the non-poor or suspend their tax breaks if they save little, stop saving, or wait decades to start. For development, it is better to let participants save in IDAs as long as they wish. Some would save for years without a matched withdrawal, sometimes depositing regularly, sometimes not depositing, and sometimes making unmatched withdrawals. But everyone would have an account. Periodic statements—regardless of balance—would keep the possibility of saving and building assets in everyone's mind.

3.6 Automatic transfer

Participants who set up automatic transfer to IDAs were more likely to be "savers", probably because they did not have to consciously and repeatedly choose to consume instead of save. Thus, automatic transfer may have large impacts on inclusion. For example, the IRS and employers could allow splitting tax refunds and paychecks across checks and direct deposits.[2] This is simple and inexpensive and so may be a good place to start policy efforts.

3.7 Financial education

Many IDA administrators believe that financial education is a must, and it was required of all participants in ADD. Each additional hour up to 10 (but not beyond)

[2] Indeed, 401(k)s *require* automatic transfer by employers.

was associated an additional $1 of monthly net IDA savings. For policy, this suggests not only that financial education matters but also that its costs may be contained—without giving up effectiveness—by limiting the hours required.

3.8 Limits on unmatched withdrawals

To reduce the risk that participants could harm themselves by saving too much, ADD placed few restrictions on unmatched withdrawals. Such withdrawals were common; two-thirds of participants made at least one, removing one-third of matchable balances. Does this reflect foolishness, or is saving—even in IDAs—just very difficult?

Many unmatched withdrawals were probably harmless. About half were less than $100, perhaps for bills or similar subsistence needs. Also, about half of participants who made matched withdrawals cleaned out "leftover" savings with unmatched withdrawals. Finally, the 23 percent of participants who were "unbanked" probably never intended to leave much of their deposits in the IDA for long.

Some other unmatched withdrawals must have been due to financial pressures. Emergencies are a fact of life for the poor, so participants may hesitate to make deposits in the first place if they fear that they taking them out later will be a hassle. At the same time, many participants recognize that mild restrictions may help them to resist the urge to make unwise withdrawals.

The design challenge is to balance commitment and liquidity. On the one hand, participants want "silken handcuffs" to deter unwise withdrawals. On the other hand,

participants sometimes need unmatched withdrawals, and the prospect of having to jump hoops may deter them from tying up funds in an IDA in the first place.

In ADD, mild restrictions on unmatched withdrawals seemed to be linked with being a "saver". Some programs were joint owners of the IDAs, so staff had to sign off on all withdrawals. This may have created a *de facto* "waiting period" that helped participants think twice. Those who could instantly cash out their savings were less likely to be "savers".

3.9 Summary: Institutions and IDAs

IDA design was strongly associated with saving in ADD. To the extent that these associations were causal, they offer direct lessons for policy. Want to include more "savers"? Increase match rates, lengthen time caps, facilitate automatic transfer, and mildly restrict unmatched withdrawals. Want to increase net IDA savings? Decrease match rates, raise match caps, and require some financial education. Policy has a lot to say about how well the poor save and build assets.

While institutions matter, and while Schreiner and Sherraden (2005a) and Beverly and Sherraden (1999) present an institutional theory of saving, policymakers want to know not only how institutions are associated with savings outcomes but also why. Causality, however, is difficult to pin down. The MIS IDA data do not come from a randomized experiment, so the results here, while based on theory and regressions that control for a wide range of factors, are not definitive. ADD points out where policy makers should start, but it still leaves them most of the hard work.

4. Conclusion

ADD shows that the poor can save. While saving varied across groups, some people in all groups saved. IDA design was also strongly linked with savings outcomes. The poor can save, and policy can help.

Should policy help the poor save? The response depends not on data but on values; ours center on inclusion, fairness, and a preference for the poor.

Escaping poverty requires asset accumulation, be it human, physical, financial, or social. The United States has huge subsidies for saving, but these usually bypass the poor because they are based on existing wealth, tax breaks, and/or residential location.[3] This is highly regressive. A fairer, more pro-poor policy would feature progressive subsidies and include everyone. Sherraden (2001) suggests providing all household with an equal dollar amount of asset-building subsidies.

Woo, Schweke, and Buchholz (2004) estimate the fiscal cost of asset-building subsidies in 2003 at $335 billion. In the largest categories, more than "a third of the benefits go to the wealthiest 1 percent of Americans—those who typically earn over $1 million per year. In contrast, less than 5 percent of the benefits go to the bottom 60 percent" (p. 1). Howard (1997, pp. 8–9) makes a similar point: "There is, still, a misconception that U.S. social programs primarily benefit the poor . . . (Social spending) flows overwhelmingly to citizens with above-average incomes".

[3] For the non-poor, education, health, and homes are highly subsidized; the only major non-subsidized assets are cars and other household durables. In many ways, this system amounts to a consumption tax.

For example, the United States in 2003 had more than $100 billion in subsidies for home ownership (Woo, Schweke, and Buchholz, 2004). A rich person with a $1 million mortgage would get annual subsidies of $20,000 or more, while a poor person would get nothing unless he or she has a home, a mortgage, and tax liability.

Most housing subsidies go to the richest half, precisely those who probably would own homes anyway. Rather than increasing home ownership, the subsidies mainly support luxury in housing and increased consumption.

To support home ownership, it would be fairer and more effective to focus almost all subsidies on the poorest half. At the least, they should get half the subsidies.[4]

How to do this? After all, many people—especially among the poor—do not own houses or do not want to. How can they receive subsidies for home ownership? Likewise, how can they receive subsidies for post-secondary education if they do not attend college, or for retirement if they do not have a 401(k)?

One way is a system of universal, permanent, individual asset-building accounts. Each person would have an account to receive annual home-ownership subsidies (and/or unearmarked "asset-building" subsidies) regardless of their current assets. Balances would accumulate and could be used to acquire a few key types of assets. Unused balances could be used for retirement or bequeathed.

[4] The same holds for subsidies for retirement savings, education, and medical care.

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